An Anarchist FAQ (04/17)

The Anarchist FAQ Editorial Collective

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Section C: What are the myths of capitalist economics?

Within capitalism, economics plays an important ideological role. Economics has been used to construct a theory from which exploitation and oppression are excluded, by definition. We will attempt here to explain why capitalism is deeply exploitative. Elsewhere, in section B, we have indicated why capitalism is oppressive and will not repeat ourselves here.

In many ways economics plays the role within capitalism that religion played in the Middle Ages, namely to provide justification for the dominant social system and hierarchies. *"The priest keeps you docile and subjected,"* argued Malatesta, *"telling you everything is God's will; the economist say it's the law of nature."* They *"end up saying that no one is responsible for poverty, so there's no point rebelling against it."* [**Fra Contadini**, p. 21] Even worse, they usually argue that collective action by working class people is counterproductive and, like the priest, urge us to tolerate current oppression and exploitation with promises of a better future (in heaven for the priest, for the economist it is an unspecified "long run"). It would be no generalisation to state that if you want to find someone to rationalise and justify an obvious injustice or form of oppression then you should turn to an economist (preferably a "free market" one).

That is not the only similarity between the "science" of economics and religion. Like religion, its basis in science is usually lacking and its theories more based upon "leaps of faith" than empirical fact. Indeed, it is hard to find a "science" more unconcerned about empirical evidence or building realistic models than economics. Just looking at the assumptions made in "perfect competition" shows that (see section C.1 for details). This means that economics is immune to such trivialities as evidence and fact, although that does not stop economics being used to rationalise and justify certain of these facts (such as exploitation and inequality). A classic example is the various ways economists have sought to explain what anarchists and other socialists have tended to call ***"surplus value"*** (i.e. profits, interest and rent). Rather than seek to explain its origin by an empirical study of the society it exists in (capitalism), economists have preferred to invent "just-so" stories, little a-historic parables about a past which never existed is used to illustrate (and so defend) a present class system and its inequalities and injustices. The lessons of a fairy tale about a society that has never existed are used as a guide for one which does and, by some strange co-incidence, they happen to justify the existing class system and its distribution of income. Hence the love of Robinson Crusoe in economics.

Ironically, this favouring of theory (ideology would be a better term) is selective as their exposure as fundamentally flawed does not stop them being repeated. As we discuss in section C.2, the neoclassical theory of capital was proven to be incorrect by left-wing economists. This was admitted by their opponents: *"The question that confronts us is not whether the Cambridge Criticism is theoretically valid. It is. Rather the question is an empirical or econometric one: is there sufficient substitutability within the system to establish neo-classical results?"* Yet this did not stop this theory being taught to this day and the successful critique forgotten. Nor has econometrics successfully refuted the analysis, as capital specified in terms of money cannot reflect a theoretical substance (neo-classical "capital") which could not exist in reality. However, that is unimportant for *"[u]ntil the econometricians have the answer for us, placing reliance upon neo-classical economic theory is a matter of faith,"* which, of course, he had [C. E. Ferguson, **The Neo-classical Theory of Production and Distribution**, p. 266 and p. xvii]

Little wonder that Joan Robinson, one of the left-wing economists who helped expose the bankruptcy of the neo-classical theory of capital, stated that economics was *"back where it was, a branch of theology."* [**Collected Economic Papers**, Vol. 4, p. 127] It remains there more than thirty years later:

> *"Economics is not a science. Many economists — particularly those who believe that decisions on whether to get married can be reduced to an equation — see the world as a complex organism that can be understood using the right differential calculus. Yet everything we know about economics suggests that it is a branch and not a particularly advanced one, of witchcraft."* [Larry Elliot and Dan Atkinson, **The Age of Insecurity**, p. 226]

The weakness of economics is even acknowledged by some within the profession itself. According to Paul Ormerod, *"orthodox economics is in many ways an empty box. Its understanding of the world is similar to that of the physical sciences in the Middle Ages. A few insights have been obtained which stand the test of time, but they are very few indeed, and the whole basis of conventional economics is deeply flawed."* Moreover, he notes the *"overwhelming empirical evidence against the validity of its theories."* It is rare to see an economist be so honest. The majority of economists seem happy to go on with their theories, trying to squeeze life into the Procrustean bed of their models. And, like the priests of old, make it hard for non-academics to question their dogmas as *"economics is often intimidating. Its practitioners … have erected around the discipline a barrier of jargon and mathematics which makes the subject difficult to penetrate for the non-initiated."* [**The Death of Economics**, p. ix, p. 67 and p. ix]

So in this section of our FAQ, we will try to get to the heart of modern capitalism, cutting through the ideological myths that supporters of the system have created around it. This will be a difficult task, as the divergence of the reality of capitalism and the economics that is used to explain (justify, more correctly) it is large. For example, the preferred model used in neo-classical economics is that of "perfect competition" which is based on a multitude of small firms producing homogenous products in a market which none of them are big enough to influence (i.e. have no market power). This theory was developed in the late 19th century when the real economy was marked by the rise of big business, a dominance which continues to this day. Nor can it be said that even small firms produce identical products — product differentiation and brand loyalty are key factors for any business. In other words, the model reflected (and still reflects) the exact opposite of reality.

In spite of the theoretical models of economics having little or no relation to reality, they are used to both explain and justify the current system. As for the former, the truly staggering aspect of economics for those who value the scientific method is the immunity of its doctrines to empirical refutation (and, in some cases, theoretical refutation). The latter is the key to not only understanding why economics is in such a bad state but also why it stays like that. While economists like to portray themselves as objective scientists, merely analysing the system, the development of their "science" has always been marked with apologetics, with rationalising the injustices of the existing system. This can be seen best in attempts by economists to show that Chief Executive Officers (CEOs) of firms, capitalists and landlords all deserve their riches while workers should be grateful for what they get. As such, economics has never been value free simply because what it says affects people and society. This produces a market for economic ideology in which those economists who supply the demand will prosper. Thus we find many *"fields of economics and economic policy where the responses of important economic professionals and the publicity given economic findings are correlated with the increased market demand for specific conclusions and a particular ideology."* [Edward S. Herman, *"The Selling of Market Economics,"* pp. 173–199, **New Ways of Knowing**, Marcus G. Raskin and Herbert J. Bernstein (eds.), p.192]

Even if we assume the impossible, namely that economists and their ideology can truly be objective in the face of market demand for their services, there is a root problem with capitalist economics. This is that it the specific social relations and classes produced by capitalism have become embedded into the theory. Thus, as an example, the concepts of the marginal productivity of land and capital are assumed to universal in spite the fact that neither makes any sense outside an economy where one class of people owns the means of life while another sells their labour to them. Thus in an artisan/peasant society or one based around co-operatives, there would be no need for such concepts for in such societies, the distinction between wages and profits has no meaning and, as a result, there is no income to the owners of machinery and land and no need to explain it in terms of the "marginal productivity" of either. Thus mainstream economics takes the class structure of capitalism as a natural, eternal, fact and builds up from there. Anarchists, like other socialists, stress the opposite, namely that capitalism is a specific historical phase and, consequently, there are no universal economic laws and if you change the system the laws of economics change. Unless you are a capitalist economist, of course, when the same laws apply no matter what.

In our discussion, it is important to remember that capitalist economics is **not** the same as the capitalist economy. The latter exists quite independently of the former (and, ironically, usually flourishes best when the policy makers ignore it). Dissident economist Steve Keen provides a telling analogy between economics and meteorology. Just as *"the climate would exist even if there were no intellectual discipline of meteorology, the economy itself would exist whether or not the intellectual pursuit of economics existed."* Both share *"a fundamental raison d'etre,"* namely *"that of attempting to understand a complex system."* However, there are differences. Like weather forecasters, *"economists frequently get their forecasts of the economic future wrong. But in fact, though weather forecasts are sometimes incorrect, overall meteorologists have an enviable record of accurate prediction — whereas the economic record is tragically bad."* This means it is impossible to ignore economics (*"to treat it and its practitioners as we these days treat astrologers"*) as it is a social discipline and so what we *"believe about economics therefore has an impact upon human society and the way we relate to one another."* Despite *"the abysmal predictive record of their discipline,"* economists *"are forever recommending ways in which the institutional environment should be altered to make the economy work better."* By that they mean make the real economy more like their models, as *"the hypothetical pure market performs better than the mixed economy in which we live."* [**Debunking Economics**, pp. 6–8] Whether this actually makes the world a better place is irrelevant (indeed, economics has been so developed as to make such questions irrelevant as what happens on the market is, by definition, for the best).

Here we expose the apologetics for what they are, expose the ideological role of economics as a means to justify, indeed ignore, exploitation and oppression. In the process of our discussion we will often expose the ideological apologetics that capitalist economics create to defend the status quo and the system of oppression and exploitation it produces. We will also attempt to show the deep flaws in the internal inconsistencies of mainstream economics. In addition, we will show how important reality is when evaluating the claims of economics.

That this needs to be done can be seen by comparing the promise of economics with its actual results when applied in reality. Mainstream economics argues that it is based on the idea of "utility" in consumption, i.e. the subjective pleasure of individuals. Thus production is, it is claimed, aimed at meeting the demands of consumers. Yet for a system supposedly based on maximising individual happiness ("utility"), capitalism produces a hell of a lot of unhappy people. Some radical economists have tried to indicate this and have created an all-embracing measure of well-being called the Index of Sustainable Economic Welfare (ISEW). Their conclusions, as summarised by Elliot and Atkinson, are significant:

> *"In the 1950s and 1960s the ISEW rose in tandem with per capita GDP. It was a time not just of rising incomes, but of greater social equity, low crime, full employment and expanding welfare states. But from the mid-1970s onwards the two measures started to move apart. GDP per head continued its inexorable rise, but the ISEW started to decline as a result of lengthening dole queues, social exclusion, the explosion in crime, habitat loss, environmental degradation and the growth of environment- and stress-related illness. By the start of the 1990s, the ISEW was almost back to the levels at which it started in the early 1950s."* [Larry Elliot and Dan Atkinson, **Op. Cit.**, p. 248]

So while capitalism continues to produce more and more goods and, presumably, maximises more and more individual utility, actual real people are being "irrational" and not realising they are, in fact, better off and happier. Ironically, when such unhappiness is pointed out most defenders of capitalism dismiss people's expressed woe's as irrelevant. Apparently **some** subjective evaluations are considered more important than others!

Given that the mid-1970s marked the start of neo-liberalism, the promotion of the market and the reduction of government interference in the economy, this is surely significant. After all, the *"global economy of the early 21st century looks a lot more like the economic textbook ideal that did the world of the 1950s … All these changes have followed the advance of economists that the unfettered market is the best way to allocate resources, and that well-intentioned interventions which oppose market forces will actually do more harm than good."* As such, *"[w]ith the market so much more in control of the global economy now than fifty years ago, then if economists are right, the world **should be** a manifestly better place: it should be growing faster, with more stability, and income should go to those who deserve it."* However, *"[u]nfortunately, the world refuses to dance the expected tune. In particularly, the final ten years of the 20th century were marked, not by tranquil growth, but by crises."* [Steve Keen, **Op. Cit.**, p. 2]

These problems and the general unhappiness with the way society is going is related to various factors, most of which are impossible to reflect in mainstream economic analysis. They flow from the fact that capitalism is a system marked by inequalities of wealth and power and so how it develops is based on them, not the subjective evaluations of atomised individuals that economics starts with. This in itself is enough to suggest that capitalist economics is deeply flawed and presents a distinctly flawed picture of capitalism and how it actually works.

Anarchists argue that this is unsurprising as economics, rather than being a science is, in fact, little more than an ideology whose main aim is to justify and rationalise the existing system. We agree with libertarian Marxist Paul Mattick's summation that economics is *"actually no more than a sophisticated apology for the social and economic **status quo**"* and hence the *"growing discrepancy between [its] theories and reality."* [**Economics, Politics and the Age of Inflation**, p. vii] Anarchists, unsurprisingly, see capitalism as a fundamentally exploitative system rooted in inequalities of power and wealth dominated by hierarchical structures (capitalist firms). In the sections that follow, the exploitative nature of capitalism is explained in greater detail. We would like to point out that for anarchists, exploitation is not more important than domination. Anarchists are opposed to both equally and consider them to be two sides of the same coin. You cannot have domination without exploitation nor exploitation without domination. As Emma Goldman pointed out, under capitalism:

> *"wealth means power; the power to subdue, to crush, to exploit, the power to enslave, to outrage, to degrade ... Nor is this the only crime ... Still more fatal is the crime of turning the producer into a mere particle of a machine, with less will and decision than his master of steel and iron. Man is being robbed not merely of the products of his labour, but of the power of free initiative, of originality, and the interest in, or desire for, the things he is making."* [**Red Emma Speaks**, pp. 66–7]

Needless to say, it would be impossible to discuss or refute **every** issue covered in a standard economics book or every school of economics. As economist Nicholas Kaldor notes, *"[e]ach year new fashions sweep the 'politico-economic complex' only to disappear again with equal suddenness ... These sudden bursts of fashion are a sure sign of the 'pre-scientific' stage [economics is in], where any crazy idea can get a hearing simply because nothing is known with sufficient confidence to rule it out."* [**The Essential Kaldor**, p. 377] We will have to concentrate on key issues like the flaws in mainstream economics, why capitalism is exploitative, the existence and role of economic power, the business cycle, unemployment and inequality.

Nor do we wish to suggest that all forms of economics are useless or equally bad. Our critique of capitalist economics does not suggest that no economist has contributed worthwhile and important work to social knowledge or our understanding of the economy. Far from it. As Bakunin put it, property *"is a god"* and has *"its metaphysics. It is the science of the bourgeois economists. Like any metaphysics it is a sort of twilight, a compromise between truth and falsehood, with the latter benefiting from it. It seeks to give falsehood the appearance of truth and leads truth to falsehood."* [**The Political Philosophy of Bakunin**, p. 179] How far this is true varies form school to school, economist to economist. Some have a better understanding of certain aspects of capitalism than others. Some are more prone to apologetics than others. Some are aware of the problems of modern economics and *"some of the most committed economists have concluded that, if economics is to become less of a religion and more of a science, then the foundations of economics should be torn down and replaced"* (although, *"left to [their] own devices"*, economists *"would continue to build an apparently grand edifice upon rotten foundations."*). [Keen, **Op. Cit.**, p. 19]

As a rule of thumb, the more free market a particular economist or school of economics is, the more likely they will be prone to apologetics and unrealistic assumptions and models. Nor are we suggesting that if someone has made a positive contribution in one or more areas of economic analysis that their opinions on other subjects are correct or compatible with anarchist ideas. It is possible to present a correct analysis of capitalism or capitalist economics while, at the same time, being blind to the problems of Keynesian economics or the horrors of Stalinism. As such, our quoting of certain critical economists does not imply agreement with their political opinions or policy suggestions.

Then there is the issue of what do we mean by the term "capitalist economics"? Basically, any form of economic theory which seeks to rationalise and defend capitalism. This can go from the extreme of free market capitalist economics (such as the so-called "Austrian" school and Monetarists) to those who advocate state intervention to keep capitalism going (Keynesian economists). We will not be discussing those economists who advocate state capitalism. As a default, we will take "capitalist economics" to refer to the mainstream "neoclassical" school as this is the dominant form of the ideology and many of its key features are accepted by the others. This seems applicable, given that the current version of capitalism being promoted is neo-liberalism where state intervention is minimised and, when it does happen, directed towards benefiting the ruling elite.

Lastly, one of the constant refrains of economists is the notion that the public is ignorant of economics. The implicit assumption behind this bemoaning of ignorance by economists is that the world should be run either by economists or on their recommendations. In section C.11 we present a case study of a nation, Chile, unlucky enough to have that fate subjected upon it. Unsurprisingly, this rule by economists could only be imposed as a result of a military coup and subsequent dictatorship. As would be expected, given the biases of economics, the wealthy did very well, workers less so (to put it mildly), in this experiment. Equally unsurprising, the system was proclaimed an economic miracle — before it promptly collapsed.

So this section of the FAQ is our modest contribution to making economists happier by making working class people less ignorant of their subject. As Joan Robinson put it:

> *"In short, no economic theory gives us ready-made answers. Any theory that we follow blindly will lead us astray. To make good use of an economic theory, we must first sort out the relations of the propagandist and the scientific elements in it, then by checking with experience, see how far the scientific element appears convincing, and finally recombine it with our own political views. The purpose of studying economics is not to acquire a set of ready-made answers to economic questions, but to learn how to avoid being deceived by economists."* [**Contributions to Modern Economics**, p. 75]

C.1 What is wrong with economics?

In a nutshell, a lot. While economists like to portray their discipline as "scientific" and "value free", the reality is very different. It is, in fact, very far from a science and hardly "value free." Instead it is, to a large degree, deeply ideological and its conclusions almost always (by a strange co-incidence) what the wealthy, landlords, bosses and managers of capital want to hear. The words of Kropotkin still ring true today:

> *"Political Economy has always confined itself to stating facts occurring in society, and justifying them in the interest of the dominant class … Having found [something] profitable to capitalists, it has set it up as a **principle**."* [**The Conquest of Bread**, p. 181]

This is at its best, of course. At its worse economics does not even bother with the facts and simply makes the most appropriate assumptions necessary to justify the particular beliefs of the economists and, usually, the interests of the ruling class. This is the key problem with economics: it is **not** a science. It is **not** independent of the class nature of society, either in the theoretical models it builds or in the questions it raises and tries to answer. This is due, in part, to the pressures of the market, in part due to the assumptions and methodology of the dominant forms of economics. It is a mishmash of ideology and genuine science, with the former (unfortunately) being the bulk of it.

The argument that economics, in the main, is not a science it not one restricted to anarchists or other critics of capitalism. Some economists are well aware of the limitations of their profession. For example, Steve Keen lists many of the flaws of mainstream (neoclassical) economics in his excellent book **Debunking Economics**, noting that (for example) it is based on a *"dynamically irrelevant and factually incorrect instantaneous static snap-shot"* of the real capitalist economy. [**Debunking Economics**, p. 197] The late Joan Robinson argued forcefully that the neoclassical economist *"sets up a 'model' on arbitrarily constructed assumptions, and then applies 'results' from it to current affairs, without even trying to pretend that the assumptions conform to reality."* [**Collected Economic Papers**, vol. 4, p. 25] More recently, economist Mark Blaug has summarised many of the problems he sees with the current state of economics:

> *"Economics has increasing become an intellectual games played for its own sake and not for its practical consequences. Economists have gradually converted the subject into a sort of social mathematics in which analytical rigor as understood in math departments is everything and empirical relevance (as understood in physics departments) is nothing … general equilibrium theory … using economic terms like 'prices', 'quantities', 'factors of production,' and so on, but that nevertheless is clearly and even scandalously unrepresentative of any recognisable economic system…*
>
> *"Perfect competition never did exist and never could exist because, even when firms are small, they do not just take the price but strive to make the price. All the current*

> *textbooks say as much, but then immediately go on to say that the 'cloud-cuckoo' fantasyland of perfect competition is the benchmark against which we may say something significant about real-world competition … But how can an idealised state of perfection be a benchmark when we are never told how to measure the gap between it and real-world competition? It is implied that all real-world competition is 'approximately' like perfect competition, but the degree of the approximation is never specified, even vaguely …*
>
> *"Think of the following typical assumptions: perfectly infallible, utterly omniscient, infinitely long-lived identical consumers; zero transaction costs; complete markets for all time-stated claims for all conceivable events, no trading of any kind at disequilibrium prices; infinitely rapid velocities of prices and quantities; no radical, incalculable uncertainty in real time but only probabilistically calculable risk in logical time; only linearly homogeneous production functions; no technical progress requiring embodied capital investment, and so on, and so on — all these are not just unrealistic but also unrobust assumptions. And yet they figure critically in leading economic theories."* [*"Disturbing Currents in Modern Economics"*, **Challenge!**, Vol. 41, No. 3, May-June, 1998]

So neoclassical ideology is based upon special, virtually ad hoc, assumptions. Many of the assumptions are impossible, such as the popular assertion that individuals can accurately predict the future (as required by "rational expectations" and general equilibrium theory), that there are a infinite number of small firms in every market or that time is an unimportant concept which can be abstracted from. Even when we ignore those assumptions which are obviously nonsense, the remaining ones are hardly much better. Here we have a collection of apparently valid positions which, in fact, rarely have any basis in reality. As we discuss in section C.1.2, an essential one, without which neoclassical economics simply disintegrates, has very little basis in the real world (in fact, it was invented simply to ensure the theory worked as desired). Similarly, markets often adjust in terms of quantities rather than price, a fact overlooked in general equilibrium theory. Some of the assumptions are mutually exclusive. For example, the neo-classical theory of the supply curve is based on the assumption that some factor of production cannot be changed in the short run. This is essential to get the concept of diminishing marginal productivity which, in turn, generates a rising marginal cost and so a rising supply curve. This means that firms **within** an industry cannot change their capital equipment. However, the theory of perfect competition requires that in the short period there are no barriers to entry, i.e. that anyone **outside** the industry can create capital equipment and move into the market. These two positions are logically inconsistent.

In other words, although the symbols used in mainstream may have economic sounding names, the theory has no point of contact with empirical reality (or, at times, basic logic):

> *"Nothing in these abstract economic models actually **works** in the real world. It doesn't matter how many footnotes they put in, or how many ways they tinker around the edges. The whole enterprise is totally rotten at the core: it has no relation to reality."* [Noam Chomsky, **Understanding Power**, pp. 254–5]

As we will indicate, while its theoretical underpinnings are claimed to be universal, they are specific to capitalism and, ironically, they fail to even provide an accurate model of that system as it ignores most of the real features of an actual capitalist economy. So if an economist does not say that mainstream economics has no bearing to reality, you can be sure that what he or she tells you will be more likely ideology than anything else. "Economic reality" is not about facts; it's about faith in capitalism. Even worse, it is about blind faith in what the economic ideologues say about capitalism. The key to understanding economists is that they believe that if it is in an economic textbook, then it must be true — particularly if it confirms any initial prejudices. The opposite is usually the case.

The obvious fact that the real world is not like that described by economic text books can have some funny results, particularly when events in the real world contradict the textbooks. For most economists, or those who consider themselves as such, the textbook is usually preferred. As such, much of capitalist apologetics is faith-driven. Reality has to be adjusted accordingly.

A classic example was the changing positions of pundits and "experts" on the East Asian economic miracle. As these economies grew spectacularly during the 1970s and 1980s, the experts universally applauded them as examples of the power of free markets. In 1995, for example, the right-wing Heritage Foundation's index of economic freedom had four Asian countries in its top seven countries. The **Economist** explained at the start of 1990s that Taiwan and South Korea had among the least price-distorting regimes in the world. Both the Word Bank and IMF agreed, downplaying the presence of industrial policy in the region. This was unsurprising. After all, their ideology said that free markets would produce high growth and stability and so, logically, the presence of both in East Asia must be driven by the free market. This meant that, for the true believers, these nations were paradigms of the free market, reality not withstanding. The markets agreed, putting billions into Asian equity markets while foreign banks loaned similar vast amounts.

In 1997, however, all this changed when all the Asian countries previously qualified as "free" saw their economies collapse. Overnight the same experts who had praised these economies as paradigms of the free market found the cause of the problem — extensive state intervention. The free market paradise had become transformed into a state regulated hell! Why? Because of ideology — the free market is stable and produces high growth and, consequently, it was impossible for any economy facing crisis to be a free market one! Hence the need to disown what was previously praised, without (of course) mentioning the very obvious contradiction.

In reality, these economies had always been far from the free market. The role of the state in these "free market" miracles was extensive and well documented. So while East Asia *"had not only grown faster and done better at reducing poverty than any other region of the world … it had also been more stable,"* these countries *"had been successful not only in spite of the fact that they had not followed most of the dictates of the Washington Consensus [i.e. neo-liberalism], but **because** they had not."* The government had played *"important roles … far from the minimalist [ones] beloved"* of neo-liberalism. During the 1990s, things had changed as the IMF had urged a *"excessively rapid financial and capital market liberalisation"* for these countries as sound economic policies. This *"was probably the single most important cause of the [1997] crisis"* which saw these economies suffer meltdown, *"the greatest economic crisis since the Great Depression"* (a meltdown worsened by IMF aid and its underlying dogmas). Even worse for the believers in market fundamentalism, those nations (like Malaysia) that refused IMF suggestions and used state intervention has a *"shorter and shallower"* downturn than those who did not. [Joseph Stiglitz, **Globalisation and its Discontents**, p. 89, p. 90, p. 91 and p. 93] Even worse, the obvious conclusion from these events is more than just the ideological perspective of economists, it is that "the market" is not all-knowing as investors (like the experts) failed to see the statist policies so bemoaned by the ideologues of capitalism **after** 1997.

This is not to say that the models produced by neoclassical economists are not wonders of mathematics or logic. Few people would deny that a lot of very intelligent people have spent a lot of time producing some quite impressive mathematical models in economics. It is a shame that they are utterly irrelevant to reality. Ironically, for a theory claims to be so concerned about allocating scarce resources efficiently, economics has used a lot of time and energy refining the analyses of economies which have not, do not, and will not ever exist. In other words, scare resources have been inefficiently allocated to produce waste.

Why? Perhaps because there is a demand for such nonsense? Some economists are extremely keen to apply their methodology in all sorts of areas outside the economy. No matter how inappropriate, they seek to colonise every aspect of life. One area, however, seems immune to such analysis. This is the market for economic theory. If, as economists stress, every human activity can be analysed by economics then why not the demand and supply of economics itself? Perhaps because if that was done some uncomfortable truths would be discovered?

Basic supply and demand theory would indicate that those economic theories which have utility to others would be provided by economists. In a system with inequalities of wealth, effective demand is skewed in favour of the wealthy. Given these basic assumptions, we would predict that only these forms of economists which favour the requirements of the wealthy would gain dominance as these meet the (effective) demand. By a strange co-incidence, this is **precisely** what has happened. This did and does not stop economists complaining that dissidents and radicals were and are biased. As Edward Herman points out:

> *"Back in 1849, the British economist Nassau Senior chided those defending trade unions and minimum wage regulations for expounding an 'economics of the poor.' The idea that he and his establishment confreres were putting forth an 'economics of the rich' never occurred to him; he thought of himself as a scientist and spokesperson of true principles. This self-deception pervaded mainstream economics up to the time of the Keynesian Revolution of the 1930s. Keynesian economics, though quickly tamed into an instrument of service to the capitalist state, was disturbing in its stress on the inherent instability of capitalism, the tendency toward chronic unemployment, and the need for substantial government intervention to maintain viability. With the resurgent capitalism of the past 50 years, Keynesian ideas, and their implicit call for intervention, have been under incessant attack, and, in the intellectual counterrevolution led by the Chicago School, the traditional laissez-faire ('let-the-fur-fly') economics of the rich has been re-established as the core of mainstream economics."* [**The Economics of the Rich**]

Herman goes on to ask *"[w]hy do the economists serve the rich?"* and argues that *"[f]or one thing, the leading economists are among the rich, and others seek advancement to similar heights. Chicago School economist Gary Becker was on to something when he argued that economic motives explain a lot of actions frequently attributed to other forces. He of course never applied this idea to economics as a profession …"* There are a great many well paying think tanks, research posts, consultancies and so on that create an *"'effective demand' that should elicit an appropriate supply resource."*

Elsewhere, Herman notes the *"class links of these professionals to the business community were strong and the ideological element was realised in the neoclassical competitive model … Spin-off* *negative effects on the lower classes were part of the 'price of progress.' It was the elite orientation of these questions [asked by economics], premises, and the central paradigm [of economic theory] that caused matters like unemployment, mass poverty, and work hazards to escape the net of mainstream economist interest until well into the twentieth century."* Moreover, *"the economics profession in the years 1880–1930 was by and large strongly conservative, reflecting in its core paradigm its class links and sympathy with the dominant business community, fundamentally anti-union and suspicious of government, and tending to view competition as the true and durable state of nature."* [Edward S. Herman, *"The Selling of Market Economics,"* pp. 173–199, **New Ways of Knowing**, Marcus G. Raskin and Herbert J. Bernstein (eds.),p. 179–80 and p. 180]

Rather than scientific analysis, economics has always been driven by the demands of the wealthy (*"How did [economics] get instituted? As a weapon of class warfare."* [Chomsky, **Op. Cit.**, p. 252]). This works on numerous levels. The most obvious is that most economists take the current class system and wealth/income distribution as granted and generate general *"laws"* of economics from a specific historical society. As we discuss in the next section, this inevitably skews the "science" into ideology and apologetics. The analysis is also (almost inevitably) based on individualistic assumptions, ignoring or downplaying the key issues of groups, organisations, class and the economic and social power they generate. Then there are the assumptions used and questions raised. As Herman argues, this has hardly been a neutral process:

> *"the theorists explicating these systems, such as Carl Menger, Leon Walras, and Alfred Marshall, were knowingly assuming away formulations that raised disturbing questions (income distribution, class and market power, instability, and unemployment) and creating theoretical models compatible with their own policy biases of status quo or modest reformism … Given the choice of 'problem,' ideology and other sources of bias may still enter economic analysis if the answer is predetermined by the structure of the theory or premises, or if the facts are selected or bent to prove the desired answer."* [**Op. Cit.**, p. 176]

Needless to say, economics is a "science" with deep ramifications within society. As a result, it comes under pressure from outside influences and vested interests far more than, say, anthropology or physics. This has meant that the wealthy have always taken a keen interest that the "science" teaches the appropriate lessons. This has resulted in a demand for a "science" which reflects the interests of the few, not the many. Is it **really** just a co-incidence that the lessons of economics are just what the bosses and the wealthy would like to hear? As non-neoclassical economist John Kenneth Galbraith noted in 1972:

> *"Economic instruction in the United States is about a hundred years old. In its first half century economists were subject to censorship by outsiders. Businessmen and their political and ideological acolytes kept watch on departments of economics and reacted promptly to heresy, the latter being anything that seemed to threaten the sanctity of property, profits, a proper tariff policy and a balanced budget, or that suggested sympathy for unions, public ownership, public regulation or, in any organised way, for the poor."* [**The Essential Galbraith**, p. 135]

It is **really** surprising that having the wealthy fund (and so control) the development of a "science" has produced a body of theory which so benefits their interests? Or that they would be keen to educate the masses in the lessons of said "science", lessons which happen to conclude that the best thing workers should do is obey the dictates of the bosses, sorry, the market? It is really just a co-incidence that the repeated use of economics is to spread the message that strikes, unions, resistance and so forth are counter-productive and that the best thing worker can do is simply wait patiently for wealth to trickle down?

This co-incidence has been a feature of the "science" from the start. The French Second Empire in the 1850s and 60s saw *"numerous private individuals and organisation, municipalities, and the central government encouraged and founded institutions to instruct workers in economic principles."* The aim was to *"impress upon [workers] the salutary lessons of economics."* Significantly, the *"weightiest motive"* for so doing *"was fear that the influence of socialist ideas upon the working class threatened the social order."* The revolution of 1848 *"convinced many of the upper classes that the must prove to workers that attacks upon the economic order were both unjustified and futile."* Another reason was the recognition of the right to strike in 1864 and so workers *"had to be warned against abuse of the new weapon."* The instruction *"was always with the aim of refuting socialist doctrines and exposing popular misconceptions. As one economist stated, it was not the purpose of a certain course to initiate workers into the complexities of economic science, but to define principles useful for 'our conduct in the social order.'"* The interest in such classes was related to the level of *"worker discontent and agitation."* The impact was less than desired: *"The future Communard Lefrancais referred mockingly to the economists … and the 'banality' and 'platitudes' of the doctrine they taught. A newspaper account of the reception given to the economist Joseph Garnier states that Garnier was greeted with shouts of: 'He is an economist' … It took courage, said the article, to admit that one was an economist before a public meeting."* [David I. Kulstein, *"Economics Instruction for Workers during the Second Empire,"* pp. 225–234, **French Historical Studies**, vol. 1, no. 2, p. 225, p. 226, p. 227 and p. 233]

This process is still at work, with corporations and the wealthy funding university departments and posts as well as their own *"think tanks"* and paid PR economists. The control of funds for research and teaching plays it part in keeping economics the *"economics of the rich."* Analysing the situation in the 1970s, Herman notes that the *"enlarged private demand for the services of economists by the business community … met a warm supply response."* He stressed that *"if the demand in the market is for specific policy conclusions and particular viewpoints that will serve such conclusions, the market will accommodate this demand."* Hence *"blatantly ideological models … are being spewed forth on a large scale, approved and often funded by large vested interests"* which helps *"shift the balance between ideology and science even more firmly toward the former."* [**Op. Cit.**, p. 184, p. 185 and p. 179] The idea that "experts" funded and approved by the wealthy would be objective scientists is hardly worth considering. Unfortunately, many people fail to exercise sufficient scepticism about economists and the economics they support. As with most experts, there are two obvious questions with which any analysis of economics should begin: *"Who is funding it?"* and *"Who benefits from it?"*

However, there are other factors as well, namely the hierarchical organisation of the university system. The heads of economics departments have the power to ensure the continuation of their ideological position due to the position as hirer and promoter of staff. As economics *"has mixed its ideology into the subject so well that the ideologically unconventional usually appear to appointment committees to be scientifically incompetent."* [Benjamin Ward, **What's Wrong with Economics?**, p. 250] Galbraith termed this *"a new despotism,"* which consisted of *"defining scientific excellence in economics not as what is true but as whatever is closest to belief and method to the scholarly* *tendency of the people who already have tenure in the subject. This is a pervasive test, not the less oppress for being, in the frequent case, both self-righteous and unconscious. It helps ensure, needless to say, the perpetuation of the neoclassical orthodoxy."* [**Op. Cit.**, p. 135] This plays a key role in keeping economics an ideology rather than a science:

> *"The power inherent in this system of quality control within the economics profession is obviously very great. The discipline's censors occupy leading posts in economics departments at the major institutions … Any economist with serious hopes of obtaining a tenured position in one of these departments will soon be made aware of the criteria by which he is to be judged … the entire academic program … consists of indoctrination in the ideas and techniques of the science."* [Ward, **Op. Cit.**, pp. 29–30]

All this has meant that the "science" of economics has hardly changed in its basics in over one hundred years. Even notions which have been debunked (and have been acknowledged as such) continue to be taught:

> *"The so-called mainline teaching of economic theory has a curious self-sealing capacity. Every breach that is made in it by criticism is somehow filled up by admitting the point but refusing to draw any consequence from it, so that the old doctrines can be repeated as before. Thus the Keynesian revolution was absorbed into the doctrine that, 'in the long run,' there is a natural tendency for a market economy to achieve full employment of available labour and full utilisation of equipment; that the rate of accumulation is determined by household saving; and that the rate of interest is identical with the rate of profit on capital. Similarly, Piero Sraffa's demolition of the neoclassical production function in labour and 'capital' was admitted to be unanswerable, but it has not been allowed to affect the propagation of the 'marginal productivity' theory of wages and profits.*
>
> *"The most sophisticated practitioners of orthodoxy maintain that the whole structure is an exercise in pure logic which has no application to real life at all. All the same they give their pupils the impression that they are being provided with an instrument which is valuable, indeed necessary, for the analysis of actual problems."* [Joan Robinson, **Op. Cit.**, vol. 5, p. 222]

The social role of economics explains this process, for *"orthodox traditional economics … was a plan for explaining to the privileged class that their position was morally right and was necessary for the welfare of society. Even the poor were better off under the existing system that they would be under any other … the doctrine [argued] that increased wealth of the propertied class brings about an automatic increase of income to the poor, so that, if the rich were made poorer, the poor would necessarily become poorer too."* [Robinson, **Op. Cit.**, vol. 4, p. 242]

In such a situation, debunked theories would continue to be taught simply because what they say has a utility to certain sections of society:

> *"Few issues provide better examples of the negative impact of economic theory on society than the distribution of income. Economists are forever opposing 'market interventions' which might raise the wages of the poor, while defending astronomical salary levels*

> *for top executives on the basis that if the market is willing to pay them so much, they must be worth it. In fact, the inequality which is so much a characteristic of modern society reflects power rather than justice. This is one of the many instances where unsound economic theory makes economists the champions of policies which, is anything, undermine the economic foundations of modern society."* [Keen, **Op. Cit.**, p. 126]

This argument is based on the notion that wages equal the marginal productivity of labour. This is supposed to mean that as the output of workers increase, their wages rise. However, as we note in section C.1.5, this law of economics has been violated for the last thirty-odd years in the US. Has this resulted in a change in the theory? Of course not. Not that the theory is actually correct. As we discuss in section C.2.5, marginal productivity theory has been exposed as nonsense (and acknowledged as flawed by leading neo-classical economists) since the early 1960s. However, its utility in defending inequality is such that its continued use does not really come as a surprise.

This is not to suggest that mainstream economics is monolithic. Far from it. It is riddled with argument and competing policy recommendations. Some theories rise to prominence, simply to disappear again (*"See, the 'science' happens to be a very flexible one: you can change it to do whatever you feel like, it's that kind of 'science.'"* [Chomsky, **Op. Cit.**, p. 253]). Given our analysis that economics is a commodity and subject to demand, this comes as no surprise. Given that the capitalist class is always in competition within itself and different sections have different needs at different times, we would expect a diversity of economics beliefs within the "science" which rise and fall depending on the needs and relative strengths of different sections of capital. While, overall, the "science" will support basic things (such as profits, interest and rent are **not** the result of exploitation) but the actual policy recommendations will vary. This is not to say that certain individuals or schools will not have their own particular dogmas or that individuals rise above such influences and act as real scientists, of course, just that (in general) supply is not independent of demand or class influence.

Nor should we dismiss the role of popular dissent in shaping the "science." The class struggle has resulted in a few changes to economics, if only in terms of the apologetics used to justify non-labour income. Popular struggles and organisation play their role as the success of, say, union organising to reduce the working day obviously refutes the claims made against such movements by economists. Similarly, the need for economics to justify reforms can become a pressing issue when the alternative (revolution) is a possibility. As Chomsky notes, during the 19^{th} century (as today) popular struggle played as much of a role as the needs of the ruling class in the development of the "science":

> *"[Economics] changed for a number of reasons. For one thing, these guys had won, so they didn't need it so much as an ideological weapon anymore. For another, they recognised that they themselves needed a powerful interventionist state to defend industry form the hardships of competition in the open market — as they had always* ***had*** *in fact. And beyond that, eliminating people's 'right to live' was starting to have some negative side-effects. First of all, it was causing riots all over the place ... Then something even worse happened — the population started to organise: you got the beginning of an organised labour movement ... then a socialist movement developed. And at that point, the elites ... recognised that the game had to be called off, else they* ***really*** *would be in*

> *trouble ... it wasn't until recent years that laissez-faire ideology was revived again — and again, it was a weapon of class warfare ... And it doesn't have any more validity than it had in the early nineteenth century — in fact it has even* ***less****. At least in the early nineteenth century ... [the] assumptions had* ***some*** *relation to reality. Today those assumptions have* ***not*** *relation to reality."* [**Op. Cit.**, pp. 253–4]

Whether the *"economics of the rich"* or the *"economics of the poor"* win out in academia is driven far more by the state of the class war than by abstract debating about unreal models. Thus the rise of monetarism came about due to its utility to the dominant sections of the ruling class rather than it winning any intellectual battles (it was decisively refuted by leading Keynesians like Nicholas Kaldor who saw their predicted fears become true when it was applied — see section C.8). Hopefully by analysing the myths of capitalist economics we will aid those fighting for a better world by giving them the means of counteracting those who claim the mantle of *"science"* to foster the *"economics of the rich"* onto society.

To conclude, neo-classical economics shows the viability of an unreal system and this is translated into assertions about the world that we live in. Rather than analyse reality, economics evades it and asserts that the economy works *"as if"* it matched the unreal assumptions of neo-classical economics. No other science would take such an approach seriously. In biology, for example, the notion that the world can be analysed *"as if"* God created it is called Creationism and rightly dismissed. In economics, such people are generally awarded professorships or even the (so-called) Nobel prize in economics (Keen critiques the *"as if"* methodology of economics in chapter 7 of his **Debunking Economics**). Moreover, and even worse, policy decisions will be enacted based on a model which has no bearing in reality — with disastrous results (for example, the rise and fall of Monetarism).

Its net effect to justify the current class system and diverts serious attention from critical questions facing working class people (for example, inequality and market power, what goes on in production, how authority relations impact on society and in the workplace). Rather than looking to how things are produced, the conflicts generated in the production process and the generation as well as division of products/surplus, economics takes what was produced as given, as well as the capitalist workplace, the division of labour and authority relations and so on. The individualistic neoclassical analysis by definition ignores such key issues as economic power, the possibility of a structural imbalance in the way economic growth is distributed, organisation structure, and so on.

Given its social role, it comes as no surprise that economics is not a genuine science. For most economists, the *"scientific method (the inductive method of natural sciences) [is] utterly unknown to them."* [Kropotkin, **Anarchism**, p. 179] The argument that most economics is not a science is not limited to just anarchists or other critics of capitalism. Many dissident economics recognise this fact as well, arguing that the profession needs to get its act together if it is to be taken seriously. Whether it could retain its position as defender of capitalism if this happens is a moot point as many of the theorems developed were done so explicitly as part of this role (particularly to defend non-labour income — see section C.2). That economics can become much broader and more relevant is always a possibility, but to do so would mean to take into account an unpleasant reality marked by class, hierarchy and inequality rather than logic deductions derived from Robinson Crusoe. While the latter can produce mathematical models to reach the conclusions that the market is already doing a good job (or, at best, there are some imperfections which can be counterbalanced by the state), the former cannot.

Anarchists, unsurprisingly, take a different approach to economics. As Kropotkin put it, *"we think that to become a science, Political Economy has to be built up in a different way. It must be treated as a natural science, and use the methods used in all exact, empirical sciences."* [**Evolution and Environment**, p. 93] This means that we must start with the world as it is, not as economics would like it to be. It must be placed in historical context and key facts of capitalism, like wage labour, not taken for granted. It must not abstract from such key facts of life as economic and social power. In a word, economics must reject those features which turn it into a sophisticated defence of the status quo. Given its social role within capitalism (and the history and evolution of economic thought), it is doubtful it will ever become a real science simply because it if did it would hardly be used to defend that system.

C.1.1 Is economics really value free?

Modern economists try and portray economics as a "value-free science." Of course, it rarely dawns on them that they are usually just taking existing social structures for granted and building economic dogmas around them, so justifying them. At best, as Kropotkin pointed out:

> *"[A]ll the so-called laws and theories of political economy are in reality no more than statements of the following nature: 'Granting that there are always in a country a considerable number of people who cannot subsist a month, or even a fortnight, without earning a salary and accepting for that purpose the conditions of work imposed upon them by the State, or offered to them by those whom the State recognises as owners of land, factories, railways, etc., then the results will be so and so.'*
>
> *"So far academic political economy has been only an enumeration of what happens under these conditions — without distinctly stating the conditions themselves. And then, having described* ***the facts*** *which arise in our society under these conditions, they represent to us these* ***facts*** *as rigid,* ***inevitable economic laws.****"* [**Anarchism**, p. 179]

In other words, economists usually take the political and economic aspects of capitalist society (such as property rights, inequality and so on) as given and construct their theories around it. At best. At worse, economics is simply speculation based on the necessary assumptions required to prove the desired end. By some strange coincidence these ends usually bolster the power and profits of the few and show that the free market is the best of all possible worlds. Alfred Marshall, one of the founders of neoclassical economics, once noted the usefulness of economics to the elite:

> *"From Metaphysics I went to Ethics, and found that the justification of the existing conditions of society was not easy. A friend, who had read a great deal of what are called the Moral Sciences, constantly said: 'Ah! if you understood Political Economy you would not say that'"* [quoted by Joan Robinson, **Collected Economic Papers**, vol. 4, p. 129]

Joan Robinson added that *"[n]owadays, of course, no one would put it so crudely. Nowadays, the hidden persuaders are concealed behind scientific objectivity, carefully avoiding value judgements;*

they are persuading all the better so." [**Op. Cit.**, p. 129] The way which economic theory systematically says what bosses and the wealthy want to hear is just one of those strange co-incidences of life, one which seems to befall economics with alarming regularity.

How does economics achieve this strange co-incidence, how does the "value free" "science" end up being wedded to producing apologetics for the current system? A key reason is the lack of concern about history, about how the current distribution of income and wealth was created. Instead, the current distribution of wealth and income is taken for granted.

This flows, in part, from the static nature of neoclassical economics. If your economic analysis starts and ends with a snapshot of time, with a given set of commodities, then how those commodities get into a specific set of hands can be considered irrelevant — particularly when you modify your theory to exclude the possibility of proving income redistribution will increase overall utility (see section C.1.3). It also flows from the social role of economics as defender of capitalism. By taking the current distribution of income and wealth as given, then many awkward questions can be automatically excluded from the "science."

This can be seen from the rise of neoclassical economics in the 1870s and 1880s. The break between classical political economy and economics was marked by a change in the kind of questions being asked. In the former, the central focus was on distribution, growth, production and the relations between social classes. The exact determination of individual prices was of little concern, particularly in the short run. For the new economics, the focus became developing a rigorous theory of price determination. This meant abstracting from production and looking at the amount of goods available at any given moment of time. Thus economics avoided questions about class relations by asking questions about individual utility, so narrowing the field of analysis by asking politically harmless questions based on unrealistic models (for all its talk of rigour, the new economics did not provide an answer to how real prices were determined any more than classical economics had simply because its abstract models had no relation to reality).

It did, however, provide a naturalistic justification for capitalist social relations by arguing that profit, interest and rent are the result of individual decisions rather than the product of a specific social system. In other words, economics took the classes of capitalism, internalised them within itself, gave them universal application and, by taking for granted the existing distribution of wealth, justified the class structure and differences in market power this produces. It does not ask (or investigate) **why** some people own all the land and capital while the vast majority have to sell their labour on the market to survive. As such, it internalises the class structure of capitalism. Taking this class structure as a given, economics simply asks the question how much does each "factor" (labour, land, capital) contribute to the production of goods.

Alfred Marshall justified this perspective as follows:

> *"In the long run the earnings of each agent (of production) are, as a rule, sufficient only to recompense the sum total of the efforts and sacrifices required to produce them ... with a partial exception in the case of land ... especially much land in old countries, if we could trace its record back to their earliest origins. But the attempt would raise controversial questions in history and ethics as well as in economics; and the aims of our present inquiry are prospective rather than retrospective."* [**Principles of Economics**, p. 832]

Which is wonderfully handy for those who benefited from the theft of the common heritage of humanity. Particularly as Marshall himself notes the dire consequences for those without access to the means of life on the market:

> *"When a workman is in fear of hunger, his need of money is very great; and, if at starting he gets the worst of the bargaining, it remains great … That is all the more probably because, while the advantage in bargaining is likely to be pretty well distributed between the two sides of a market for commodities, it is more often on the side of the buyers than on that of the sellers in a market for labour."* [**Op. Cit.**, pp. 335–6]

Given that market exchanges will benefit the stronger of the parties involved, this means that inequalities become stronger and more secure over time. Taking the current distribution of property as a given (and, moreover, something that must not be changed) then the market does not correct this sort of injustice. In fact, it perpetuates it and, moreover, it has no way of compensating the victims as there is no mechanism for ensuring reparations. So the impact of previous acts of aggression has an impact on how a specific society developed and the current state of the world. To dismiss *"retrospective"* analysis as it raises *"controversial questions"* and *"ethics"* is not value-free or objective science, it is pure ideology and skews any *"prospective"* enquiry into apologetics.

This can be seen when Marshall noted that labour *"is often sold under special disadvantages, arising from the closely connected group of facts that labour power is 'perishable,' that the sellers of it are commonly poor and have no reserve fund, and that they cannot easily withhold it from the market."* Moreover, the *"disadvantage, wherever it exists, is likely to be cumulative in its effects."* Yet, for some reason, he still maintains that *"wages of every class of labour tend to be equal to the net product due to the additional labourer of this class."* [**Op. Cit.**, p. 567, p. 569 and p. 518] Why should it, given the noted fact that workers are at a disadvantage in the market place? Hence Malatesta:

> *"Landlords, capitalists have robbed the people, with violence and dishonesty, of the land and all the means of production, and in consequence of this initial theft can each day take away from workers the product of their labour."* [**Errico Malatesta: His Life and Ideas**, p. 168]

As such, how could it possibly be considered "scientific" or "value-free" to ignore history? It is hardly *"retrospective"* to analyse the roots of the current disadvantage working class people have in the current and *"prospective"* labour market, particularly given that Marshall himself notes their results. This is a striking example of what Kropotkin deplored in economics, namely that in the rare situations when social conditions were *"mentioned, they were forgotten immediately, to be spoken of no more."* Thus reality is mentioned, but any impact this may have on the distribution of income is forgotten for otherwise you would have to conclude, with the anarchists, that the *"appropriation of the produce of human labour by the owners of capital [and land] exists only because millions of men [and women] have literally nothing to live upon, unless they sell their labour force and their intelligence at a price that will make the net profit of the capitalist and 'surplus value' possible."* [**Evolution and Environment**, p. 92 and p. 106]

This is important, for respecting property rights is easy to talk about but it only faintly holds some water if the existing property ownership distribution is legitimate. If it is illegitimate, if the current property titles were the result of theft, corruption, colonial conquest, state intervention, and other forms of coercion then things are obviously different. That is why economics rarely, if ever, discusses this. This does not, of course, stop economists arguing against current interventions in the market (particularly those associated with the welfare state). In effect, they are arguing that it is okay to reap the benefits of past initiations of force but it is wrong to try and rectify them. It is as if someone walks into a room of people, robs them at gun point and then asks that they should respect each others property rights from now on and only engage in voluntary exchanges with what they had left. Any attempt to establish a moral case for the "free market" in such circumstances would be unlikely to succeed. This is free market capitalist economics in a nutshell: never mind past injustices, let us all do the best we can given the current allocations of resources.

Many economists go one better. Not content in ignoring history, they create little fictional stories in order to justify their theories or the current distribution of wealth and income. Usually, they start from isolated individual or a community of approximately equal individuals (a community usually without any communal institutions). For example, the "waiting" theories of profit and interest (see section C.2.7) requires such a fiction to be remotely convincing. It needs to assume a community marked by basic equality of wealth and income yet divided into two groups of people, one of which was industrious and farsighted who abstained from directly consuming the products created by their **own** labour while the other was lazy and consumed their income without thought of the future. Over time, the descendants of the diligent came to own the means of life while the descendants of the lazy and the prodigal have, to quote Marx, *"nothing to sell but themselves."* In that way, modern day profits and interest can be justified by appealing to such *"insipid childishness."* [**Capital**, vol. 1, p. 873] The real history of the rise of capitalism is, as we discuss in section F.8, grim.

Of course, it may be argued that this is just a model and an abstraction and, consequently, valid to illustrate a point. Anarchists disagree. Yes, there is often the need for abstraction in studying an economy or any other complex system, but this is not an abstraction, it is propaganda and a historical invention used not to illustrate an abstract point but rather a specific system of power and class. That these little parables and stories have all the necessary assumptions and abstractions required to reach the desired conclusions is just one of those co-incidences which seem to regularly befall economics.

The strange thing about these fictional stories is that they are given much more credence than real history within economics. Almost always, fictional "history" will always top actual history in economics. If the actual history of capitalism is mentioned, then the defenders of capitalism will simply say that we should not penalise current holders of capital for actions in the dim and distant past (that current and future generations of workers are penalised goes unmentioned). However, the fictional "history" of capitalism suffers from no such dismissal, for invented actions in the dim and distant past justify the current owners holdings of wealth and the income that generates. In other words, heads I win, tails you loose.

Needless to say, this (selective) myopia is not restricted to just history. It is applied to current situations as well. Thus we find economists defending current economic systems as "free market" regimes in spite of obvious forms of state intervention. As Chomsky notes:

> *"when people talk about … free-market 'trade forces' inevitably kicking all these people out of work and driving the whole world towards a kind of a Third World-type polarisa-*

> *tion of wealth … that's true if you take a narrow enough perspective on it. But if you look into the factors that* ***made*** *things the way they are, it doesn't even come* ***close*** *to being true, it's not remotely in touch with reality. But when you're studying economics in the ideological institutions, that's all irrelevant and you're not supposed to ask questions like these."* [**Understanding Power**, p. 260]

To ignore all that and simply take the current distribution of wealth and income as given and then argue that the "free market" produces the best allocation of resources is staggering. Particularly as the claim of *"efficient allocation"* does not address the obvious question: "efficient" for whose benefit? For the idealisation of freedom in and through the market ignores the fact that this freedom is very limited in scope to great numbers of people as well as the consequences to the individuals concerned by the distribution of purchasing power amongst them that the market throws up (rooted, of course in the original endowments). Which, of course, explains why, even **if** these parables of economics were true, anarchists would still oppose capitalism. We extend Thomas Jefferson's comment that the *"earth belongs always to the living generation"* to economic institutions as well as political — the past should not dominate the present and the future (Jefferson: *"Can one generation bind another and all others in succession forever? I think not. The Creator has made the earth for the living, not for the dead. Rights and powers can only belong to persons, not to things, not to mere matter unendowed with will"*). For, as Malatesta argued, people should *"not have the right … to subject people to their rule and even less of bequeathing to the countless successions of their descendants the right to dominate and exploit future generations."* [**At the Cafe**, p. 48]

Then there is the strange co-incidence that "value free" economics generally ends up blaming all the problems of capitalism on workers. Unemployment? Recession? Low growth? Wages are too high! Proudhon summed up capitalist economic theory well when he stated that *"Political economy — that is, proprietary despotism — can never be in the wrong: it must be the proletariat."* [**System of Economical Contradictions**, p. 187] And little has changed since 1846 (or 1776!) when it comes to economics *"explaining"* capitalism's problems (such as the business cycle or unemployment).

As such, it is hard to consider economics as "value free" when economists regularly attack unions while being silent or supportive of big business. According to neo-classical economic theory, both are meant to be equally bad for the economy but you would be hard pressed to find many economists who would urge the breaking up of corporations into a multitude of small firms as their theory demands, the number who will thunder against "monopolistic" labour is substantially higher (ironically, as we note in section C.1.4, their own theory shows that they must urge the break up of corporations or support unions for, otherwise, unorganised labour **is** exploited). Apparently arguing that high wages are always bad but high profits are always good is value free.

So while big business is generally ignored (in favour of arguments that the economy works *"as if"* it did not exist), unions are rarely given such favours. Unlike, say, transnational corporations, unions are considered monopolistic. Thus we see the strange situation of economists (or economics influenced ideologies like right-wing "libertarians") enthusiastically defending companies that raise their prices in the wake of, say, a natural disaster and making windfall profits while, at the same time, attacking workers who decide to raise their wages by striking for being selfish. It is, of course, unlikely that they would let similar charges against bosses pass without comment. But what can you expect from an ideology which presents unemployment as a good thing (namely, increased leisure — see section C.1.5) and being rich as, essentially, a **disutility** (the pain of abstaining from present consumption falls heaviest on those with wealth — see section C.2.7).

Ultimately, only economists would argue, with a straight face, that the billionaire owner of a transnational corporation is exploited when the workers in his sweatshops successfully form a union (usually in the face of the economic and political power wielded by their boss). Yet that is what many economists argue: the transnational corporation is not a monopoly but the union is and monopolies exploit others! Of course, they rarely state it as bluntly as that. Instead they suggest that unions get higher wages for their members be forcing other workers to take less pay (i.e. by exploiting them). So when bosses break unions they are doing this **not** to defend their profits and power but really to raise the standard of other, less fortunate, workers? Hardly. In reality, of course, the reason why unions are so disliked by economics is that bosses, in general, hate them. Under capitalism, labour is a cost and higher wages means less profits (all things being equal). Hence the need to demonise unions, for one of the less understood facts is that while unions increase wages for members, they also increase wages for non-union workers. This should not be surprising as non-union companies have to raise wages stop their workers unionising and to compete for the best workers who will be drawn to the better pay and conditions of union shops (as we discuss in section C.9, the neoclassical model of the labour market is seriously flawed).

Which brings us to another key problem with the claim that economics is "value free," namely the fact that it takes the current class system of capitalism and its distribution of wealth as not only a fact but as an ideal. This is because economics is based on the need to be able to differentiate between each factor of production in order to determine if it is being used optimally. In other words, the given class structure of capitalism is required to show that an economy uses the available resources efficiently or not. It claims to be "value free" simply because it embeds the economic relationships of capitalist society into its assumptions about nature.

Yet it is impossible to define profit, rent and interest independently of the class structure of any given society. Therefore, this *"type of distribution is the peculiarity of capitalism. Under feudalism the surplus was extracted as land rent. In an artisan economy each commodity is produced by a men with his own tools; the distinction between wages and profits has no meaning there."* This means that *"the very essence of the theory is bound up with a particular institution — wage labour. The central doctrine is that 'wages tend to equal marginal product of labour.' Obviously this has no meaning for a peasant household where all share the work and the income of their holding according to the rules of family life; nor does it apply in a [co-operative] where, the workers' council has to decide what part of net proceeds to allot to investment, what part to a welfare found and what part to distribute as wage."* [Joan Robinson, **Collected Economic Papers**, p. 26 and p. 130]

This means that the "universal" principles of economics end up by making any economy which does **not** share the core social relations of capitalism inherently "inefficient." If, for example, workers own all three "factors of production" (labour, land and capital) then the "value-free" laws of economics concludes that this will be inefficient. As there is only "income", it is impossible to say which part of it is attributable to labour, land or machinery and, consequently, if these factors are being efficiently used. This means that the "science" of economics is bound up with the current system and its specific class structure and, therefore, as a *"ruling class paradigm, the competitive model"* has the *"substantial"* merit that *"it can be used to rule off the agenda any proposals for* *substantial reform or intervention detrimental to large economic interests … as the model allows (on its assumptions) a formal demonstration that these would reduce efficiency."* [Edward S. Herman, *"The Selling of Market Economics,"* pp. 173–199, **New Ways of Knowing**, Marcus G. Raskin and Herbert J. Bernstein (eds.), p. 178]

Then there are the methodological assumptions based on individualism. By concentrating on individual choices, economics abstracts from the social system within which such choices are made and what influences them. Thus, for example, the analysis of the causes of poverty is turned towards the failings of individuals rather than the system as a whole (to be poor becomes a personal stigma). That the reality on the ground bears little resemblance to the myth matters little — when people with two jobs still fail to earn enough to feed their families, it seems ridiculous to call them lazy or selfish. It suggests a failure in the system, not in the poor themselves. An individualistic analysis is guaranteed to exclude, by definition, the impact of class, inequality, social hierarchies and economic/social power and any analysis of any inherent biases in a given economic system, its distribution of wealth and, consequently, its distribution of income between classes.

This abstracting of individuals from their social surroundings results in the generating economic "laws" which are applicable for all individuals, in all societies, for all times. This results in all concrete instances, no matter how historically different, being treated as expressions of the same universal concept. In this way the uniqueness of contemporary society, namely its basis in wage labour, is ignored (*"The period through which we are passing … is distinguished by a special characteristic — WAGES."* [Proudhon, **Op. Cit.**, p. 199]). Such a perspective cannot help being ideological rather than scientific. By trying to create a theory applicable for all time (and so, apparently, value free) they just hide the fact their theory assumes and justifies the inequalities of capitalism (for example, the assumption of given needs and distribution of wealth and income secretly introduces the social relations of the current society back into the model, something which the model had supposedly abstracted from). By stressing individualism, scarcity and competition, in reality economic analysis reflects nothing more than the dominant ideological conceptions found in capitalist society. Every few economic systems or societies in the history of humanity have actually reflected these aspects of capitalism (indeed, a lot of state violence has been used to create these conditions by breaking up traditional forms of society, property rights and customs in favour of those desired by the current ruling elite).

The very general nature of the various theories of profit, interest and rent should send alarm bells ringing. Their authors construct these theories based on the deductive method and stress how they are applicable in **every** social and economic system. In other words, the theories are just that, theories derived independently of the facts of the society they are in. It seems somewhat strange, to say the least, to develop a theory of, say, interest independently of the class system within which it is charged but this is precisely what these "scientists" do. It is understandable why. By ignoring the current system and its classes and hierarchies, the economic aspects of this system can be justified in terms of appeals to universal human existence. This will raise less objections than saying, for example, that interest exists because the rich will only part with their money if they get more in return and the poor will pay for this because they have little choice due to their socio-economic situation. Far better to talk about "time preference" rather than the reality of class society (see section C.2.6).

Neoclassical economics, in effect, took the "political" out of "political economy" by taking capitalist society for granted along with its class system, its hierarchies and its inequalities. This is reflected in the terminology used. These days even the term capitalism has gone out of fashion, replaced with the approved terms *"market system,"* the *"free market"* or *"free enterprise."* Yet, as Chomsky noted, terms such as *"free enterprise"* are used *"to designate a system of autocratic governance of the economy in which neither the community nor the workforce has any role (a system we would call 'fascist' if translated to the political sphere)."* [**Language and Politics**, p. 175] As such, it seems hardly "value-free" to proclaim a system free when, in reality, most people are distinctly not free for most of their waking hours and whose choices outside production are influenced by the inequality of wealth and power which that system of production create.

This shift in terminology reflects a political necessity. It effectively removes the role of wealth (capital) from the economy. Instead of the owners and manager of capital being in control or, at the very least, having significant impact on social events, we have the impersonal activity of *"the markets"* or *"market forces."* That such a change in terminology is the interest of those whose money accords them power and influence goes without saying. By focusing on the market, economics helps hide the real sources of power in an economy and attention is drawn away from such a key questions of how money (wealth) produces power and how it skews the "free market" in its favour. All in all, as dissident economist John Kenneth Galbraith once put it, *"[w]hat economists believe and teach is rarely hostile to the institutions that reflect the dominant economic power. Not to notice this takes effort, although many succeed."* [**The Essential Galbraith**, p. 180]

This becomes obvious when we look at how the advice economics gives to working class people. In theory, economics is based on individualism and competition yet when it comes to what workers should do, the "laws" of economics suddenly switch. The economist will now deny that competition is a good idea and instead urge that the workers co-operate (i.e. obey) their boss rather than compete (i.e. struggle over the division of output and authority in the workplace). They will argue that there is *"harmony of interests"* between worker and boss, that it is in the **self**-interest of workers **not** to be selfish but rather to do whatever the boss asks to further **the bosses** interests (i.e. profits).

That this perspective implicitly recognises the **dependent** position of workers, goes without saying. So while the sale of labour is portrayed as a market exchange between equals, it is in fact an authority relation between servant and master. The conclusions of economics is simply implicitly acknowledging that authoritarian relationship by identifying with the authority figure in the relationship and urging obedience to them. It simply suggests workers make the best of it by refusing to be independent individuals who need freedom to flourish (at least during working hours, outside they can express their individuality by shopping).

This should come as no surprise, for, as Chomsky notes, economics is rooted in the notion that *"you only harm the poor by making them believe that they have rights other than what they can win on the market, like a basic right to live, because that kind of right interferes with the market, and with efficiency, and with growth and so on — so ultimately people will just be worse off if you try to recognise them."* [**Op. Cit**., p. 251] Economics teaches that you must accept change without regard to whether it is appropriate it not. It teaches that you must not struggle, you must not fight. You must simply accept whatever change happens. Worse, it teaches that resisting and fighting back are utterly counter-productive. In other words, it teaches a servile mentality to those subject to authority. For business, economics is ideal for getting their employees to change their attitudes rather than collectively change how their bosses treat them, structure their jobs or how they are paid — or, of course, change the system.

Of course, the economist who says that they are conducting "value free" analysis are indifferent to the kinds of relationships within society is being less than honest. Capitalist economic theory is rooted in very specific assumptions and concepts such as "economic man" and "perfect competition." It claims to be "value-free" yet its preferred terminology is riddled with value connotations. For example, the behaviour of "economic man" (i.e., people who are self-interested utility maximisation machines) is described as *"rational."* By implication, then, the behaviour of real people is *"irrational"* whenever they depart from this severely truncated account of human nature and society. Our lives consist of much more than buying and selling. We have goals and concerns which cannot be bought or sold in markets. In other words, humanity and liberty transcend the limits of property and, as a result, economics. This, unsurprisingly, affects those who study the "science" as well:

> *"Studying economics also seems to make you a nastier person. Psychological studies have shown that economics graduate students are more likely to 'free ride' — shirk contributions to an experimental 'public goods' account in the pursuit of higher private returns — than the general public. Economists also are less generous that other academics in charitable giving. Undergraduate economics majors are more likely to defect in the classic prisoner's dilemma game that are other majors. And on other tests, students grow less honest — expressing less of a tendency, for example, to return found money — after studying economics, but not studying a control subject like astronomy.*
>
> *"This is no surprise, really. Mainstream economics is built entirely on a notion of self-interested individuals, rational self-maximisers who can order their wants and spend accordingly. There's little room for sentiment, uncertainty, selflessness, and social institutions. Whether this is an accurate picture of the average human is open to question, but there's no question that capitalism as a system and economics as a discipline both reward people who conform to the model."* [Doug Henwood, **Wall Street**, p, 143]

So is economics "value free"? Far from it. Given its social role, it would be surprising that it were. That it tends to produce policy recommendations that benefit the capitalist class is not an accident. It is rooted in the fibre of the "science" as it reflects the assumptions of capitalist society and its class structure. Not only does it take the power and class structures of capitalism for granted, it also makes them the ideal for any and every economy. Given this, it should come as no surprise that economists will tend to support policies which will make the real world conform more closely to the standard (usually neoclassical) economic model. Thus the models of economics become more than a set of abstract assumptions, used simply as a tool in theoretical analysis of the casual relations of facts. Rather they become political goals, an ideal towards which reality should be forced to travel.

This means that economics has a dual character. On the one hand, it attempts to prove that certain things (for example, that free market capitalism produces an optimum allocation of resources or that, given free competition, price formation will ensure that each person's income corresponds to their productive contribution). On the other, economists stress that economic "science" has nothing to do with the question of the justice of existing institutions, class structures or the current economic system. And some people seem surprised that this results in policy recommendations which consistently and systematically favour the ruling class.

C.1.2 Is economics a science?

In a word, no. If by "scientific" it is meant in the usual sense of being based on empirical observation and on developing an analysis that was consistent with and made sense of the data, then most forms of economics are not a science.

Rather than base itself on a study of reality and the generalisation of theory based on the data gathered, economics has almost always been based on generating theories rooted on whatever assumptions were required to make the theory work. Empirical confirmation, if it happens at all, is usually done decades later and if the facts contradict the economics, so much the worse for the facts.

A classic example of this is the neo-classical theory of production. As noted previously, neo-classical economics is focused on individual evaluations of existing products and, unsurprisingly, economics is indelibly marked by *"the dominance of a theoretical vision that treats the inner workings of the production process as a 'black box.'"* This means that the *"neoclassical theory of the 'capitalist' economy makes no qualitative distinction between the corporate enterprise that employs tens of thousands of people and the small family undertaking that does no employ any wage labour at all. As far as theory is concerned, it is technology and market forces, not structures of social power, that govern the activities of corporate capitalists and petty proprietors alike."* [William Lazonick, **Competitive Advantage on the Shop Floor**, p. 34 and pp. 33–4] Production in this schema just happens — inputs go in, outputs go out — and what happens inside is considered irrelevant, a technical issue independent of the social relationships those who do the actual production form between themselves — and the conflicts that ensure.

The theory does have a few key assumptions associated with it, however. First, there are diminishing returns. This plays a central role. In mainstream diminishing returns are required to produce a downward sloping demand curve for a given factor. Second, there is a rising supply curve based on rising marginal costs produced by diminishing returns. The average variable cost curve for a firm is assumed to be U-shaped, the result of first increasing and then diminishing returns. These are logically necessary for the neo-classical theory to work.

Non-economists would, of course, think that these assumptions are generalisations based on empirical evidence. However, they are not. Take the U-shaped average cost curve. This was simply invented by A. C. Pigou, *"a loyal disciple of [leading neo-classical Alfred] Marshall and quite innocent of any knowledge of industry. He therefore constructed a U-shaped average cost curve for a firm, showing economies of scale up to a certain size and rising costs beyond it."* [Joan Robinson, **Collected Economic Papers**, vol. 5, p. 11] The invention was driven by need of the theory, not the facts. With increasing returns to scale, then large firms would have cost advantages against small ones and would drive them out of business in competition. This would destroy the concept of perfect competition. However, the invention of the average cost curve allowed the theory to work as *"proved"* that a competitive market could **not** become dominated by a few large firms, as feared.

The model, in other words, was adjusted to ensure that it produced the desired result rather than reflect reality. The theory was required to prove that markets remained competitive and the existence of diminishing marginal returns to scale of production **did** tend by itself to limit the size of individual firms. That markets did become dominated by a few large firms was neither here nor there. It did not happen in theory and, consequently, that was the important thing and so *"when the great concentrations of power in the multinational corporations are bringing the age of national* *employment policy to an end, the text books are still illustrated by U-shaped curves showing the limitation on the size of firms in a perfectly competitive market."* [Joan Robinson, **Contributions to Modern Economics**, p. 5]

To be good, a theory must have two attributes: They accurately describe the phenomena in question and they make accurate predictions. Neither holds for Pigou's invention: reality keeps getting in the way. Not only did the rise of a few large firms dominating markets indirectly show that the theory was nonsense, when empirical testing was finally done decades after the theory was proposed it showed that in most cases the opposite is the case: that there were constant or even falling costs in production. Just as the theories of marginality and diminishing marginal returns taking over economics, the real world was showing how wrong it was with the rise of corporations across the world.

So the reason why the market become dominated by a few firms should be obvious enough: actual corporate price is utterly different from the economic theory. This was discovered when researchers did what the original theorists did not think was relevant: they actually asked firms what they did and the researchers consistently found that, for the vast majority of manufacturing firms their average costs of production declined as output rose, their marginal costs were always well below their average costs, and substantially smaller than 'marginal revenue', and the concept of a 'demand curve' (and therefore its derivative 'marginal revenue') was simply irrelevant.

Unsurprisingly, real firms set their prices prior to sales, based on a mark-up on costs at a target rate of output. In other words, they did not passively react to the market. These prices are an essential feature of capitalism as prices are set to maintain the long-term viability of the firm. This, and the underlying reality that per-unit costs fell as output levels rose, resulted in far more stable prices than were predicted by traditional economic theory. One researcher concluded that administered prices *"differ so sharply from the behaviour to be expected from"* the theory *"as to challenge the basic conclusions"* of it. He warned that until such time as *"economic theory can explain and take into account the implications"* of this empirical data, *"it provides a poor basis for public policy."* Needless to say, this did not disturb neo-classical economists or stop them providing public policy recommendations. [Gardiner C. Means, *"The Administered-Price Thesis Reconfirmed",* **The American Economic Review**, pp. 292–306, Vol. 62, No. 3, p. 304]

One study in 1952 showed firms a range of hypothetical cost curves, and asked firms which ones most closely approximated their own costs. Over 90% of firms chose a graph with a declining average cost rather than one showing the conventional economic theory of rising marginal costs. These firms faced declining average cost, and their marginal revenues were much greater than marginal cost at all levels of output. Unsurprisingly, the study's authors concluded if this sample was typical then it was *"obvious that short-run marginal price theory should be revised in the light of reality."* We are still waiting. [Eiteman and Guthrie, *"The Shape of the Average Cost Curve",* **The American Economic Review**, pp. 832–8, Vol. 42, No. 5, p. 838]

A more recent study of the empirical data came to the same conclusions, arguing that it is *"overwhelming bad news ... for economic theory."* While economists treat rising marginal cost as the rule, 89% of firms in the study reported marginal costs which were either constant or declined with output. As for price elasticity, it is not a vital operational concept for corporations. In other words, the *"firms that sell 40 percent of GDP believe their demand is totally insensitive to price"* while *"only about one-sixth of GDP is sold under conditions of elastic demand."* [A.S. Blinder, E. Cabetti, D. Lebow and J. Rudd, **Asking About Prices**, p. 102 and p. 101]

Thus empirical research has concluded that actual price setting has nothing to do with clearing the market by equating market supply to market demand (i.e. what economic theory sees as the role of prices). Rather, prices are set to enable the firm to continue as a going concern and equating supply and demand in any arbitrary period of time is irrelevant to a firm which hopes to exist for the indefinite future. As Lee put it, basing himself on extensive use of empirical research, *"market prices are not market-clearing or profit-maximising prices, but rather are enterprise-, and hence transaction-reproducing prices."* Rather than a non-existent equilibrium or profit maximisation at a given moment determining prices, the market price is *"set and the market managed for the purpose of ensuring continual transactions for those enterprises in the market, that is for the benefit of the business leaders and their enterprises."* A significant proportion of goods have prices based on mark-up, normal cost and target rate of return pricing procedures and are relatively stable over time. Thus *"the existence of stable, administered market prices implies that the markets in which they exist are not organised like auction markets or like the early retail markets and oriental bazaars"* as imagined in mainstream economic ideology. [Frederic S. Lee, **Post Keynesian Price Theory**, p. 228 and p. 212]

Unsurprisingly, most of these researchers were highly critical the conventional economic theory of markets and price setting. One viewed the economists' concepts of perfect competition and monopoly as virtual nonsense and *"the product of the itching imaginations of uninformed and inexperienced armchair theorisers."* [Tucker, quoted by Lee, **Op. Cit.**, p. 73f] Which **was** exactly how it was produced.

No other science would think it appropriate to develop theory utterly independently of phenomenon under analysis. No other science would wait decades before testing a theory against reality. No other science would then simply ignore the facts which utterly contradicted the theory and continue to teach that theory as if it were a valid generalisation of the facts. But, then, economics is not a science.

This strange perspective makes sense once it is realised how key the notion of diminishing costs is to economics. In fact, if the assumption of increasing marginal costs is abandoned then so is perfect competition and *"the basis of which economic laws can be constructed … is shorn away,"* causing the *"wreckage of the greater part of general equilibrium theory."* This will have *"a very destructive consequence for economic theory,"* in the words of one leading neo-classical economist. [John Hicks, **Value and Capital**, pp. 83–4] As Steve Keen notes, this is extremely significant:

> *"Strange as it may seem … this is a very big deal. If marginal returns are constant rather than falling, then the neo-classical explanation of everything collapses. Not only can economic theory no longer explain how much a firm produces, it can explain nothing else.*
>
> *"Take, for example, the economic theory of employment and wage determination … The theory asserts that the real wage is equivalent to the marginal product of labour … An employer will employ an additional worker if the amount the worker adds to output — the worker's marginal product — exceeds the real wage … [This] explains the economic predilection for blaming everything on wages being too high — neo-classical economics can be summed up, as [John Kenneth] Galbraith once remarked, in the twin propositions that the poor don't work hard enough because they're paid too much, and the rich don't work hard enough because they're not paid enough …*

> *"If in fact the output to employment relationship is relatively constant, then the neo-classical explanation for employment and output determination collapses. With a flat production function, the marginal product of labour will be constant, and it will* ***never*** *intersect the real wage. The output of the form then can't be explained by the cost of employing labour... [This means that] neo-classical economics simply cannot explain anything: neither the level of employment, nor output, nor, ultimately, what determines the real wage ...the entire edifice of economics collapses."* [**Debunking Economics**, pp. 76–7]

It should be noted that the empirical research simply confirmed an earlier critique of neo-classical economics presented by Piero Sraffa in 1926. He argued that while the neo-classical model of production works in theory only if we accept its assumptions. If those assumptions do not apply in practice, then it is irrelevant. He therefore *"focussed upon the economic assumptions that there were 'factors of production' which were fixed in the short run, and that supply and demand were independent of each other. He argued that these two assumptions could be fulfilled simultaneously. In circumstances where it was valid to say some factor of production was fixed in the short term, supply and demand could not independent, so that every point on the supply curve would be associated with a different demand curve. On the other hand, in circumstances where supply and demand could justifiably be treated as independent, then it would be impossible for any factor of production to be fixed. Hence the marginal costs of production would be constant."* He stressed firms would have to be irrational to act otherwise, foregoing the chance to make profits simply to allow economists to build their models of how they should act. [Keen, **Op. Cit.**, pp. 66–72]

Another key problem in economics is that of time. This has been known, and admitted, by economists for some time. Marshall, for example, stated that *"the element of* ***time****"* was *"the source of many of the greatest difficulties of economics."* [**Principles of Economics**, p. 109] The founder of general equilibrium theory, Walras, recognised that the passage of time wrecked his whole model and stated that we *"shall resolve the ... difficulty purely and simply by ignoring the time element at this point."* This was due, in part, because production *"requires a certain lapse of time."* [**Elements of Pure Economics**, p. 242] This was generalised by Gerard Debreu (in his Nobel Prize for economics winning **Theory of Value**) who postulated that everyone makes their sales and purchases for all time in one instant.

Thus the cutting edge of neo-classical economics, general equilibrium ignores both time **and** production. It is based on making time stop, looking at finished goods, getting individuals to bid for them and, once all goods are at equilibrium, allowing the transactions to take place. For Walras, this was for a certain moment of time and was repeated, for his followers it happened once for all eternity. This is obviously not the way markets work in the real world and, consequently, the dominant branch of economics is hardly scientific. Sadly, the notion of individuals having full knowledge of both now and the future crops up with alarming regularly in the "science" of economics.

Even if we ignore such minor issues as empirical evidence and time, economics has problems even with its favoured tool, mathematics. As Steve Keen has indicated, economists have *"obscured reality using mathematics because they have practised mathematics badly, and because they have not realised the limits of mathematics."* indeed, there are *"numerous theorems in economics that reply upon mathematically fallacious propositions."* [**Op. Cit.**, p. 258 and p. 259] For a theory born from the desire to apply calculus to economics, this is deeply ironic. As an example, Keen points to the theory of perfect competition which assumes that while the demand curve for the market as a whole is downward sloping, an individual firm in perfect competition is so small that it cannot affect the market price and, consequently, faces a horizontal demand curve. Which is utterly impossible. In other words, economics breaks the laws of mathematics.

These are just two examples, there are many, many more. However, these two are pretty fundamental to the whole edifice of modern economic theory. Much, if not most, of mainstream economics is based upon theories which have little or no relation to reality. Kropotkin's dismissal of *"the metaphysical definitions of the academical economists"* is as applicable today. [**Evolution and Environment**, p. 92] Little wonder dissident economist Nicholas Kaldor argued that:

> *"The Walrasian [i.e. general] equilibrium theory is a highly developed intellectual system, much refined and elaborated by mathematical economists since World War II — an intellectual experiment … But it does not constitute a scientific hypothesis, like Einstein's theory of relativity or Newton's law of gravitation, in that its basic assumptions are axiomatic and not empirical, and no specific methods have been put forward by which the validity or relevance of its results could be tested. The assumptions make assertions about reality in their implications, but these are not founded on direct observation, and, in the opinion of practitioners of the theory at any rate, they cannot be contradicted by observation or experiment."* [**The Essential Kaldor**, p. 416]

C.1.3 Can you have an economics based on individualism?

In a word, no. No economic system is simply the sum of its parts. The idea that capitalism is based on the subjective evaluations of individuals for goods flies in the face of both logic and the way capitalism works. In other words, modern economists is based on a fallacy. While it would be expected for critics of capitalism to conclude this, the ironic thing is that economists themselves have proven this to be the case.

Neoclassical theory argues that marginal utility determines demand and price, i.e. the price of a good is dependent on the intensity of demand for the marginal unit consumed. This was in contrast to classic economics, which argued that price (exchange value) was regulated by the cost of production, ultimately the amount of labour used to create it. While realistic, this had the political drawback of implying that profit, rent and interest were the product of unpaid labour and so capitalism was exploitative. This conclusion was quickly seized upon by numerous critics of capitalism, including Proudhon and Marx. The rise of marginal utility theory meant that such critiques could be ignored.

However, this change was not unproblematic. The most obvious problem with it is that it leads to circular reasoning. Prices are supposed to measure the "marginal utility" of the commodity, yet consumers need to know the price **first** in order to evaluate how best to maximise their satisfaction. Hence it *"obviously rest[s] on circular reasoning. Although it tries to explain prices, prices [are] necessary to explain marginal utility."* [Paul Mattick, **Economics, Politics and the Age of Inflation**, p.58] In the end, as Jevons (one of the founders of the new economics) acknowledged, the price of a commodity is the only test we have of the utility of the commodity to the producer. Given that marginality utility was meant to explain those prices, the failure of the theory could not be more striking.

However, this is the least of its problems. At first, the neoclassical economists used cardinal utility as their analysis tool. Cardinal utility meant that it was measurable between individuals, i.e. that the utility of a given good was the same for all. While this allowed prices to be determined, it caused obvious political problems as it obviously justified the taxation of the wealthy. As cardinal utility implied that the "utility" of an extra dollar to a poor person was clearly greater than the loss of one dollar to a rich man, it was appropriated by reformists precisely to justify social reforms and taxation.

Capitalist economists had, yet again, created a theory that could be used to attack capitalism and the income and wealth hierarchy it produces. As with classical economics, socialists and other social reformists used the new theories to do precisely that, appropriating it to justify the redistribution of income and wealth downward (i.e. back into the hands of the class who had created it in the first place). Combine this with the high levels of class conflict at the time and it should come as no surprise that the "science" of economics was suitably revised.

There was, of course, a suitable "scientific" rationale for this revision. It was noted that as individual evaluations are inherently subjective, it is obvious that cardinal utility was impossible in practice. Of course, cardinality was not totally rejected. Neoclassical economics retained the idea that capitalists maximise profits, which is a cardinal quantity. However for demand utility became "ordinal," that is utility was considered an individual thing and so could not be measured. This resulted in the conclusion that there was no way of making interpersonal comparisons between individuals and, consequently, no basis for saying a pound in the hands of a poor person had more utility than if it had remained in the pocket of a billionaire. The economic case for taxation was now, apparently, closed. While you may think that income redistribution was a good idea, it was now proven by "science" that this little more than a belief as all interpersonal comparisons were now impossible. That this was music to the ears of the wealthy was, of course, just one of those strange co-incidences which always seems to plague economic "science."

The next stage of the process was to abandon then ordinal utility in favour of "indifference curves" (the continued discussion of "utility" in economics textbooks is primarily heuristic). In this theory consumers are supposed to maximise their utility by working out which bundle of goods gives them the highest level of satisfaction based on the twin constraints of income and given prices (let us forget, for the moment, that marginal utility was meant to determines prices in the first place). To do this, it is assumed that incomes and tastes are independent and that consumers have pre-existing preferences for all possible bundles.

This produces a graph that shows different quantities of two different goods, with the "indifference curves" showing the combinations of goods which give the consumer the same level of satisfaction (hence the name, as the consumer is "indifferent" to any combination along the curve). There is also a straight line representing relative prices and the consumer's income and this budget line shows the uppermost curve the consumer can afford to reach. That these indifference curves could not be observed was not an issue although leading neo-classical economist Paul Samuelson provided an apparent means see these curves by his concept of *"revealed preference"* (a basic tautology). There is a reason why "indifference curves" cannot be observed. They are literally impossible for human beings to calculate once you move beyond a trivially small set of alternatives and it is impossible for actual people to act as economists argue they do. Ignoring this slight problem, the "indifference curve" approach to demand can be faulted for another, even more basic, reason. It does not prove what it seeks to show:

> *"Though mainstream economics began by assuming that this hedonistic, individualist approach to analysing consumer demand was intellectually sound, **it ended up proving that it was not**. The critics were right: society is more than the sum of its individual members."* [Steve Keen, **Debunking Economics**, p. 23]

As noted above, to fight the conclusion that redistributing wealth would result in a different level of social well-being, economists had to show that *"altering the distribution of income did not alter social welfare. They worked out that two conditions were necessary for this to be true: (a) that all people have the same tastes; (b) that each person's tastes remain the same as her income changes, so that every additional dollar of income was spent exactly the same way as all previous dollars."* The former assumption *"in fact amounts to assuming that there is only one person in society"* or that *"society consists of a multitude of identical drones"* or clones. The latter assumption *"amounts to assuming that there is only one commodity — since otherwise spending patterns would necessary change as income rose."* [Keen, **Op. Cit.**, p. 24] This is the real meaning of the assumption that all goods and consumers can be considered *"representative."* Sadly, such individuals and goods do not exist. Thus:

> *"Economics can prove that 'the demand curve slows downward in price' for a single individual and a single commodity. But in a society consisting of many different individuals with many different commodities, the 'market demand curve' is more probably jagged, and slopes every which way. One essential building block of the economic analysis of markets, the demand curve, therefore does not have the characteristics needed for economic theory to be internally consistent ... most mainstream academic economists are aware of this problem, but they pretend that the failure can be managed with a couple of assumptions. Yet the assumptions themselves are so absurd that only someone with a grossly distorted sense of logic could accept them. That grossly distorted sense of logic is acquired in the course of a standard education in economics."* [**Op. Cit.**, pp. 25–7]

Rather than produce a *"social indifference map which had the same properties as the individual indifference maps"* by adding up all the individual maps, economics *"proved that this consistent summation from individual to society could **not** be achieved."* Any sane person would have rejected the theory at this stage, but not economists. Keen states the obvious: *"That economists, in general, failed to draw this inference speaks volumes for the unscientific nature of economic theory."* They simply invented *"some fudge to disguise the gapping hole they have uncovered in the theory."* [**Op. Cit.**, p. 40 and p. 48] Ironically, it took over one hundred years and advanced mathematical logic to reach the same conclusion that the classical economists took for granted, namely that individual utility could not be measured and compared. However, instead of seeking exchange value (price) in the process of production, neoclassical economists simply that made a few absurd assumptions and continued on its way as if nothing was wrong.

This is important because *"economists are trying to prove that a market economy necessarily maximises social welfare. If they can't prove that the market demand curve falls smoothly as price rises, they can't prove that the market maximises social welfare."* In addition, *"the concept of a social indifference curve is crucial to many of the key notions of economics: the argument that free trade is necessarily superior to regulated trade, for example, is first constructed using a social indifference* *curve. Therefore, if the concept of a social indifference curve itself is invalid, then so too are many of the most treasured notions of economics."* [Keen, **Op. Cit.**, p. 50] This means much of economic theory is invalidated and with it the policy recommendations based on it.

This elimination of individual differences in favour of a society of clones by marginalism is not restricted to demand. Take the concept of the *"representative firm"* used to explain supply. Rather than a theoretical device to deal with variety, it ignores diversity. It is a heuristic concept which deals with a varied collection of firms by identifying a single set of distinct characteristics which are deemed to represent the essential qualities of the industry as a whole. It is **not** a single firm or even a typical or average firm. It is an imaginary firm which exhibits the "representative" features of the entire industry, i.e. it treats an industry as if it were just one firm. Moreover, it should be stressed that this concept is driven by the needs to prove the model, not by any concern over reality. The *"real weakness"* of the *"representative firm"* in neo-classical economics is that it is *"no more than a firm which answers the requirements expected from it by the supply curve"* and because it is *"nothing more than a small-scale replica of the industry's supply curve that it is unsuitable for the purpose it has been called into being."* [Kaldor, **The Essential Kaldor**, p. 50]

Then there is neoclassical analysis of the finance market. According to the Efficient Market Hypothesis, information is disseminated equally among all market participants, they all hold similar interpretations of that information and all can get access to all the credit they need at any time at the same rate. In other words, everyone is considered to be identical in terms of what they know, what they can get and what they do with that knowledge and cash. This results in a theory which argues that stock markets accurately price stocks on the basis of their unknown future earnings, i.e. that these identical expectations by identical investors are correct. In other words, investors are able to correctly predict the future and act in the same way to the same information. Yet if everyone held identical opinions then there would be no trading of shares as trading obviously implies **different** opinions on how a stock will perform. Similarly, in reality investors are credit rationed, the rate of borrowing tends to rise as the amount borrowed increases and the borrowing rate normally exceeds the leading rate. The developer of the theory was honest enough to state that the *"consequence of accommodating such aspects of reality are likely to be disastrous in terms of the usefulness of the resulting theory … The theory is in a shambles."* [W.F Sharpe, quoted by Keen, **Op. Cit.**, p. 233]

Thus the world was turned into a single person simply to provide a theory which showed that stock markets were "efficient" (i.e. accurately reflect unknown future earnings). In spite of these slight problems, the theory was accepted in the mainstream as an accurate reflection of finance markets. Why? Well, the implications of this theory are deeply political as it suggests that finance markets will never experience bubbles and deep slumps. That this contradicts the well-known history of the stock market was considered unimportant. Unsurprisingly, *"as time went on, more and more data turned up which was not consistent with"* the theory. This is because the model's world *"is clearly not our world."* The theory *"cannot apply in a world in which investors differ in their expectations, in which the future is uncertain, and in which borrowing is rationed."* It *"should never have been given any credibility — yet instead it became an article of faith for academics in finance, and a common belief in the commercial world of finance."* [Keen, **Op. Cit.**, p. 246 and p. 234]

This theory is at the root of the argument that finance markets should be deregulated and as many funds as possible invested in them. While the theory may benefit the minority of share holders who own the bulk of shares and help them pressurise government policy, it is hard to see how it benefits the rest of society. Alternative, more realistic theories, argue that finance markets show endogenous instability, result in bad investment as well as reducing the overall level of investment as investors will not fund investments which are not predicted to have a sufficiently high rate of return. All of which has a large and negative impact on the real economy. Instead, the economic profession embraced a highly unreal economic theory which has encouraged the world to indulge in stock market speculation as it argues that they do not have bubbles, booms or bursts (that the 1990s stock market bubble finally burst like many previous ones is unlikely to stop this). Perhaps this has to do the implications for economic theory for this farcical analysis of the stock market? As two mainstream economists put it:

> *"To reject the Efficient Market Hypothesis for the whole stock market … implies broadly that production decisions based on stock prices will lead to inefficient capital allocations. More generally, if the application of rational expectations theory to the virtually 'idea' conditions provided by the stock market fails, then what confidence can economists have in its application to other areas of economics … ?"* [Marsh and Merton, quoted by Doug Henwood, **Wall Street**, p. 161]

Ultimately, neoclassical economics, by means of the concept of "representative" agent, has proved that subjective evaluations could not be aggregated and, as a result, a market supply and demand curves cannot be produced. In other words, neoclassical economics has shown that if society were comprised of one individual, buying one good produced by one factory then it could accurately reflect what happened in it. *"It is stating the obvious,"* states Keen, *"to call the representative agent an 'ad hoc' assumption, made simply so that economists can pretend to have a sound basis for their analysis, when in reality they have no grounding whatsoever."* [**Op. Cit.**, p. 188]

There is a certain irony about the change from cardinal to ordinal utility and finally the rise of the impossible nonsense which are "indifference curves." While these changes were driven by the need to deny the advocates of redistributive taxation policies the mantel of economic science to justify their schemes, the fact is by rejecting cardinal utility, it becomes impossible to say whether state action like taxes decreases utility at all. With ordinal utility and its related concepts, you cannot actually show that government intervention actually harms "social utility." All you can say is that they are indeterminate. While the rich may lose income and the poor gain, it is impossible to say anything about social utility without making an interpersonal (cardinal) utility comparison. Thus, ironically, ordinal utility based economics provides a much weaker defence of free market capitalism by removing the economist of the ability to call any act of government "inefficient" and they would have to be evaluated in, horror of horrors, non-economic terms. As Keen notes, it is *"ironic that this ancient defence of inequality ultimately backfires on economics, by making its impossible to construct a market demand curve which is independent on the distribution of income … economics cannot defend any one distribution of income over any other. A redistribution of income that favours the poor over the rich cannot be formally opposed by economic theory."* [**Op. Cit.**, p. 51]

Neoclassical economics has also confirmed that the classical perspective of analysing society in terms of classes is also more valid than the individualistic approach it values. As one leading neoclassical economist has noted, if economics is *"to progress further we may well be forced to theorise in terms of groups who have collectively coherent behaviour."* Moreover, the classical economists would not be surprised by the admission that *"the addition of production **can** help"* economic analysis nor the conclusion that the *"idea that we should start at the level of the isolated individual is one which we may well have to abandon ... If we aggregate over several individuals, such a model is unjustified."* [Alan Kirman, *"The Intrinsic Limits of Modern Economy Theory"*, pp. 126–139, **The Economic Journal**, Vol. 99, No. 395, p. 138, p. 136 and p. 138]

So why all the bother? Why spend over 100 years driving economics into a dead-end? Simply because of political reasons. The advantage of the neoclassical approach was that it abstracted away from production (where power relations are clear) and concentrated on exchange (where power works indirectly). As libertarian Marxist Paul Mattick notes, the *"problems of bourgeois economics seemed to disappear as soon as one ignored production and attended only to the market ... Viewed apart from production, the price problem can be dealt with purely in terms of the market."* [**Economic Crisis and Crisis Theory**, p. 9] By ignoring production, the obvious inequalities of power produced by the dominant social relations within capitalism could be ignored in favour of looking at abstract individuals as buyers and sellers. That this meant ignoring such key concepts as time by forcing economics into a static, freeze frame, model of the economy was a price worth paying as it allowed capitalism to be justified as the best of all possible worlds:

> *"On the one hand, it was thought essential to represent the winning of profit, interest, and rent as participation in the creation of wealth. On the other, it was thought desirable to found the authority of economics on the procedures of natural science. This second desire prompted a search for general economic laws independent of time and circumstances. If such laws could be proven, the existing society would thereby be legitimated and every idea of changing it refuted. Subjective value theory promised to accomplish both tasks at once. Disregarding the exchange relationship peculiar to capitalism — that between the sellers and buyers of labour power — it could explain the division of the social product, under whatever forms, as resulting from the needs of the exchangers themselves."* [Mattick, **Op. Cit.**, p. 11]

The attempt to ignore production implied in capitalist economics comes from a desire to hide the exploitative and class nature of capitalism. By concentrating upon the "subjective" evaluations of individuals, those individuals are abstracted away from real economic activity (i.e. production) so the source of profits and power in the economy can be ignored (section C.2 indicates why exploitation of labour in production is the source of profit, interest and rent and **not** exchanges in the market).

Hence the flight from classical economics to the static, timeless world of individuals exchanging pre-existing goods on the market. The evolution of capitalist economics has always been towards removing any theory which could be used to attack capitalism. Thus classical economics was rejected in favour of utility theory once socialists and anarchists used it to show that capitalism was exploitative. Then this utility theory was modified over time in order to purge it of undesirable political consequences. In so doing, they ended up not only proving that an economics based on individualism was impossible but also that it cannot be used to oppose redistribution policies after all.

C.1.4 What is wrong with equilibrium analysis?

The dominant form of economic analysis since the 1880s has been equilibrium analysis. While equilibrium had been used by classical economics to explain what regulated market prices, it did not consider it as reflecting any real economy. This was because classical economics analysed capitalism as a mode of production rather than as a mode of exchange, as a mode of circulation, as neo-classical economics does. It looked at the process of creating products while neo-classical economics looked at the price ratios between already existing goods (this explains why neo-classical economists have such a hard time understanding classical or Marxist economics, the schools are talking about different things and why they tend to call any market system "capitalism" regardless of whether wage labour predominates of not). The classical school is based on an analysis of markets based on production of commodities through time. The neo-classical school is based on an analysis of markets based on the exchange of the goods which exist at any moment of time.

This indicates what is wrong with equilibrium analysis, it is essentially a static tool used to analyse a dynamic system. It assumes stability where none exists. Capitalism is always unstable, always out of equilibrium, since *"growing out of capitalist competition, to heighten exploitation, … the relations of production … [are] in a state of perpetual transformation, which manifests itself in changing relative prices of goods on the market. Therefore the market is continuously in disequilibrium, although with different degrees of severity, thus giving rise, by its occasional approach to an equilibrium state, to the illusion of a tendency toward equilibrium."* [Mattick, **Op. Cit.**, p. 51] Given this obvious fact of the real economy, it comes as no surprise that dissident economists consider equilibrium analysis as *"a major obstacle to the development of economics as a **science** — meaning by the term 'science' a body of theorems based on assumptions that are **empirically** derived (from observations) and which embody hypotheses that are capable of verification both in regard to the assumptions and the predictions."* [Kaldor, **The Essential Kaldor**, p. 373]

Thus the whole concept is an unreal rather than valid abstraction of reality. Sadly, the notions of "perfect competition" and (Walrasian) "general equilibrium" are part and parcel of neoclassical economics. It attempts to show, in the words of Paul Ormerod, *"that under certain assumptions the free market system would lead to an allocation of a given set of resources which was in a very particular and restricted sense optimal from the point of view of every individual and company in the economy."* [**The Death of Economics**, p. 45] This was what Walrasian general equilibrium proved. However, the assumptions required prove to be somewhat unrealistic (to understate the point). As Ormerod points out:

> *"[i]t cannot be emphasised too strongly that … the competitive model is far removed from being a reasonable representation of Western economies in practice… [It is] a travesty of reality. The world does not consist, for example, of an enormous number of small firms, none of which has any degree of control over the market … The theory introduced by the marginal revolution was based upon a series of postulates about human behaviour and the workings of the economy. It was very much an experiment in pure thought, with little empirical rationalisation of the assumptions."* [**Op. Cit.**, p. 48]

Indeed, *"the weight of evidence"* is *"against the validity of the model of competitive general equilibrium as a plausible representation of reality."* [**Op. Cit.**, p. 62] For example, to this day, economists still start with the assumption of a multitude of firms, even worse, a "continuum" of them exist in **every** market. How many markets are there in which there is an infinite number of traders? This means that from the start the issues and problems associated with oligopoly and imperfect competition have been abstracted from. This means the theory does not allow one to answer interesting questions which turn on the asymmetry of information and bargaining power among economic agents, whether due to size, or organisation, or social stigmas, or whatever else. In the real world, oligopoly is common place and asymmetry of information and bargaining power the norm. To abstract from these means to present an economic vision at odds with the reality people face and, therefore, can only propose solutions which harm those with weaker bargaining positions and without information.

General equilibrium is an entirely static concept, a market marked by perfect knowledge and so inhabited by people who are under no inducement or need to act. It is also timeless, a world without a future and so with no uncertainty (any attempt to include time, and so uncertainty, ensures that the model ceases to be of value). At best, economists include "time" by means of comparing one static state to another, i.e. *"the features of one non-existent equilibrium were compared with those of a later non-existent equilibrium."* [Mattick, **Op. Cit.**, p. 22] How the economy actually changed from one stable state to another is left to the imagination. Indeed, the idea of any long-run equilibrium is rendered irrelevant by the movement towards it as the equilibrium also moves. Unsurprisingly, therefore, to construct an equilibrium path through time requires all prices for all periods to be determined at the start and that everyone foresees future prices correctly for eternity — including for goods not invented yet. Thus the model cannot easily or usefully account for the reality that economic agents do not actually know such things as future prices, future availability of goods, changes in production techniques or in markets to occur in the future, etc. Instead, to achieve its results — proofs about equilibrium conditions — the model assumes that actors have perfect knowledge at least of the probabilities of all possible outcomes for the economy. The opposite is obviously the case in reality:

> *"Yet the main lessons of these increasingly abstract and unreal theoretical constructions are also increasingly taken on trust … It is generally taken for granted by the great majority of academic economists that the economy always approaches, or is near to, a state of 'equilibrium' … all propositions which the* ***pure*** *mathematical economist has shown to be valid only on assumptions that are manifestly unreal — that is to say, directly contrary to experience and not just 'abstract.' In fact, equilibrium theory has reached the stage where the pure theorist has successfully (though perhaps inadvertently) demonstrated that the main implications of this theory cannot possibly hold in reality, but has not yet managed to pass his message down the line to the textbook writer and to the classroom."* [Kaldor, **Op. Cit.**, pp. 376–7]

In this timeless, perfect world, "free market" capitalism will prove itself an efficient method of allocating resources and all markets will clear. In part at least, General Equilibrium Theory is an abstract answer to an abstract and important question: Can an economy relying only on price signals for market information be orderly? The answer of general equilibrium is clear and definitive — one can describe such an economy with these properties. However, no actual economy has been described and, given the assumptions involved, none could ever exist. A theoretical question has been answered involving some amount of intellectual achievement, but it is a answer which has no bearing to reality. And this is often termed the "high theory" of equilibrium. Obviously most economists must treat the real world as a special case.

Little wonder, then, that Kaldor argued that his *"basic objection to the theory of general equilibrium is not that it is abstract — all theory is abstract and must necessarily be so since there can be no analysis without abstraction — but that it starts from the wrong kind of abstraction, and therefore gives a misleading 'paradigm' … of the world as it is; it gives a misleading impression of the nature and the manner of operation of economic forces."* Moreover, belief that equilibrium theory is the only starting point for economic analysis has survived *"despite the increasing (**not** diminishing) arbitrariness of its based assumptions — which was forced upon its practitioners by the ever more precise cognition of the needs of logical consistency. In terms of gradually converting an 'intellectual experiment' … into a scientific theory — in other words, a set of theorems directly related to observable phenomena — the development of theoretical economics was one of continual **de**gress, not **pro**gress … The process … of **relaxing** the unreal basis assumptions … has not yet started. Indeed, [they get] … thicker and more impenetrable with every successive reformation of the theory."* [**Op. Cit.**, p. 399 and pp. 375–6]

Thus General Equilibrium theory analyses an economic state which there is no reason to suppose will ever, or has ever, come about. It is, therefore, an abstraction which has no discernible applicability or relevance to the world as it is. To argue that it can give insights into the real world is ridiculous. While it is true that there are certain imaginary intellectual problems for which the general equilibrium model is well designed to provide precise answers (if anything really could), in practice this means the same as saying that if one insists on analysing a problem which has no real world equivalent or solution, it may be appropriate to use a model which has no real-world application. Models derived to provide answers to imaginary problems will be unsuitable for resolving practical, real-world economic problems or even providing a useful insight into how capitalism works and develops.

This can have devastating real world impact, as can be seen from the results of neoclassical advice to Eastern Europe and other countries in their transition from state capitalism (Stalinism) to private capitalism. As Joseph Stiglitz documents it was a disaster for all but the elite due to the *"market fundamentalism preached"* by economists It resulted in *"a marked deterioration"* in most peoples *"basic standard of living, reflected in a host of social indicators"* and well as large drops in GDP. [**Globalisation and its discontents**, p. 138 and p. 152] Thus real people can be harmed by unreal theory. That the advice of neoclassical economists has made millions of people look back at Stalinism as "the good old days" should be enough to show its intellectual and moral bankruptcy.

What can you expect? Mainstream economic theory begins with axioms and assumptions and uses a deductive methodology to arrive at conclusions, its usefulness in discovering how the world works is limited. The deductive method is **pre-scientific** in nature. The axioms and assumptions can be considered fictitious (as they have negligible empirical relevance) and the conclusions of deductive models can only really have relevance to the structure of those models as the models themselves bear no relation to economic reality:

> *"Some theorists, even among those who reject general equilibrium as useless, praise its logical elegance and completeness … But if any proposition drawn from it is applied to an economy inhabited by human beings, it immediately becomes self-contradictory. Human life does not exist outside history and no one had correct foresight of his own*

> *future behaviour, let alone of the behaviour of all the other individuals which will impinge upon his. I do not think that it is right to praise the logical elegance of a system which becomes self-contradictory when it is applied to the question that it was designed to answer."* [Joan Robinson, **Contributions to Modern Economics**, pp. 127–8]

Not that this deductive model is internally sound. For example, the assumptions required for perfect competition are mutually exclusive. In order for the market reach equilibrium, economic actors need to able to affect it. So, for example, if there is an excess supply some companies must lower their prices. However, such acts contradict the basic assumption of "perfect competition," namely that the number of buyers and sellers is so huge that no one individual actor (a firm or a consumer) can determine the market price by their actions. In other words, economists assume that the impact of each firm is zero but yet when these zeroes are summed up over the whole market the total is greater than zero. This is impossible. Moreover, the *"requirements of equilibrium are carefully examined in the Walrasian argument but there is no way of demonstrating that a market which starts in an out-of-equilibrium position will tend to get into equilibrium, except by putting further very severe restrictions on the already highly abstract argument."* [Joan Robinson, **Collected Economic Papers**, vol. 5, p. 154] Nor does the stable unique equilibrium actually exist for, ironically, *"mathematicians have shown that, under fairly general conditions, general equilibrium is unstable."* [Keen, **Debunking Economics**, p. 173]

Another major problem with equilibrium theory is the fact that it does not, in fact, describe a capitalist economy. It should go without saying that models which focus purely on exchange cannot, by definition, offer a realistic analysis, never mind description, of the capitalism or the generation of income in an industrialised economy. As Joan Robinson summarises:

> *"The neo-classical theory … pretends to derive a system of prices from the relative scarcity of commodities in relation to the demand for them. I say **pretend** because this system cannot be applied to capitalist production.*
>
> *"The Walrasian conception of equilibrium arrived at by higgling and haggling in a market illuminates the account of prisoners of war swapping the contents of their Red Cross parcels.*
>
> *"It makes sense also, with some modifications, in an economy of artisans and small traders …*
>
> *"Two essential characteristics of industrial capitalism are absent in these economic systems — the distinction between income from work and income from property and the nature of investments made in the light of uncertain expectations about a long future."* [**Collected Economic Papers**, vol. 5, p. 34]

Even such basic things as profits and money have a hard time fitting into general equilibrium theory. In a perfectly competitive equilibrium, super-normal profit is zero so profit fails to appear. Normal profit is assumed to be the contribution capital makes to output and is treated as a cost of production and notionally set as the zero mark. A capitalism without profit? Or growth, *"since there is no profit or any other sort of surplus in the neoclassical equilibrium, there can be no expanded reproduction of the system."* [Mattick, **Op. Cit.**, p. 22] It also treats capitalism as little more than a barter economy. The concept of general equilibrium is incompatible with the actual role of money in a capitalist economy. The assumption of *"perfect knowledge"* makes the keeping of cash reserves as a precaution against unexpected developments would not be necessary as the future is already known. In a world where there was absolute certainty about the present and future there would be no need for a medium of exchange like money at all. In the real world, money has a real effect on production an economic stability. It is, in other words, not neutral (although, conveniently, in a fictional world with neutral money *"crises **do not occur**"* and it *"assumed away the very matter under investigation,"* namely depressions. [Keynes, quoted by Doug Henwood, **Wall Street**, p. 199]).

Given that general equilibrium theory does not satisfactorily encompass such things as profit, money, growth, instability or even firms, how it can be considered as even an adequate representation of any real capitalist economy is hard to understand. Yet, sadly, this perspective has dominated economics for over 100 years. There is almost no discussion of how scarce means are organised to yield outputs, the whole emphasis is on exchanges of ready made goods. This is unsurprising, as this allows economics to abstract from such key concepts as power, class and hierarchy. It shows the *"the bankruptcy of academic economic teaching. The structure of thought which it expounds was long ago proven to be hollow. It consisted of a set of propositions which bore hardly any relation to the structure and evolution of the economy that they were supposed to depict."* [Joan Robinson, **Op. Cit.**, p. 90]

Ultimately, equilibrium analysis simply presents an unreal picture of the real world. Economics treat a dynamic system as a static one, building models rooted in the concept of equilibrium when a non-equilibrium analysis makes obvious sense. As Steven Keen notes, it is not only the real world that has suffered, so has economics:

> *"This obsession with equilibrium has imposed enormous costs on economics … unreal assumptions are needed to maintain conditions under which there will be a unique, 'optimal' equilibrium … If you believe you can use unreality to model reality, then eventually your grip on reality itself can become tenuous."* [**Op. Cit.**, p. 177]

Ironically, given economists usual role in society as defenders of big business and the elite in general, there is one conclusion of general equilibrium theory which does have some relevance to the real world. In 1956, two economists *"demonstrated that serious problems exist for the model of competitive equilibrium if any of its assumptions are breached."* They were *"not dealing with the fundamental problem of whether a competitive equilibrium exists,"* rather they wanted to know what happens if the assumptions of the model were violated. Assuming that two violations existed, they worked out what would happen if only one of them were removed. The answer was a shock for economists — *"If just one of many, or even just one of two [violations] is removed, it is not possible to prejudge the outcome. The economy as a whole can theoretically be worse off it just one violation exists than it is when two such violations exist."* In other words, any single move towards the economists' ideal market may make the world worse off. [Ormerod, **Op. Cit.**, pp. 82–4]

What Kelvin Lancaster and Richard Lipsey had shown in their paper *"The General Theory of the Second Best"* [**Review of Economic Studies**, December 1956] has one obvious implication, namely that neoclassical economics itself has shown that trade unions were essential to stop workers being exploited under capitalism. This is because the neoclassical model requires there to be a multitude of small firms and no unions. In the real world, most markets are dominated by a few big firms. Getting rid of unions in such a less than competitive market would result in the wage being less than the price for which the marginal worker's output can be sold, i.e. workers are exploited by capital. In other words, economics has **itself** disproved the neoclassical case against trade unions. Not that you would know that from neoclassical economists, of course. In spite of knowing that, in their own terms, breaking union power while retaining big business would result, in the exploitation of labour, neoclassical economists lead the attack on "union power" in the 1970s and 1980s. The subsequent explosion in inequality as wealth flooded upwards provided empirical confirmation of this analysis.

Strangely, though, most neoclassical economists are still as anti-union as ever — in spite of both their own ideology and the empirical evidence. That the anti-union message is just what the bosses want to hear can just be marked up as yet another one of those strange co-incidences which the value-free science of economics is so prone to. Suffice to say, if the economics profession ever questions general equilibrium theory it will be due to conclusions like this becoming better known in the general population.

C.1.5 Does economics really reflect the reality of capitalism?

As we discussed in section C.1.2, mainstream economics is rooted in capitalism and capitalist social relations. It takes the current division of society into classes as both given **as well as** producing the highest form of efficiency. In other words, mainstream economics is rooted in capitalist assumptions and, unsurprisingly, its conclusions are, almost always, beneficial to capitalists, managers, landlords, lenders and the rich rather than workers, tenants, borrowers and the poor.

However, on another level mainstream capitalist economics simply does **not** reflect capitalism at all. While this may seem paradoxical, it is not. Neoclassical economics has always been marked by apologetics. Consequently, it must abstract or ignore from the more unpleasant and awkward aspects of capitalism in order to present it in the best possible light.

Take, for example, the labour market. Anarchists, like other socialists, have always stressed that under capitalism workers have the choice between selling their liberty/labour to a boss or starving to death (or extreme poverty, assuming some kind of welfare state). This is because they do not have access to the means of life (land and workplaces) unless they sell their labour to those who own them. In such circumstances, it makes little sense to talk of liberty as the only real liberty working people have is, if they are lucky, agreeing to be exploited by one boss rather than another. How much an person works, like their wages, will be based on the relative balance of power between the working and capitalist classes in a given situation.

Unsurprisingly, neoclassical economics does not portray the choice facing working class people in such a realistic light. Rather, it argues that the amount of hours an individual works is based on their preference for income and leisure time. Thus the standard model of the labour market is somewhat paradoxical in that there is no actual labour in it. There is only income, leisure and the preference of the individual for more of one or the other. It is leisure that is assumed to be a "normal good" and labour is just what is left over after the individual "consumes" all the leisure they want. This means that working resolves itself into the vacuous double negative of not-not-working and the notion that all unemployment is voluntary.

That this is nonsense should be obvious. How much "leisure" can someone indulge in without an income? How can an economic theory be considered remotely valid when it presents unemployment (i.e. no income) as the ultimate utility in an economy where everything is (or should be) subject to a price? Income, then, has an overwhelming impact upon the marginal utility of leisure time. Equally, this perspective cannot explain why the prospect of job loss is seen with such fear by most workers. If the neoclassical (non-)analysis of the labour market were true, workers would be happy to be made unemployed. In reality, fear of the sack is a major disciplining tool within capitalism. That free market capitalist economists have succeeded in making unemployment appear as a desirable situation suggests that its grip on the reality of capitalism is slim to say the least (here, as in many other areas, Keynes is more realistic although most of his followers have capitulated faced with neoclassical criticism that standard Keynesian theory had bad micro-economic foundations rather than admit that later was nonsense and the former *"an emasculated version of Keynes"* inflicted on the world by J.R. Hicks. [Keen, **Op. Cit.**, p. 211]).

However, this picture of the "labour" market does hide the reality of working class dependency and, consequently, the power of the capitalist class. To admit that workers do not exercise any free choice over whether they work or not and, once in work, have to accept the work hours set by their employers makes capitalism seem less wonderful than its supporters claim. Ultimately, this fiction of the labour market being driven by the workers' desire for "leisure" and that all unemployment is "voluntary" is rooted in the need to obscure the fact that unemployment is an essential feature of capitalism and, consequently, is endemic to it. This is because it is the fundamental disciplinary mechanism of the system (*"it is a whip in [the bosses'] hands, constantly held over you, so you will slave hard for him and 'behave' yourself,"* to quote Alexander Berkman). As we argued in section B.4.3, capitalism **must** have unemployment in order to ensure that workers will obey their bosses and not demand better pay and conditions (or, even worse, question why they have bosses in the first place). It is, in other words, *"inherent in the wage system"* and *"the fundamental condition of successful capitalist production."* While it is *"dangerous and degrading"* to the worker, it is *"very advantageous to the boss"* and so capitalism *"can't exist without it."* [Berkman, **What is Anarchism?**, p. 26] The experience of state managed full employment between (approximately) 1950 and 1970 confirms this analysis, as does the subsequent period (see section C.7.1).

For the choice of leisure and labour to be a reality, then workers need an independent source of income. The model, in other words, assumes that workers need to be enticed by the given wage and this is only the case when workers have the option of working for themselves, i.e. that they own their own means of production. If this were the case, then it would not be capitalism. In other words, the vision of the labour market in capitalist economics assumes a non-capitalist economy of artisans and peasant farmers — precisely the kind of economy capitalism destroyed (with the help of the state). An additional irony of this neoclassical analysis is that those who subscribe to it most are also those who attack the notion of a generous welfare state (or oppose the idea of welfare state in all forms). Their compliant is that with a welfare state, the labour market becomes "inefficient" as people can claim benefits and so need not seek work. Yet, logically, they should support a generous welfare state as it gives working people a genuine choice between labour and leisure. That bosses find it hard to hire people should be seen as a good thing as work is obviously being evaluated as a "disutility" rather than as a necessity. As an added irony, as we discuss in section C.9, the capitalist analysis of the labour market is **not** based on any firm empirical evidence nor does it have any real logical basis (it is just an assumption). In fact, the evidence we do have points against it and in favour of the socialist analysis of unemployment and the labour market.

One of the reasons why neoclassical economics is so blasé about unemployment is because it argues that it should never happen. That capitalism has always been marked by unemployment and that this rises and falls as part of the business cycle is a inconvenient fact which neoclassical economics avoided seriously analysing until the 1930s. This flows from Say's law, the argument that supply creates its own demand. This theory, and its more formally put Walras' Law, is the basis on which the idea that capitalism could never face a general economic crisis is rooted in. That capitalism has **always** been marked by boom and bust has never put Say's Law into question except during the 1930s and even then it was quickly put back into the centre of economic ideology.

For Say, *"every producer asks for money in exchange for his products only for the purpose of employing that money again immediately in the purchase of another product."* However, this is not the case in a capitalist economy as capitalists seek to accumulate wealth and this involves creating a difference between the value of commodities someone desired to sell and buy on the market. While Say asserts that people simply want to consume commodities, capitalism is marked by the desire (the need) to accumulate. The ultimate aim is **not** consumption, as Say asserted (and today's economists repeat), but rather to make as much profit as possible. To ignore this is to ignore the essence of capitalism and while it may allow the economist to reason away the contradictions of that system, the reality of the business cycle cannot be ignored.

Say's law, in other words, assumes a world without **capital**:

> *"what is a given stock of capital? In this context, clearly, it is the actual equipment and stocks of commodities that happen to be in existence today, the result of recent or remote past history, together with the know-how, skill of labour, etc., that makes up the state of technology. Equipment … is designed for a particular range of uses, to be operated by a particular labour force. There is not a great deal of play in it. The description of the stock of equipment in existence at any moment as 'scare means with alternative uses' is rather exaggerated. The uses in fact are fairly specific, though they may be changed over time. But they* ***can*** *be utilised, at any moment, by offering less or more employment to labour. This is a characteristic of the wage economy. In an artisan economy, where each producer owns his own equipment, each produces what he can and sells it for what it will fetch. Say's law, that goods are the demand for goods, was ceasing to be true at the time he formulated it."* [Joan Robinson, **Collected Economic Papers**, vol. 4, p. 133]

As Keen notes, Say's law *"evisage[s] an exchange-only economy: an economy in which goods exist at the outset, but where no production takes place. The market simply enables the exchange of pre-existing goods."* However, once we had capital to the economy, things change as capitalists wish *"to supply more than they demand, and to accumulate the difference as profit which adds to their wealth."* This results in an excess demand and, consequently, the possibility of a crisis. Thus mainstream capitalist economics *"is best suited to the economic irrelevance of an exchange-only economy, or a production economy in which growth does not occur. If production and growth do occur, then they take place outside the market, when ironically the market is the main intellectual focus of neoclassical economics. Conventional economics is this a theory which suits a static economy … when what is needed are theories to analyse dynamic economies."* [**Debunking Economics**, p. 194, p. 195 and p. 197]

Ultimately, capital assets are not produced for their own stake but in expectation of profits. This obvious fact is ignored by Say's law, but was recognised by Marx (and subsequently acknowledged by Keynes as being correct). As Keen notes, unlike Say and his followers, *"Marx's perspective thus integrates production, exchange and credit as holistic aspects of a capitalist economy, and therefore as essential elements of any theory of capitalism. Conventional economics, in contrast, can only analyse an exchange economy in which money is simply a means to make barter easier."* [**Op. Cit.**, pp. 195–6]

Rejecting Say's Law as being applicable to capitalism means recognising that the capitalist economy is not stable, that it can experience booms and slumps. That this reflects the reality of that economy should go without saying. It also involves recognising that it can take time for unemployed workers to find new employment, that unemployment can by involuntary and that bosses can gain advantages from the fear of unemployment by workers.

That last fact, the fear of unemployment is used by bosses to get workers to accept reductions in wages, hours and benefits, is key factor facing workers in any real economy. Yet, according to the economic textbooks, workers should have been falling over themselves to maximise the utility of leisure and minimise the disutility of work. Similarly, workers should not fear being made unemployed by globalisation as the export of any jobs would simply have generated more economic activity and so the displaced workers would immediately be re-employed (albeit at a lower wage, perhaps). Again, according to the economic textbooks, these lower wages would generate even more economic activity and thus lead, in the long run, to higher wages. If only workers had only listened to the economists then they would realise that that not only did they actually gain (in the long run) by their wages, hours and benefits being cut, many of them also gained (in the short term) increased utility by not having to go to work. That is, assuming the economists know what they are talking about.

Then there is the question of income. For most capitalist economics, a given wage is supposed to be equal to the *"marginal contribution"* that an individual makes to a given company. Are we **really** expected to believe this? Common sense (and empirical evidence) suggests otherwise. Consider Mr. Rand Araskog, the CEO of ITT in 1990, who in that year was paid a salary of $7 million. Is it conceivable that an ITT accountant calculated that, all else being the same, the company's $20.4 billion in revenues that year would have been $7 million less without Mr. Araskog — hence determining his marginal contribution to be $7 million? This seems highly unlikely.

Which feeds into the question of exploding CEO pay. While this has affected most countries, the US has seen the largest increases (followed by the UK). In 1979 the CEO of a UK company earned slightly less than 10 times as much as the average worker on the shop floor. By 2002 a boss of a FTSE 100 company could expect to make 54 times as much as the typical worker. This means that while the wages for those on the shopfloor went up a little, once inflation is taken into account, the bosses wages arose from £200,000 per year to around £1.4m a year. In America, the increase was even worse. In 1980, the ratio of CEO to worker pay 50 to 1. Twenty years later it was 525 to 1, before falling back to 281 to 1 in 2002 following the collapse of the share price bubble. [Larry Elliott, *"Nice work if you can get it: chief executives quietly enrich themselves for mediocrity,"* **The Guardian**, 23 January, 2006]

The notion of marginal productivity is used to justify many things on the market. For example, the widening gap between high-paid and low-paid Americans (it is argued) simply reflects a labour market efficiently rewarding more productive people. Thus the compensation for corporate chief executives climbs so sharply because it reflects their marginal productivity. The strange thing about this kind of argument is that, as we indicate in section C.2.5, the problem of defining and measuring capital wrecked the entire neoclassical theory of marginal factor productivity and with it the associated marginal productivity theory of income back in the 1960s — and was admitted as the leading neo-classical economists of the time. That marginal productivity theory is still invoked to justify capitalist inequalities shows not only how economics ignores the reality of capitalism but also the intellectual bankruptcy of the "science" and whose interests it, ultimately, serves.

In spite of this awkward little fact, what of the claims made based on it? Is this pay **really** the result of any increased productivity on the part of CEOs? The evidence points the other way. This can be seen from the performance of the economies and companies in question. In Britain trend growth was a bit more than 2% in 1980 and is still a bit more than 2% a quarter of a century later. A study of corporate performance in Britain and the United States looked at the companies that make up the FTSE 100 index in Britain and the S&P 500 in the US and found that executive income is rarely justified by improved performance. [Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams, **Financialisation and Strategy: Narrative and Number**] Rising stock prices in the 1990s, for example, were the product of one of the financial market's irrational bubbles over which the CEO's had no control or role in creating.

During the same period as soaring CEO pay, workers' real wages remained flat. Are we to believe that since the 1980s, the marginal contribution of CEOs has increased massively whereas workers' marginal contributions remained stagnant? According to economists, in a free market wages should increase until they reach their marginal productivity. In the US, however, during the 1960s *"pay and productivity grew in tandem, but they separated in the 1970s. In the 1990s boom, pay growth lagged behind productivity by almost 30%."* Looking purely at direct pay, *"overall productivity rose four times as fast as the average real hourly wage — and twenty times as fast in manufacturing."* Pay did catch up a bit in the late 1990s, but after 2000 *"pay returned to its lagging position."* [Doug Henwood, **After the New Economy**, pp. 45–6] In other words, over two decades of free market reforms has produced a situation which has refuted the idea that a workers wage equals their marginal productivity.

The standard response by economists would be to state that the US economy is not a free market. Yet the 1970s, after all, saw the start of reforms based on the recommendations of free market capitalist economists. The 1980s and 1990s saw even more. Regulation was reduced, if not effectively eliminated, the welfare state rolled back and unions marginalised. So it staggers belief to state that the US was **more** free market in the 1950s and 1960s than in the 1980s and 1990s but, logically, this is what economists suggest. Moreover, this explanation sits ill at ease with the multitude of economists who justified growing inequality and skyrocketing CEO pay and company profits during this period in terms of free market economics. What is it to be? If the US is not a free market, then the incomes of companies and the wealth are **not** the result of their marginal contribution but rather are gained at the expense of the working class. If the US is a free market, then the rich are justified (in terms of economic theory) in their income but workers' wages do not equal their marginal productivity. Unsurprisingly, most economists do not raise the question, never mind answer it.

So what is the reason for this extreme wage difference? Simply put, it's due to the totalitarian nature of capitalist firms (see section B.4). Those at the bottom of the company have no say in what happens within it; so as long as the share-owners are happy, wage differentials will rise and rise (particularly when top management own large amounts of shares!). It is capitalist property relations that allow this monopolisation of wealth by the few who own (or boss) but do not produce. The workers do not get the full value of what they produce, nor do they have a say in how the surplus value produced by their labour gets used (e.g. investment decisions). Others have monopolised both the wealth produced by workers and the decision-making power within the company (see section C.2 for more discussion). This is a private form of taxation without representation, just as the company is a private form of statism. Unlike the typical economist, most people would not consider it too strange a coincidence that the people with power in a company, when working out who contributes most to a product, decide it's themselves!

Whether workers will tolerate stagnating wages depends, of course, on the general economic climate. High unemployment and job insecurity help make workers obedient and grateful for any job and this has been the case for most of the 1980s and 1990s in both America and the UK. So a key reason for the exploding pay is to be found in the successful class struggle the ruling class has been waging since the 1970s. There has *"been a real shift in focus, so that the beneficiaries of corporate success (such as it is) are no longer the workers and the general public as a whole but shareholders. And given that there is evidence that only households in the top half of the income distribution in the UK and the US hold shares, this represents a significant redistribution of money and power."* [Larry Elliott, **Op. Cit.**] That economics ignores the social context of rising CEO pay says a lot about the limitations of modern economics and how it can be used to justify the current system.

Then there is the trivial little thing of production. Economics used to be called "political economy" and was production orientated. This was replaced by an economics based on marginalism and subjective evaluations of a given supply of goods is fixed. For classical economics, to focus on an instant of time was meaningless as time does not stop. To exclude production meant to exclude time, which as we noted in section C.1.2 this is precisely and knowingly what marginalist economics did do. This means modern economics simply ignores production as well as time and given that profit making is a key concern for any firm in the real world, such a position shows how irrelevant neoclassical economics really is.

Indeed, the neo-classical theory falls flat on its face. Basing itself, in effect, on a snapshot of time its principles for the rational firm are, likewise, based on time standing still. It argues that profit is maximised where marginal cost equals marginal revenue yet this is only applicable when you hold time constant. However, a real firm will not maximise profit with respect to quantity but also in respect to time. The neoclassical rule about how to maximise profit *"is therefore correct if the quantity produced never changes"* and *"by ignoring time in its analysis of the firm, economic theory ignores some of the most important issues facing a firm."* Neo-classical economics exposes its essentially static nature again. It *"ignores time, and is therefore only relevant in a world in which time does no matter."* [Keen, **Op. Cit.**, pp. 80–1]

Then there is the issue of consumption. While capitalist apologists go on about *"consumer sovereignty"* and the market as a *"consumers democracy,"* the reality is somewhat different. Firstly, and most obviously, big business spends a lot of money trying to shape and influence demand by means of advertising. Not for them the neoclassical assumption of "given" needs, determined outside the system. So the reality of capitalism is one where the "sovereign" is manipulated by others. Secondly, there is the distribution of resources within society.

Market demand is usually discussed in terms of tastes, not in the distribution of purchasing power required to satisfy those tastes. Income distribution is taken as given, which is very handy for those with the most wealth. Needless to say, those who have a lot of money will be able to maximise their satisfactions far easier than those who have little. Also, of course, they can out-bid those with less money. If capitalism is a "consumers" democracy then it is a strange one, based on *"one dollar, one vote."* It should be obvious whose values are going to be reflected most strongly in the market. If we start with the orthodox economics (convenient) assumption of a *"given distribution of income"* then any attempt to determine the best allocation of resources is flawed to start with as money replaces utility from the start. To claim after that the market based distribution is the best one is question begging in the extreme.

In other words, under capitalism, it is not individual need or "utility" as such that is maximised, rather it is ***effective*** utility (usually called "effective demand") — namely utility that is backed up with money. This is the reality behind all the appeals to the marvels of the market. As right-wing guru von Hayek put, the *"[s]pontaneous order produced by the market does not ensure that what general opinion regards as more important needs are always met before the less important ones."* [*"Competition as a discovery process",* **The Essence of Hayek**, p. 258] Which is just a polite way of referring to the process by which millionaires build a new mansion while thousands are homeless or live in slums or feed luxury food to their pets while humans go hungry. It is, in effect, to dismiss the needs of, for example, the 37 million Americans who lived below the poverty line in 2005 (12.7% of the population, the highest percentage in the developed world and is based on the American state's absolute definition of poverty, looking at relative levels, the figures are worse). Similarly, the 46 million Americans without health insurance may, of course, think that their need to live should be considered as *"more important"* than, say, allowing Paris Hilton to buy a new designer outfit. Or, at the most extreme, when agribusiness grow cash crops for foreign markets while the landless starve to death. As E.P. Thompson argues, Hayek's answer:

> *"promote[s] the notion that high prices were a (painful) remedy for dearth, in drawing supplies to the afflicted region of scarcity. But what draws supply are not high prices but sufficient money in their purses to pay high prices. A characteristic phenomenon in times of dearth is that it generates unemployment and empty pursues; in purchasing necessities at inflated prices people cease to be able to buy inessentials [causing unemployment] … Hence the number of those able to pay the inflated prices declines in the afflicted regions, and food may be exported to neighbouring, less afflicted, regions where employment is holding up and consumers still have money with which to pay. In this sequence, high prices can actually withdraw supply from the most afflicted area."* [**Customs in Common**, pp. 283–4]

Therefore *"the law of supply and demand"* may not be the "most efficient" means of distribution in a society based on inequality. This is clearly reflected in the "rationing" by purse which this system is based on. While in the economics books, price is the means by which scare resources are "rationed" in reality this creates many errors. As Thompson notes, *"[h]owever persuasive the metaphor, there is an elision of the real Relationships assigned by price, which suggests … ideological sleight-of-mind. Rationing by price does not allocate resources equally among those in need; it reserves the supply to those who can pay the price and excludes those who can't … The raising of prices during dearth could 'ration' them [the poor] out of the market altogether."* [**Op. Cit.**, p. 285] Which is precisely what does happen. As economist (and famine expert) Amartya Sen notes:

> *"Take a theory of entitlements based on a set of rights of 'ownership, transfer and rectification.' In this system a set of holdings of different people are judged to be just (or unjust) by looking at past history, and not by checking the consequences of that set of*

holdings. But what if the consequences are recognisably terrible? …[R]efer[ing] to some empirical findings in a work on famines … evidence [is presented] to indicate that in many large famines in the recent past, in which millions of people have died, there was no over-all decline in food availability at all, and the famines occurred precisely because of shifts in entitlement resulting from exercises of rights that are perfectly legitimate… [Can] famines … occur with a system of rights of the kind morally defended in various ethical theories, including Nozick's. I believe the answer is straightforwardly yes, since for many people the only resource that they legitimately possess, viz. their labour-power, may well turn out to be unsaleable in the market, giving the person no command over food … [i]f results such as starvations and famines were to occur, would the distribution of holdings still be morally acceptable despite their disastrous consequences? There is something deeply implausible in the affirmative answer." [**Resources, Values and Development**, pp. 311–2]

Recurring famines were a constant problem during the lassiez-faire period of the British Empire. While the Irish Potato famine is probably the best known, the fact is that millions died due to starvation mostly due to a firm believe in the power of the market. In British India, according to the most reliable estimates, the deaths from the 1876–1878 famine were in the range of 6–8 million and between 1896 and 1900, were between 17 to 20 million. According to a British statistician who analysed Indian food security measures in the two millennia prior to 1800, there was one major famine a century in India. Under British rule there was one every four years. Over all, the late 1870s and the late 1890s saw somewhere between 30 to 60 million people die in famines in India, China and Brazil (not including the many more who died elsewhere). While bad weather started the problem by placing the price of food above the reach of the poorest, the market and political decisions based on profound belief in it made the famine worse. Simply put, had the authorities distributed what food existed, most of the victims would have survived yet they did not as this would have, they argued, broke the laws of the market and produced a culture of dependency. [Mike Davis, **Late Victorian Holocausts**] This pattern, incidentally, has been repeated in third world countries to this day with famine countries exporting food as the there is no "demand" for it at home.

All of which puts Hayek's glib comments about *"spontaneous order"* into a more realistic context. As Kropotkin put it:

"The very essence of the present economic system is that the worker can never enjoy the well-being he [or she] has produced … Inevitably, industry is directed … not towards what is needed to satisfy the needs of all, but towards that which, at a given moment, brings in the greatest profit for a few. Of necessity, the abundance of some will be based on the poverty of others, and the straitened circumstances of the greater number will have to be maintained at all costs, that there may be hands to sell themselves for a part only of what which they are capable of producing; without which private accumulation of capital is impossible." [**Anarchism**, p. 128]

In other words, the market cannot be isolated and abstracted from the network of political, social and legal relations within which it is situated. This means that all that "supply and demand" tells us is that those with money can demand more, and be supplied with more, than those without. Whether this is the "most efficient" result for society cannot be determined (unless, of course, you assume that rich people are more valuable than working class ones **because** they are rich). This has an obvious effect on production, with "effective demand" twisting economic activity and so, under capitalism, meeting needs is secondary as the *"only aim is to increase the profits of the capitalist."* [Kropotkin, **Op. Cit.**, p. 55]). George Barrett brings home of evil effects of such a system:

> *"To-day the scramble is to compete for the greatest profits. If there is more profit to be made in satisfying my lady's passing whim than there is in feeding hungry children, then competition brings us in feverish haste to supply the former, whilst cold charity or the poor law can supply the latter, or leave it unsupplied, just as it feels disposed. That is how it works out."* [**Objections to Anarchism**, p. 347]

Therefore, as far as consumption is concerned, anarchists are well aware of the need to create and distribute necessary goods to those who require them. This, however, cannot be achieved under capitalism and for all its talk of "utility," "demand", "consumer sovereignty" and so forth the real facts are those with most money determine what is an "efficient" allocation of resources. This is directly, in terms of their control over the means of life as well as indirectly, by means of skewing market demand. For if financial profit is the sole consideration for resource allocation, then the wealthy can outbid the poor and ensure the highest returns. The less wealthy can do without.

All in all, the world assumed by neo-classical economics is not the one we actually live in, and so applying that theory is both misleading and (usually) disastrous (at least to the "have-nots"). While this may seen surprisingly, it is not once we take into account its role as apologist and defender of capitalism. Once that is recognised, any apparent contradiction falls away.

C.1.6 Is it possible to a non-equilibrium based capitalist economics?

Yes, it is but it would be unlikely to be free-market based as the reality of capitalism would get the better of its apologetics. This can be seen from the two current schools of economics which, rightly, reject the notion of equilibrium — the post-Keynesian school and the so-called Austrian school.

The former has few illusions in the nature of capitalism. At its best, this school combines the valid insights of classical economics, Marx and Keynes to produce a robust radical (even socialist) critique of both capitalism and capitalist economics. At its worse, it argues for state intervention to save capitalism from itself and, politically, aligns itself with social democratic (*"liberal",* in the USA) movements and parties. If economics does become a science, then this school of economics will play a key role in its development. Economists of this school include Joan Robinson, Nicholas Kaldor, John Kenneth Galbraith, Paul Davidson and Steven Keen. Due to its non-apologetic nature, we will not discuss it here.

The Austrian school has a radically different perspective. This school, so named because its founders were Austrian, is passionately pro-capitalist and argues against **any** form of state intervention (bar, of course, the definition and defence of capitalist property rights and the power that these create). Economists of this school include Eugen von Böhm-Bawerk, Ludwig von Mises, Murray Rothbard, Israel Kirzner and Frederick von Hayek (the latter is often attacked by other

Austrian economists as not being sufficiently robust in his opposition to state intervention). It is very much a minority school.

As it shares many of the same founding fathers as neoclassical economics and is rooted in marginalism, the Austrian school is close to neoclassical economics in many ways. The key difference is that it rejects the notion that the economy is in equilibrium and embraces a more dynamic model of capitalism. It is rooted in the notion of entrepreneurial activity, the idea that entrepreneurs act on information and disequilibrium to make super profits and bring the system closer to equilibrium. Thus, to use their expression, their focus is on the market process rather than a non-existent end state. As such, it defends capitalism in terms of how it reacts of **dis**-equilibrium and presents a theory of the market process that brings the economy closer to equilibrium. And fails.

The claim that markets tend continually towards equilibrium, as the consequence of entrepreneurial actions, is hard to justify in terms of its own assumptions. While the adjustments of a firm may bring the specific market it operates in more towards equilibrium, their ramifications may take other markets away from it and so any action will have stabilising and destabilising aspects to it. It strains belief to assume that entrepreneurial activity will only push an economy more towards equilibrium as any change in the supply and demand for any specific good leads to changes in the markets for other goods (including money). That these adjustments will all (mostly) tend towards equilibrium is little more than wishful thinking.

While being more realistic than mainstream neo-classical theory, this method abandons the possibility of demonstrating that the market outcome is in any sense a realisation of the individual preferences of whose interaction it is an expression. It has no way of establishing the supposedly stabilising character of entrepreneurial activity or its alleged socially beneficial character as the dynamic process could lead to a divergence rather than a convergence of behaviour. A dynamic system need not be self-correcting, particularly in the labour market, nor show any sign of self-equilibrium (i.e. it will be subject to the business cycle).

Given that the Austrian theory is, in part, based on Say's Law the critique we presented in the last section also applies here. However, there is another reason to think the Austrian self-adjusting perspective on capitalism is flawed and this is rooted in their own analysis. Ironically enough, economists of this school often maintain that while equilibrium does not exist their analysis is rooted on two key markets being in such a state: the labour market and the market for credit. The reason for these strange exceptions to their general assumption is, fundamentally, political. The former is required to deflect claims that *"pure"* capitalism would result in the exploitation of the working class, the latter is required to show that such a system would be stable.

Looking at the labour market, the Austrians argue that free market capitalism would experience full employment. That this condition is one of equilibrium does not seem to cause them much concern. Thus we find von Hayek, for example, arguing that the *"cause of unemployment … is a deviation of prices and wages from their equilibrium position which would establish itself with a free market and stable money. But we can never know at what system of relative prices and wages such an equilibrium would establish itself."* Therefore, *"the deviation of existing prices from that equilibrium position … is the cause of the impossibility of selling part of the labour supply."* [**New Studies**, p. 201] Therefore, we see the usual embrace of equilibrium theory to defend capitalism against the evils it creates even by those who claim to know better.

Of course, the need to argue that there would be full employment under *"pure"* capitalism is required to maintain the fiction that everyone will be better off under it. It is hard to say that working class people will benefit if they are subject to high levels of unemployment and the resulting fear and insecurity that produces. As would be expected, the Austrian school shares the same perspective on unemployment as the neoclassical school, arguing that it is *"voluntary"* and the result of the price of labour being too high (who knew that depressions were so beneficial to workers, what with some having more leisure to enjoy and the others having higher than normal wages?). The reality of capitalism is very different than this abstract model.

Anarchists have long realised that the capitalist market is based upon inequalities and changes in power. Proudhon argued that *"[t]he manufacturer says to the labourer, 'You are as free to go elsewhere with your services as I am to receive them. I offer you so much.' The merchant says to the customer, 'Take it or leave it; you are master of your money, as I am of my goods. I want so much.' Who will yield? The weaker."* He, like all anarchists, saw that domination, oppression and exploitation flow from inequalities of market/economic power and that the *"power of invasion lies in superior strength."* [**What is Property?**, p. 216 and p. 215] This is particularly the case in the labour market, as we argued in section B.4.3.

As such, it is unlikely that "pure" capitalism would experience full employment for under such conditions the employers loose the upper hand. To permanently experience a condition which, as we indicate in section C.7, causes "actually existing" capitalism so many problems seems more like wishful thinking than a serious analysis. If unemployment is included in the Austrian model (as it should) then the bargaining position of labour is obviously weakened and, as a consequence, capital will take advantage and gather profits at the expense of labour. Conversely, if labour is empowered by full employment then they can use their position to erode the profits and managerial powers of their bosses. Logically, therefore, we would expect less than full unemployment and job insecurity to be the normal state of the economy with short periods of full unemployment before a slump. Given this, we would expect "pure" capitalism to be unstable, just as the approximations to it in history have always been. Austrian economics gives no reason to believe that would change in the slightest. Indeed, given their obvious hatred of trade unions and the welfare state, the bargaining power of labour would be weakened further during most of the business cycle and, contra Hayek, unemployment would remain and its level would fluctuate significantly throughout the business cycle.

Which brings us to the next atypical market in Austrian theory, namely the credit market. According to the Austrian school, "pure" capitalism would not suffer from a business cycle (or, at worse, a very mild one). This is due to the lack of equilibrium in the credit market due to state intervention (or, more correctly, state non-intervention). Austrian economist W. Duncan Reekie provides a summary:

> *"The business cycle is generated by monetary expansion and contraction … When new money is printed it appears as if the supply of savings has increased. Interest rates fall and businessmen are misled into borrowing additional founds to finance extra investment activity … This would be of no consequence if it had been the outcome of [genuine saving] … — but the change was government induced. The new money reaches factor owners in the form of wages, rent and interest … the factor owners will then spend the higher money incomes in their existing consumption:investment proportions … Capital*

goods industries will find their expansion has been in error and malinvestments have been incurred." [**Markets, Entrepreneurs and Liberty**, pp. 68–9]

This analysis is based on their notion that the interest rate reflects the "time preference" of individuals between present and future goods (see section C.2.6 for more details). The argument is that banks or governments manipulate the money supply or interest rates, making the actual interest rate different from the "real" interest rate which equates savings and loans. Of course, that analysis is dependent on the interest rate equating savings and loans which is, of course, an equilibrium position. If we assume that the market for credit shows the same disequilibrium tendencies as other markets, then the possibility for malinvestment is extremely likely as banks and other businesses extend credit based on inaccurate assumptions about present conditions and uncertain future developments in order to secure greater profits. Unsurprisingly, the Austrians (like most economists) expect the working class to bear the price for any recession in terms of real wage cuts in spite of their theory indicating that its roots lie in capitalists and bankers seeking more profits and, consequently, the former demanding and the latter supplying more credit than the "natural" interest rate would supply.

Ironically, therefore, the Austrian business cycle is rooted in the concept of **dis**-equilibrium in the credit market, the condition it argues is the standard situation in all other markets. In effect, they think that the money supply and interest rates are determined exogenously (i.e. outside the economy) by the state. However, this is unlikely as the evidence points the other way, i.e. to the endogenous nature of the money supply itself. This account of money (proposed strongly by, among others, the post-Keynesian school) argues that the money supply is a function of the demand for credit, which itself is a function of the level of economic activity. In other words, the banking system creates as much money as people need and any attempt to control that creation will cause economic problems and, perhaps, crisis. Money, in other words, emerges from **within** the system and so the Austrian attempt to *"blame the state"* is simply wrong. As we discuss in section C.8, attempts by the state to control the money during the Monetarist disasters of the early 1980s failed and it is unlikely that this would change in a *"pure"* capitalism marked by a totally privatised banking system.

It should also be noted that in the 1930s, the Austrian theory of the business cycle lost the theoretical battle with the Keynesian one (not to be confused with the neoclassical-Keynesian synthesis of the post-war years). This was for three reasons. Firstly, it was irrelevant (its conclusion was do nothing). Secondly, it was arrogant (it essentially argued that the slump would not have happened if people had listened to them and the pain of depression was fully deserved for not doing so). Thirdly, and most importantly, the leading Austrian theorist on the business cycle was completely refuted by Piero Sraffa and Nicholas Kaldor (Hayek's own follower who turned Keynesian) both of whom exposed the internal contradictions of his analysis.

The empirical record backs our critique of the Austrian claims on the stability of capitalism and unemployment. Throughout the nineteenth century there were a continual economic booms and slumps. This was the case in the USA, often pointed to as an approximately lassiez-faire economy, where the last third of the 19th century (often considered as a heyday of private enterprise) was a period of profound instability and anxiety. Between 1867 and 1900 there were 8 complete business cycles. Over these 396 months, the economy expanded during 199 months and contracted during 197. Hardly a sign of great stability (since the end of world war II, only about a fifth of the time has spent in periods of recession or depression, by way of comparison). Overall, the economy went into a slump, panic or crisis in 1807, 1817, 1828, 1834, 1837, 1854, 1857, 1873, 1882, and 1893 (in addition, 1903 and 1907 were also crisis years). Full employment, needless to say, was not the normal situation (during the 1890s, for example, the unemployment rate exceeded 10% for 6 consecutive years, reaching a peak of 18.4% in 1894, and was under 4% for just one, 1892). So much for temporary and mild slumps, prices adjusting fast and markets clearing quickly in pre-Keynesian economies!

Luckily, though, the Austrian school's methodology allows it to ignore such irritating constrictions as facts, statistics, data, history or experimental confirmation. While neoclassical economics at least **pretends** to be scientific, the Austrian school displays its deductive (i.e. pre-scientific) methodology as a badge of pride along side its fanatical love of free market capitalism. For the Austrians, in the words of von Mises, economic theory *"is not derived from experience; it is prior to experience"* and *"no kind of experience can ever force us to discard or modify **a priori** theorems; they are logically prior to it and cannot be either proved by corroborative experience or disproved by experience to the contrary."* And if this does not do justice to a full exposition of the phantasmagoria of von Mises' **a priorism**, the reader may take some joy (or horror) from the following statement:

> *"If a contradiction appears between a theory and experience, **we must always assume** that a condition pre-supposed by the theory was not present, or else there is some error in our observation. The disagreement between the theory and the facts of experience frequently forces us to think through the problems of the theory again. **But so long as a rethinking of the theory uncovers no errors in our thinking, we are not entitled to doubt its truth**"* [emphasis added, quoted by Homa Katouzian, **Ideology and Method in Economics**, pp. 39–40]

In other words, if reality is in conflict with your ideas, do not adjust your views because reality must be at fault! The scientific method would be to revise the theory in light of the facts. It is not scientific to reject the facts in light of the theory! Without experience, any theory is just a flight of fantasy. For the higher a deductive edifice is built, the more likely it is that errors will creep in and these can only be corrected by checking the analysis against reality. Starting assumptions and trains of logic may contain inaccuracies so small as to be undetectable, yet will yield entirely false conclusions. Similarly, trains of logic may miss things which are only brought to light by actual experiences or be correct, but incomplete or concentrate on or stress inappropriate factors. To ignore actual experience is to loose that input when evaluating a theory.

Ignoring the obvious problems of the empirical record, as any consistent Austrian would, the question does arise why does the Austrian school make exceptions to its disequilibrium analysis for these two markets. Perhaps this is a case of political expediency, allowing the ideological supporters of free market capitalism to attack the notion of equilibrium when it clearly clashes with reality but being able to return to it when attacking, say, trade unions, welfare programmes and other schemes which aim to aid working class people against the ravages of the capitalist market? Given the self-appointed role of Austrian economics as the defender of "pure" (and, illogically, not so pure) capitalism that conclusion is not hard to deny.

Rejecting equilibrium is not as straightforward as the Austrians hope, both in terms of logic and in justifying capitalism. Equilibrium plays a role in neo-classical economics for a reason. A disequilibrium trade means that people on the winning side of the bargain will gain real income at the expense of the losers. In other words, Austrian economics is rooted (in most markets, at least) in the idea that trading benefits one side more than the other which flies in the face of the repeated dogma that trade benefits both parties. Moreover, rejecting the idea of equilibrium means rejecting any attempt to claim that workers' wages equal their just contribution to production and so to society. If equilibrium does not exist or is never actually reached then the various economic laws which "prove" that workers are not exploited under capitalism do not apply. This also applies to accepting that any real market is unlike the ideal market of perfect competition. In other words, by recognising and taking into account reality capitalist economics cannot show that capitalism is stable, non-exploitative or that it meets the needs of all.

Given that they reject the notion of equilibrium as well as the concept of empirical testing of their theories and the economy, their defence of capitalism rests on two things: "freedom" and anything else would be worse. Neither are particularly convincing.

Taking the first option, this superficially appears appealing, particularly to anarchists. However this stress on "freedom" — the freedom of individuals to make their own decisions — flounders on the rocks of capitalist reality. Who can deny that individuals, when free to choose, will pick the option they consider best for themselves? However, what this praise for individual freedom ignores is that capitalism often reduces choice to picking the lesser of two (or more) evils due to the inequalities it creates (hence our reference to the **quality** of the decisions available to us). The worker who agrees to work in a sweatshop does "maximise" her "utility" by so doing — after all, this option is better than starving to death — but only an ideologue blinded by capitalist economics will think that she is free or that her decision is not made under (economic) compulsion.

The Austrian school is so in love with markets they even see them where they do not exist, namely inside capitalist firms. There, hierarchy reigns and so for all their talk of "liberty" the Austrian school at best ignores, at worse exalts, factory fascism (see section F.2.1) For them, management is there to manage and workers are there to obey. Ironically, the Austrian (like the neo-liberal) ethic of "freedom" is based on an utterly credulous faith in authority in the workplace. Thus we have the defenders of "freedom" defending the hierarchical and autocratic capitalist managerial structure, i.e. "free" workers subject to a relationship distinctly **lacking** freedom. If your personal life were as closely monitored and regulated as your work life, you would rightly consider it oppression.

In other words, this idealisation of freedom through the market completely ignores the fact that this freedom can be, to a large number of people, very limited in scope. Moreover, the freedom associated with capitalism, as far as the labour market goes, becomes little more than the freedom to pick your master. All in all, this defence of capitalism ignores the existence of economic inequality (and so power) which infringes the freedom and opportunities of others. Social inequalities can ensure that people end up *"wanting what they get"* rather than *"getting what they want"* simply because they have to adjust their expectations and behaviour to fit into the patterns determined by concentrations of economic power. This is particularly the case within the labour market, where sellers of labour power are usually at a disadvantage when compared to buyers due to the existence of unemployment as we have discussed.

As such, their claims to be defenders of "liberty" ring hollow in anarchist ears. This can be seen from the 1920s. For all their talk of "freedom", when push came to shove, they end up defending authoritarian regimes in order to save capitalism when the working classes rebel against the "natural" order. Thus we find von Mises, for example, arguing in the 1920s that it *"cannot be* *denied that Fascism and similar movements aiming at the establishment of dictatorships are full of the best intentions and that their intervention has, for the moment, saved European civilisation. The merit that Fascism has thereby won for itself will live eternally in history."* [**Liberalism**, p. 51] Faced with the Nazis in the 1930s, von Mises changed his tune somewhat as, being Jewish, he faced the same state repression he was happy to see inflicted upon rebellious workers the previous decade. Unsurprisingly, he started to stress that Nazi was short for "National Socialism" and so the horrors of fascism could be blamed on "socialism" rather than the capitalists who funded the fascist parties and made extensive profits under them once the labour, anarchist and socialist movements had been crushed.

Similarly, when right-wing governments influenced by the Austrian school were elected in various countries in the 1980s, those countries saw an increase in state authoritarianism and centralisation. In the UK, for example, Thatcher's government strengthened the state and used it to break the labour movement (in order to ensure management authority over their workers). In other words, instead of regulating capital and the people, the state just regulates the people. The general public will have the freedom of doing what the market dictates and if they object to the market's "invisible hand", then the very visible fist of the state (or private defence companies) will ensure they do. We can be sure if a large anarchist movement developed the Austrian economists will, like von Mises in the 1920s, back whatever state violence was required to defend "civilisation" against it. All in the name of "freedom," of course.

Then there is the idea that anything else that "pure" capitalism would be worse. Given their ideological embrace of the free market, the Austrians attack those economists (like Keynes) who tried to save capitalism from itself. For the Austrian school, there is only capitalism or "socialism" (i.e. state intervention) and they cannot be combined. Any attempt to do so would, as Hayek put it in his book **The Road to Serfdom**, inevitably lead to totalitarianism. Hence the Austrians are at the forefront in attacking the welfare state as not only counterproductive but inherently leading to fascism or, even worse, some form of state socialism. Needless to say, the state's role in creating capitalism in the first place is skilfully ignored in favour of endless praise for the "natural" system of capitalism. Nor do they realise that the victory of state intervention they so bemoan is, in part, necessary to keep capitalism going and, in part, a consequence of attempts to approximate their utopia (see section D.1 for a discussion).

Not that Hayek's thesis has any empirical grounding. No state has ever become fascist due to intervening in the economy (unless a right-wing coup happens, as in Chile, but that was not his argument). Rather, dictatorial states have implemented planning rather than democratic states becoming dictatorial after intervening in the economy. Moreover, looking at the Western welfare states, the key compliant by the capitalist class in the 1960s and 1970s was not a lack of general freedom but rather too much. Workers and other previously oppressed but obedient sections of society were standing up for themselves and fighting the traditional hierarchies within society. This hardly fits in with serfdom, although the industrial relations which emerged in Pinochet's Chile, Thatcher's Britain and Reagan's America does. The call was for the state to defend the *"management's right to manage"* against rebellious wage slaves by breaking their spirit and organisation while, at the same time, intervening to bolster capitalist authority in the workplace. That this required an increase in state power and centralisation would only come as a surprise to those who confuse the rhetoric of capitalism with its reality.

Similarly, it goes without saying Hayek's thesis was extremely selectively applied. It is strange to see, for example, Conservative politicians clutching Hayek's **Road to Serfdom** with one hand

and using it to defend cutting the welfare state while, with the other, implementing policies which give billions to the Military Industrial Complex. Apparently "planning" is only dangerous to liberty when it is in the interests of the many. Luckily, defence spending (for example) has no such problems. As Chomsky stresses, *"the 'free market' ideology is very **useful** — it's a weapon against the general population … because it's an argument against social spending, and it's a weapon against poor people abroad … But nobody [in the ruling class] really pays attention to this stuff when it comes to actual planning — and no one ever has."* [**Understanding Power**, p. 256] That is why anarchists stress the importance of reforms from **below** rather than from above — as long as we have a state, any reforms should be directed first and foremost to the (much more generous) welfare state for the rich rather than the general population (the experience of the 1980s onwards shows what happens when reforms are left to the capitalist class).

This is not to say that Hayek's attack upon those who refer to totalitarian serfdom as a "new freedom" was not fully justified. Nor is his critique of central planning and state "socialism" without merit. Far from it. Anarchists would agree that any valid economic system must be based on freedom and decentralisation in order to be dynamic and meet needs, they simply apply such a critique to capitalism **as well as** state socialism. The ironic thing about Hayek's argument is that he did not see how his theory of tacit knowledge, used to such good effect against state socialist ideas of central planning, were just as applicable to critiquing the highly centralised and top-down capitalist company and economy. Nor, ironically enough, that it was just as applicable to the price mechanism he defended so vigorously (as we note in section I.1.2, the price system hides as much, if not more, necessary information than it provides). As such, his defence of capitalism can be turned against it and the centralised, autocratic structures it is based on.

To conclude, while its open and extreme support for free market capitalism and its inequalities is, to say the least, refreshing, it is not remotely convincing or scientific. In fact, it amounts to little more than a vigorous defence of business power hidden behind a thin rhetoric of "free markets." As it preaches the infallibility of capitalism, this requires a nearly unyielding defence of corporations, economic and social power and workplace hierarchy. It must dismiss the obvious fact that allowing big business to flourish into oligopoly and monopoly (as it does, see section C.4) reduces the possibility of competition solving the problem of unethical business practices and worker exploitation, as they claim. This is unsurprising, as the Austrian school (like economics in general) identifies "freedom" with the "freedom" of private enterprise, i.e. the lack of accountability of the economically privileged and powerful. This simply becomes a defence of the economically powerful to do what they want (within the laws specified by their peers in government).

Ironically, the Austrian defence of capitalism is dependent on the belief that it will remain close to equilibrium. However, as seems likely, capitalism is endogenously unstable, then any real "pure" capitalism will be distant from equilibrium and, as a result, marked by unemployment and, of course, booms and slumps. So it is possible to have a capitalist economics based on non-equilibrium, but it is unlikely to convince anyone that does not already believe that capitalism is the best system ever unless they are unconcerned about unemployment (and so worker exploitation) and instability. As Steve Keen notes, it is *"an alternative way to ideologically support a capitalist economy … If neoclassical economics becomes untenable for any reason, the Austrians are well placed to provide an alternative religion for believers in the primacy of the market over all other forms of social organisation."* [Keen, **Debunking Economics**, p. 304]

Those who seek freedom for all and want to base themselves on more than faith in an economic system marked by hierarchy, inequality and oppression would be better seeking a more realistic and less apologetic economic theory.

C.2 Why is capitalism exploitative?

For anarchists, capitalism is marked by the exploitation of labour by capital. While this is most famously expressed by Proudhon's ***"property is theft,"*** this perspective can be found in all forms of anarchism. For Bakunin, capitalism was marked by an *"economic relationship between the exploiter and exploited"* as it meant the few have *"the power and right to live by exploiting the labour of someone else, the right to exploit the labour of those who possess neither property nor capital and who thus are forced to sell their productive power to the lucky owners of both."* [**The Political Philosophy of Bakunin**, p. 183] This means that when a worker *"sells his labour to an employee ... some part of the value of his produce will be unjustly taken by the employer."* [Kropotkin, **Anarchism and Anarchist-Communism**, p. 52]

At the root this criticism is based, ironically enough, on the **capitalist** defence of private property as the product of labour. As noted in section B.4.2, Locke defended private property in terms of labour yet allowed that labour to be sold to others. This allowed the buyers of labour (capitalists and landlords) to appropriate the product of other people's labour (wage workers and tenants) and so, in the words of dissident economist David Ellerman, *"capitalist production, i.e. production based on the employment contract denies workers the right to the (positive and negative) fruit of their labour. Yet people's right to the fruits of their labour has always been the natural basis for private property appropriation. Thus capitalist production, far from being founded on private property, in fact denies the natural basis for private property appropriation."* [**The Democratic worker-owned firm**, p. 59] This was expressed by Proudhon in the following way:

> *"Whoever labours becomes a proprietor — this is an inevitable deduction from the principles of political economy and jurisprudence. And when I say proprietor, I do not mean simply (as do our hypocritical economists) proprietor of his allowance, his salary, his wages, — I mean proprietor of the value his creates, and by which the master alone profits ...* ***The labourer retains, even after he has received his wages, a natural right in the thing he was produced.****"* [**What is Property?**, pp. 123–4]

In other words, taking the moral justification for capitalism, anarchists argue that it fails to meet its own criteria (*"With me who, as a labourer, have a right to the possession of the products of Nature and my own industry — and who, as a proletaire [wage labourer], enjoy none of them."* [Proudhon, **Op. Cit.**, p. 65]). Whether this principle should be applied in a free society is a moot point within anarchism. Individualist and mutualist anarchists argue it should be and, therefore, say that individual workers should receive the product of their toil (and so argue for distribution according to deed). Communist-anarchists argue that *"social ownership and sharing according to need ... would be the best and most just economic arrangement."* This is for two reasons. Firstly, because *"in modern industry"* there is *"no such thing"* as an individual product as *"all labour and the products of labour are social."* [Berkman, **What is Anarchism?**, pp. 169–70] Secondly, in terms of simple justice need is not related to the ability to work and, of course, it would be wrong to penalise those who cannot work (i.e. the sick, the young and the old). Yet, while anarchists disagree over exactly how this should be most justly realised, they all agree that labour should control **all** that it produces (either individually or collectively) and, consequently, non-labour income is exploitation (it should be stressed that as both schemes are voluntary, there is no real contradiction between them). Anarchists tend to call non-labour income "surplus-value" or "usury" and these terms are used to group together profits, rent and interest (see section C.2.1 for details).

That this critique is a problem for capitalism can be seen from the many varied and wonderful defences created by economists to justify non-labour income. Economists, at least in the past, saw the problem clear enough. John Stuart Mill, the final great economist of the classical school, presented the typical moral justification of capitalism, along with the problems it causes. As he explains in his classic introduction to economics, the *"institution of property, when limited to its essential elements, consists in the recognition, in each person, of a right to the exclusive disposal of what he or she have produced by their own exertions ... The foundation of the whole is, the right of producers to what they themselves have produced."* He then notes the obvious contradiction — workers do **not** receive what they have produced. Thus it *"may be objected"* that capitalist society *"recognises rights of property in individuals over which they have not produced,"* for example *"the operatives in a manufactory create, by their labour and skill, the whole produce; yet, instead of it belonging to them, the law gives them only their stipulated hire [wages], and transfers the produce to someone who has merely supplied the funds, without perhaps contributing to the work itself."* [**Principles of Political Economy**, p. 25] With the rise of neoclassical economics, the problem remained and so did need to justify capitalism continued to drive economics. J. B. Clark, for example, knew what was at stake and, like Mill, expressed it:

> *"When a workman leaves the mill, carrying his pay in his pocket, the civil law guarantees to him what he thus takes away; but before he leaves the mill he is the rightful owner of a part of the wealth that the day's industry has brought forth. Does the economic law which, in some way that he does not understand, determines what his pay shall be, make it to correspond with the amount of his portion of the day's product, or does it force him to leave some of his rightful share behind him? A plan of living that should force men to leave in their employer's hands anything that by right of creation is theirs, would be an institutional robbery — a legally established violation of the principle on which property is supposed to rest."* [**The Distribution of Wealth**, pp. 8–9]

Why should the owners of land, money and machinery get an income in the first place? Capitalist economics argues that everything involves a cost and, as such, people should be rewarded for the sacrifices they suffer when they contribute to production. Labour, in this schema, is considered a cost to those who labour and, consequently, they should be rewarded for it. Labour is thought of a disutility, i.e. something people do not want, rather than something with utility, i.e. something people do want. Under capitalism (like any class system), this perspective makes some sense as workers are bossed about and often subject to long and difficult labour. Most people will happily agree that labour is an obvious cost and should be rewarded.

Economists, unsurprisingly, have tended to justify surplus value by arguing that it involves as much cost and sacrifice as labour. For Mill, labour *"cannot be carried on without materials and* *machinery ... All these things are the fruits of previous production. If the labourers possessed of them, they would not need to divide the produce with any one; but while they have them not, an equivalent must be given to those who have."* [**Op. Cit.**, p. 25] This rationale for profits is called the "abstinence" or "waiting" theory. Clark, like Mill, expressed a defence of non-labour income in the face of socialist and anarchist criticism, namely the idea of marginal productivity to explain and justify non-labour income. Other theories have been developed as the weaknesses of previous ones have been exposed and we will discuss some of them in subsequent sections.

The ironic thing is that, well over 200 years after it came of age with Adam Smith's **Wealth of Nations**, economics has no agreed explanation for the source of surplus value. As dissident economists Michele I. Naples and Nahid Aslanbeigui show, introductory economics texts provide *"no consistent, widely accepted theory"* on the profit rate. Looking at the top three introductions to economics, they discovered that there was a *"strange amalgam"* of theories which is *"often confusing, incomplete and inconsistent."* Given that internal consistency is usually heralded as one of the hallmarks of neoclassical theory, *"the theory must be questioned."* This *"failure ... to provide a coherent theory of the rate of profit in the short run or long run"* is damning, as the *"absence of a coherent explanation for the profit rate represents a fundamental failure for the neoclassical model."* [*"What **does** determine the profit rate? The neoclassical theories present in introductory textbooks,"* pp. 53–71, **Cambridge Journal of Economics**, vol. 20, p. 53, p. 54, p. 69 and p. 70]

As will become clear, anarchists consider defences of *"surplus value"* to be essentially ideological and without an empirical base. As we will attempt to indicate, capitalists are not justified in appropriating surplus value from workers for no matter how this appropriation is explained by capitalist economics, we find that inequality in wealth and power are the real reasons for this appropriation rather than some actual productive act on the part of capitalists, investors or landlords. Mainstream economic theories generally seek to justify the distribution of income and wealth rather than to understand it. They are parables about what should be rather than what is. We argue that any scientific analysis of the source of *"surplus value"* cannot help conclude that it is due, primarily, to inequalities of wealth and, consequently, inequalities of power on the market. In other words, that Rousseau was right:

> *"The terms of social compact between these two estates of men may be summed up in a few words: 'You have need of me, because I am rich and you are poor. We will therefore come to an agreement. I will permit you to have the honour of serving me, on condition that you bestow on me that little you have left, in return for the pains I shall take to command you.'"* [**The Social Contract and Discourses**, p. 162]

This is the analysis of exploitation we present in more detail in section C.2.2. To summarise it, labour faces social inequality when it passes from the market to production. In the workplace, capitalists exercise social power over how labour is used and this allows them to produce more value from the productive efforts of workers than they pay for in wages. This social power is rooted in social dependence, namely the fact that workers have little choice but to sell their liberty to those who own the means of life. To ensure the creation and appropriation of surplus-value, capitalists must not only own the production process and the product of the workers' labour, they must own the labour of the workers itself. In other words, they must control the workers. Hence capitalist production must be, to use Proudhon's term, *"despotism."* How much surplus-value can be produced depends on the relative economic power between bosses and workers as this determines the duration of work and the intensity of labour, however its roots are the same — the hierarchical and class nature of capitalist society.

C.2.1 What is *"surplus value"*?

Before discussing how surplus-value exists and the flaws in capitalist defences of it, we need to be specific about what we mean by the term ***"surplus value."*** To do this we must revisit the difference between possession and private property we discussed in section B.3. For anarchists, private property (or capital) is *"the power to produce without labour."* [Proudhon, **What is Property?**, p. 161] As such, surplus value is created when the owners of property let others use them and receive an income from so doing. Therefore something only becomes capital, producing surplus value, under specific social relationships.

Surplus value is *"the difference between the value produced by the workers and the wages they receive"* and is *"appropriated by the landlord and capitalist class ... absorbed by the non-producing classes as profits, interest, rent, etc."* [Charlotte Wilson, **Anarchist Essays**, pp. 46–7] It basically refers to any non-labour income (some anarchists, particularly individualist anarchists, have tended to call *"surplus value"* usury). As Proudhon noted, it *"receives different names according to the thing by which it is yielded: if by land, **ground-rent**; if by houses and furniture, **rent**; if by life-investments, **revenue**; if by money, **interest**; if by exchange, **advantage**, **gain**, **profit** (three things which must not be confounded with the wages of legitimate price of labour)."* [**Op. Cit.**, p. 159]

For simplicity, we will consider *"surplus value"* to have three component parts: profits, interest and rent. All are based on payment for letting someone else use your property. Rent is what we pay to be allowed to exist on part of the earth (or some other piece of property). Interest is what we pay for the use of money. Profit is what we pay to be allowed to work a farm or use piece of machinery. Rent and interest are easy to define, they are obviously the payment for using someone else's property and have existed long before capitalism appeared. Profit is a somewhat more complex economic category although, ultimately, is still a payment for using someone else's property.

The term "profit" is often used simply, but incorrectly, to mean an excess over costs. However, this ignores the key issue, namely how a workplace is organised. In a co-operative, for example, while there is a surplus over costs, *"there is no profit, only income to be divided among members. Without employees the labour-managed firm does not have a wage bill, and labour costs are not counted among the expenses to be extracted from profit, as they are in the capitalist firm."* This means that the *"**economic category of profit does not exist in the labour-managed firm,** as it does in the capitalist firm where wages are a cost to be subtracted from gross income before a residual profit is determined ... Income shared among all producers is net income generated by the firm: the total of value added by human labour applied to the means of production, less payment of all costs of production and any reserves for depreciation of plant and equipment."* [Christopher Eaton Gunn, **Workers' Self-Management in the United States**, p. 41 and p. 45] Gunn, it should be noted, follows both Proudhon and Marx in his analysis (*"Let us suppose the workers are themselves in possession of their respective means of production and exchange their commodities with one another. These commodities would not be products of capital."* [Marx, **Capital**, vol. 3, p. 276]).

In other words, by profits we mean income that flows to the owner of a workplace or land who hires others to do the work. As such returns to capital are as unique to capitalism as unemployment is. This means that a farmer who works their own land receives a labour income when they sell the crop while one who hires labourers to work the land will receives a non-labour income, profit. Hence the difference between ***possession*** and ***private property*** (or ***capital***) and anarchist opposition to *"capitalist property, that is, property which allows some to live by the work of others and which therefore presupposes a class of … people, obliged to sell their labour power to the property-owners for less than its value."* [Malatesta, **Errico Malatesta: His Life and Ideas**, p. 102]

Another complication arises due to the fact that the owners of private property sometimes do work on them (i.e. be a boss) or hire others to do boss-like work on their behalf (i.e. executives and other managerial staff). It could be argued that bosses and executives are also *"workers"* and so contribute to the value of the commodities produced. However, this is not the case. Exploitation does not just happen, it needs to be organised and managed. In other words, exploitation requires labour (*"There is work and there is work,"* as Bakunin noted, *"There is productive labour and there is the labour of exploitation."* [**The Political Philosophy of Bakunin**, p. 180]). The key is that while a workplace would grind to a halt without workers, the workers could happily do without a boss by organising themselves into an association to manage their own work. As such, while bosses may work, they are not taking part in productive activity but rather exploitative activity.

Much the same can be said of executives and managers. Though they may not own the instruments of production, they are certainly buyers and controllers of labour power, and under their auspices production is still **capitalist** production. The creation of a "salary-slave" strata of managers does not alter the capitalist relations of production. In effect, the management strata are **de facto** capitalists and they are like "working capitalist" and, consequently, their "wages" come from the surplus value appropriated from workers and realised on the market. Thus the exploitative role of managers, even if they can be fired, is no different from capitalists. Moreover, *"shareholders and managers/technocrats share common motives: to make profits and to reproduce hierarchy relations that exclude most of the employees from effective decision making"* [Takis Fotopoulos, *"The Economic Foundations of an Ecological Society"*, pp. 1–40, **Society and Nature**, No.3, p. 16] In other words, the high pay of the higher levels of management is a share of profits **not** a labour income based on their contribution to production but rather due to their position in the economic hierarchy and the power that gives them.

So management is paid well because they monopolise power in the company and can get away with it. As Bakunin argued, within the capitalist workplace *"administrative work … [is] monopolised … if I concentrate in my hands the administrative power, it is not because the interests of production demand it, but in order to serve my own ends, the ends of exploitation. As absolute boss of my establishment I get for my labours [many] … times more than my workers get for theirs."* [**Op. Cit.**, p. 186] Given this, it is irrelevant whether those in the hierarchy simply control (in the case of managers) or actually own the means of production. What counts is that those who do the actual work are excluded from the decision making process.

This is not to say that 100 percent of what managers do is exploitative. The case is complicated by the fact that there is a legitimate need for co-ordination between various aspects of complex production processes — a need that would remain under libertarian socialism and would be filled by elected and recallable (and in some cases rotating) managers (see section I.3). But under capitalism, managers become parasitic in proportion to their proximity to the top of the pyramid.

In fact, the further the distance from the production process, the higher the salary; whereas the closer the distance, the more likely that a "manager" is a worker with a little more power than average. In capitalist organisations, the less you do, the more you get. In practice, executives typically call upon subordinates to perform managerial (i.e. co-ordinating) functions and restrict themselves to broader policy-making decisions. As their decision-making power comes from the hierarchical nature of the firm, they could be easily replaced if policy making was in the hands of those who are affected by it. As such, their role as managers do not require them to make vast sums. They are paid that well currently because they monopolise power in the company and can, consequently, get away with deciding that they, unsurprisingly, contribute most to the production of useful goods rather than those who do the actual work.

Nor are we talking, as such, of profits generated by buying cheap and selling dear. We are discussing the situation at the level of the economy as a whole, **not** individual transactions. The reason is obvious. If profits could just explained in terms of buying cheap in order to sell dear then, over all, such transactions would cancel each other out when we look at the market as a whole as any profit will cancel any loss. For example, if someone buys a product at, say, £20 and sells it at £25 then there would be no surplus overall as someone else will have to pay £20 for something which cost £25. In other words, what one person gains as a seller, someone else will lose as a buyer and no net surplus has been created. Capitalists, in other words, do not simply profit at each other's expense. There is a creation of surplus rather than mere redistribution of a given product. This means that we are explaining why production results in a aggregate surplus and why it gets distributed between social classes under capitalism.

This means that capitalism is based on the creation of surplus rather than mere redistribution of a given sum of products. If this were not the case then the amount of goods in the economy would not increase, growth would not exist and all that would happen is that the distribution of goods would change, depending on the transactions made. Such a world would be one without production and, consequently, not realistic. Unsurprisingly, as we noted in section C.1, this is the world of neoclassical economics. This shows the weakness of attempts to explain the source of profits in terms of the market rather than production. While the market can explain how, perhaps, a specific set of goods and surplus is distributed, it cannot explain how a surplus is generated in the first place. To understand how a surplus is created we need to look at the process of value creation. For this, it is necessary to look at production to see if there is something which produces more than it gets paid for. Anarchists, like other socialists, argue that this is labour and, consequently, that capitalism is an exploitative system. We discuss why in the next section.

Obviously, pro-capitalist economics argues against this theory of how a surplus arises and the conclusion that capitalism is exploitative. We will discuss the more common arguments below. However, one example will suffice here to see why labour is the source of a surplus, rather than (say) "waiting", risk or the productivity of capital (to list some of the more common explanations for capitalist appropriation of surplus value). This is a card game. A good poker-player uses equipment (capital), takes risks, delays gratification, engages in strategic behaviour, tries new tricks (innovates), not to mention cheats, and can make large winnings. However, no surplus product results from such behaviour; the gambler's winnings are simply redistributions from others with no new production occurring. For one to win, the rest must lose. Thus risk-taking, abstinence, entrepreneurship, and so on might be necessary for an individual to receive profits but they are far from sufficient for them not to be the result a pure redistribution from others.

In short, our discussion of exploitation under capitalism is first and foremost an economy-wide one. We are concentrating on how value (goods and services) and surplus value (profits, rent and interest) are produced rather than how they are distributed. The distribution of goods between people and the division of income into wages and surplus value between classes is a secondary concern as this can only occur under capitalism if workers produce goods and services to sell (this is the direct opposite of mainstream economics which assumes a static economy with almost no discussion of how scarce means are organised to yield outputs, the whole emphasis is on exchanges of ready made goods).

Nor is this distribution somehow fixed. As we discuss in section C.3, how the amount of value produced by workers is divided between wages and surplus value is source of much conflict and struggle, the outcome of which depends on the balance of power between and within classes. The same can be said of surplus value. This is divided between profits, interest and rent — capitalists, financiers and landlords. This does not imply that these sections of the exploiting class see eye to eye or that there is not competition between them. Struggle goes on within classes and well as between classes and this applies at the top of the economic hierarchy as at the bottom. The different sections of the ruling elite fight over their share of surplus value. This can involve fighting over control of the state to ensure that their interests are favoured over others. For example, the Keynesian post-war period can be considered a period when industrial capitalists shaped state policy while the period after 1973 represents a shift in power towards finance capital.

We must stress, therefore, that the exploitation of workers is not defined as payment less than competitive ("free market") for their labour. Rather, exploitation occurs even if they are paid the market wage. This is because workers are paid for their ability to labour (their *"labour-power,"* to use Marx's term) rather the labour itself. This means that for a given hour's work (labour), the capitalist expects the worker to produce more than their wage (labour power). How much more is dependent on the class struggle and the objective circumstances each side faces. Indeed, a rebellious workforce willing to take direct action in defence of their interests will not allow subjection or its resulting exploitation.

Similarly, it would be wrong to confuse exploitation with low wages. Yes, exploitation is often associated with paying low wages but it is more than possible for real wages to go up while the rate of exploitation falls or rises. While some anarchists in the nineteenth century did argue that capitalism was marked by falling real wages, this was more a product of the time they were living through rather than an universal law. Most anarchists today argue that whether wages rise or fall depends on the social and economic power of working people and the historic context of a given society. This means, in other words, that labour is exploited not because workers have a low standard of living (although it can) but because labour produces the whole of the value created in any process of production or creation of a service but gets only part of it back.

As such, it does not matter **if** real wages do go up or not. Due to the accumulation of capital, the social and economic power of the capitalists and their ability to extract surplus-value can go up at a higher rate than real wages. The key issue is one of freedom rather than the possibility of consuming more. Bosses are in a position, due to the hierarchical nature of the capitalist workplace, to make workers produce more than they pay them in wages. The absolute level of those wages is irrelevant to the creation and appropriation of value and surplus-value as this happens at all times within capitalism.

As an example, since the 1970s American workers have seen their wages stagnate and have placed themselves into more and more debt to maintain an expected standard of living. During this time, productivity has increased and so they have been increasingly exploited. However, between 1950s and 1970s wages did increase along with productivity. Strong unions and a willingness to strike mitigated exploitation and increased living standards but exploitation continued. As Doug Henwood notes, while *"average incomes have risen considerably"* since 1945, *"the amount of work necessary to earn those incomes has risen with equal relentlessness ... So, despite the fact that productivity overall is up more than threefold"* over this time *"the average worker would have to toil six months longer to make the average family income."* [**After the New Economy**, pp. 39–40] In other words, rising exploitation **can** go hand in hand with rising wages.

Finally, we must stress that we are critiquing economics mostly in its own terms. On average workers sell their labour-power at a "fair" market price and still exploitation occurs. As sellers of a commodity (labour-power) they do not receive its full worth (i.e. what they actually produce). Even if they did, almost all anarchists would still be against the system as it is based on the worker becoming a wage-slave and subject to hierarchy. In other words, they are not free during production and, consequently, they would still being robbed, although this time it is as human beings rather than a factor of production (i.e. they are oppressed rather than exploited). As Bookchin put it:

> *"To the modern mind, labour is viewed as a rarefied, abstract activity, a process extrinsic to human notions of genuine self-actualisation. One usually 'goes to work' the way a condemned person 'goes' to a place of confinement: the workplace is little more than a penal institution in which mere existence must a penalty in the form of mindless labour ... We 'measure' labour in hours, products, and efficiency, but rarely do we understand it as a concrete human activity. Aside from the earnings it generates, labour is normally alien to human fulfilment ... [as] the rewards one acquires by submitting to a work discipline. By definition, these rewards are viewed as incentives for submission, rather than for the freedom that should accompany creativity and self-fulfilment. We commonly are 'paid' for supinely working on our knees, not for heroically standing in our feet."* [**The Ecology of Freedom**, p. 308]

Almost all anarchists seek to change this, combat oppression and alienation as well as exploitation (some individualist anarchists are the exception on this issue). Needless to say, the idea that we could be subject to oppression during working hours and ***not*** be exploited is one most anarchists would dismiss as a bad joke and, as a result, follow Proudhon and demand the abolition of wage labour (most take it further and advocate the abolition of the wages system as well, i.e. support libertarian communism).

C.2.2 How does exploitation happen?

In order to make more money, money must be transformed into capital, i.e., workplaces, machinery and other *"capital goods."* By itself, however, capital (like money) produces nothing. While a few even talk about *"making money work for you"* (as if pieces of paper can actually do any form of work!) obviously this is not the case — human beings have to do the actual work. As Kropotkin put it, *"if [the capitalist] locks [his money] up, it will not increase, because [it] does not grow like seed, and after a lapse of a twelve month he will not find £110 in his drawer if he only* *put £100 into it.* [**The Place of Anarchism in Socialistic Evolution**, p. 4] Capital only becomes productive in the labour process when workers use it:

> *"Values created by net product are classed as savings and capitalised in the most highly exchangeable form, the form which is freest and least susceptible of depreciation, — in a word, the form of specie, the only constituted value. Now, if capital leaves this state of freedom and* ***engages itself****, — that is, takes the form of machines, buildings, etc., — it will still be susceptible of exchange, but much more exposed than before to the oscillations of supply and demand. Once engaged, it cannot be* ***disengaged*** *without difficulty; and the sole resource of its owner will be exploitation. Exploitation alone is capable of maintaining engaged capital at its nominal value."* [**System of Economical Contradictions**, p. 291]

Under capitalism, workers not only create sufficient value (i.e. produced commodities) to maintain existing capital and their own existence, they also produce a surplus. This surplus expresses itself as a surplus of goods and services, i.e. an excess of commodities compared to the number a workers' wages could buy back. The wealth of the capitalists, in other words, is due to them *"accumulating the product of the labour of others."* [Kropotkin, **Op. Cit.**, p. 3] Thus Proudhon:

> *"The working man cannot ... repurchase that which he has produced for his master. It is thus with all trades whatsoever... since, producing for a master who in one form or another makes a profit, they are obliged to pay more for their own labour than they get for it."* [**What is Property**, p. 189]

In other words, the price of all produced goods is greater than the money value represented by the workers' wages (plus raw materials and overheads such as wear and tear on machinery) when those goods were produced. The labour contained in these "surplus-products" is the source of profit, which has to be realised on the market (in practice, of course, the value represented by these surplus-products is distributed throughout all the commodities produced in the form of profit — the difference between the cost price and the market price). In summary, surplus value is unpaid labour and hence capitalism is based on exploitation. As Proudhon noted, *"**Products,** say economists, **are only bought by products**. This maxim is property's condemnation. The proprietor producing neither by his own labour nor by his implement, and receiving products in exchange for nothing, is either a parasite or a thief."* [**Op. Cit.**, p. 170]

It is this appropriation of wealth from the worker by the owner which differentiates capitalism from the simple commodity production of artisan and peasant economies. All anarchists agree with Bakunin when he stated that:

> *"**what is property, what is capital in their present form?** For the capitalist and the property owner they mean the power and the right, guaranteed by the State, to live without working ... [and so] the power and right to live by exploiting the work of someone else ... those ... [who are] forced to sell their productive power to the lucky owners of both."* [**The Political Philosophy of Bakunin**, p. 180]

It is the nature of capitalism for the monopolisation of the worker's product by others to exist. This is because of private property in the means of production and so in *"consequence of [which]*

... [the] worker, when he is able to work, finds no acre to till, no machine to set in motion, unless he agrees to sell his labour for a sum inferior to its real value." [Peter Kropotkin, **Anarchism**, p. 55]

Therefore workers have to sell their labour on the market. However, as this "commodity" *"cannot be separated from the person of the worker like pieces of property. The worker's capacities are developed over time and they form an integral part of his self and self-identity; capacities are internally not externally related to the person. Moreover, capacities or labour power cannot be used without the worker using his will, his understanding and experience, to put them into effect. The use of labour power requires the presence of its 'owner'... To contract for the use of labour power is a waste of resources unless it can be used in the way in which the new owner requires ... The employment contract must, therefore, create a relationship of command and obedience between employer and worker."* So, *"the contract in which the worker allegedly sells his labour power is a contract in which, since he cannot be separated from his capacities, he sells command over the use of his body and himself... The characteristics of this condition are captured in the term **wage slave**."* [Carole Pateman, **The Sexual Contract**, pp. 150–1]

Or, to use Bakunin's words, *"the worker sells his person and his liberty for a given time"* and so *"concluded for a term only and reserving to the worker the right to quit his employer, this contract constitutes a sort of **voluntary** and **transitory** serfdom."* [**The Political Philosophy of Bakunin**, p. 187] This domination is the source of the surplus, for *"wage slavery is not a consequence of exploitation — exploitation is a consequence of the fact that the sale of labour power entails the worker's subordination. The employment contract creates the capitalist as master; he has the political right to determine how the labour of the worker will be used, and — consequently — can engage in exploitation."* [Pateman, **Op. Cit.**, p. 149]

So profits exist because the worker sells themselves to the capitalist, who then owns their activity and, therefore, controls them (or, more accurately, **tries** to control them) like a machine. Benjamin Tucker's comments with regard to the claim that capital is entitled to a reward are of use here. He notes that some *"combat... the doctrine that surplus value — oftener called profits — belong to the labourer because he creates it, by arguing that the horse... is rightly entitled to the surplus value which he creates for his owner. So he will be when he has the sense to claim and the power to take it... Th[is] argument . . is based upon the assumption that certain men are born owned by other men, just as horses are. Thus its **reductio ad absurdum** turns upon itself."* [**Instead of a Book**, pp. 495–6] In other words, to argue that capital should be rewarded is to implicitly assume that workers are just like machinery, another "factor of production" rather than human beings and the creator of things of value. So profits exists because during the working day the capitalist controls the activity and output of the worker (i.e. owns them during working hours as activity cannot be separated from the body and *"[t]here is an integral relationship between the body and self. The body and self are not identical, but selves are inseparable from bodies."* [Carole Pateman, **Op. Cit.**, p. 206]).

Considered purely in terms of output, this results in, as Proudhon noted, workers working *"for an entrepreneur who pays them and keeps their products."* [quoted by Martin Buber, **Paths in Utopia**, p. 29] The ability of capitalists to maintain this kind of monopolisation of another's time and output is enshrined in *"property rights"* enforced by either public or private states. In short, therefore, property *"is the right to enjoy and dispose at will of another's goods — the fruit of an other's industry and labour."* [P-J Proudhon, **What is Property**, p. 171] And because of this "right," a worker's wage will always be less than the wealth that he or she produces.

The surplus value produced by labour is divided between profits, interest and rent (or, more correctly, between the owners of the various factors of production other than labour). In practice, this surplus is used by the owners of capital for: (a) investment (b) to pay themselves dividends on their stock, if any; (c) to pay for rent and interest payments; and (d) to pay their executives and managers (who are sometimes identical with the owners themselves) much higher salaries than workers. As the surplus is being divided between different groups of capitalists, this means that there can be clashes of interest between (say) industrial capitalists and finance capitalists. For example, a rise in interest rates can squeeze industrial capitalists by directing more of the surplus from them into the hands of rentiers. Such a rise could cause business failures and so a slump (indeed, rising interest rates is a key way of regulating working class power by generating unemployment to discipline workers by fear of the sack). The surplus, like the labour used to reproduce existing capital, is embodied in the finished commodity and is realised once it is sold. This means that workers do not receive the full value of their labour, since the surplus appropriated by owners for investment, etc. represents value added to commodities by workers — value for which they are not paid nor control.

The size of this surplus, the amount of unpaid labour, can be changed by changing the duration and intensity of work (i.e. by making workers labour longer and harder). If the duration of work is increased, the amount of surplus value is increased absolutely. If the intensity is increased, e.g. by innovation in the production process, then the amount of surplus value increases relatively (i.e. workers produce the equivalent of their wage sooner during their working day resulting in more unpaid labour for their boss). Introducing new machinery, for example, increases surplus-value by reducing the amount of work required per unit of output. In the words of economist William Lazonick:

> *"As a general rule, all market prices, including wages, are given to the particular capitalist. Moreover, in a competitive world a particular capitalist cannot retain privileged access to process or product innovations for any appreciable period of time. But the capitalist does have privileged access to, and control over, the workers that he employs. Precisely because the work is not perfectly mobile but is dependent on the capitalist to gain a living, the capitalist is not subject to the dictates of market forces in dealing with the worker in the production process. The more dependent the worker is on his or her particular employer, the more power the capitalist has to demand longer and harder work in return for a day's pay. The resultant unremunerated increase in the productivity of the worker per unit of time is the source of surplus-value.*
>
> *"The measure of surplus-value is the difference between the value-added by and the value paid to the worker. As owner of the means of production, the industrial capitalist has a legal right to keep the surplus-value for himself."* [**Competitive Advantage on the Shop Floor**, p. 54]

Such surplus indicates that labour, like any other commodity, has a use value and an exchange value. Labour's exchange value is a worker's wages, its use value their ability to work, to do what the capitalist who buys it wants. Thus the existence of "surplus products" indicates that there is a difference between the exchange value of labour and its use value, that labour can **potentially** create **more** value than it receives back in wages. We stress potentially, because the extraction of use value from labour is not a simple operation like the extraction of so many joules of energy from a ton of coal. Labour power cannot be used without subjecting the labourer to the will of the capitalist — unlike other commodities, labour power remains inseparably embodied in human beings. Both the extraction of use value and the determination of exchange value for labour depends upon — and are profoundly modified by — the actions of workers. Neither the effort provided during an hours work, nor the time spent in work, nor the wage received in exchange for it, can be determined without taking into account the worker's resistance to being turned into a commodity, into an order taker. In other words, the amount of "surplus products" extracted from a worker is dependent upon the resistance to dehumanisation within the workplace, to the attempts by workers to resist the destruction of liberty during work hours.

Thus unpaid labour, the consequence of the authority relations explicit in private property, is the source of profits. Part of this surplus is used to enrich capitalists and another to increase capital, which in turn is used to increase profits, in an endless cycle (a cycle, however, which is not a steady increase but is subject to periodic disruption by recessions or depressions — "The business cycle." The basic causes for such crises will be discussed later, in sections C.7 and C.8).

It should be noted that few economists deny that the "value added" by workers in production must exceed the wages paid. It has to, if a profit is to be made. As Adam Smith put it:

> *"As soon as stock has accumulated in the hands of particular persons, some of them will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials … The value which the workmen add to the materials, therefore, resolves itself in this case into two parts, of which one pays their wages, the other the profits of their employer upon the whole stock of materials and wages which he advanced. He could have no interest to employ them, unless he expected from the sale of their work something more than what was sufficient to replace his stock to him."* [**The Wealth of Nations**, p. 42]

That surplus value consists of unpaid labour is a simple fact. The difference is that non-socialist economists refuse to explain this in terms of exploitation. Like Smith, David Ricardo argued in a similar manner and justified surplus value appropriation in spite of this analysis. Faced with the obvious interpretation of non-labour income as exploitation which could easily be derived from classical economics, subsequent economists have sought to obscure this fact and have produced a series of rationales to justify the appropriation of workers labour by capitalists. In other words, to explain and justify the fact that capitalism is not based on its own principle that labour creates and justifies property. These rationales have developed over time, usually in response to socialist and anarchist criticism of capitalism and its economics (starting in response to the so-called Ricardian Socialists who predated Proudhon and Marx and who first made such an analysis commonplace). These have been based on many factors, such as the abstinence or waiting by the capitalist, the productivity of capital, "time-preference," entrepreneurialism and so forth. We discuss most rationales and indicate their weaknesses in subsequent sections.

C.2.3 Is owning capital sufficient reason to justify profits?

No, it does not. To understand why, we must first explain the logic behind this claim. It is rooted in what is termed "marginal productivity" theory. In the words of one of its developers:

> *"If each productive function is paid for according to the amount of its product, then each man get what he himself produces. If he works, he gets what he creates by working; if he provides capital, he gets what his capital produces; and if, further, he renders service by co-ordinating labour and capital, he gets the product that can be separately traced to that function. Only in one of these ways can a man produce anything. If he receives all that he brings into existence through any one of these three functions, he receives all that he creates at all."* [John Bates Clark, **The Distribution of Wealth**, p.7]

Needless to say, this analysis was based on the need to justify the existing system, for it was *"the purpose of this work to show that the distribution of income to society is controlled by a natural law, and that this law, if it worked without friction, would give to every agent of production the amount of wealth which that agent creates."* In other words, *"what a social class gets is, under natural law, what it contributes to the general output of industry."* [Clark, **Op. Cit.**, p. v and p. 313] And only mad people can reject a *"natural law"* like gravity — or capitalism!

Most schools of capitalist economics, when they bother to try and justify non-labour income, hold to this theory of productivity. Unsurprisingly, as it proves what right-wing economist Milton Friedman called the *"capitalist ethic"*: *"To each according to what he and the instruments he owns produces."* [**Capitalism and Freedom**, pp. 161–162] As such, this is one of the key defences of capitalism, based as it is on the productive contribution of each factor (labour, land and capital). Anarchists as unconvinced.

Unsurprisingly, this theory took some time to develop given the theoretical difficulties involved. After all, you need all three factors to produce a commodity, say a bushel of wheat. How can we determine that percentage of the price is due to the land, what percentage to labour and what percentage to capital? You cannot simply say that the "contribution" of each factor just happens to be identical to its cost (i.e. the contribution of land is what the market rent is) as this is circular reasoning. So how is it possible to specify contribution of each factor of production independently of the market mechanism in such a way as to show, firstly, that the contributions add up to 100 percent and, secondly, that the free market will in fact return to each factor its respective contribution?

This is where marginal productivity theory comes in. In neo-classical theory, the contribution of a specific factor is defined as the marginal product of that factor when the other factors are left constant. Take, as an example, a hundred bushels of wheat produced by X acres of land being worked by Y workers using £Z worth of capital. The contribution of land can then be defined as the increase in wheat that an extra acre of land would produce (X+1) if the same number of workers employed the same capital worked it. Similarly, the contribution of a worker would be the increase that would result if an addition worker was hired (Y + 1) to work the same land (X) with the same capital (£Z). The contribution of capital, obviously, would be the increase in wheat produced by the same number of workers (X) working the same amount of land (Y) using one more unit of capital (£Z+1). Then mathematics kicks in. If enough assumptions are made in terms of the substitutability of factors, diminishing returns, and so forth, then a mathematical theorem (Euler's Theorem) can be used to show that the sum of these marginal contributions would be a hundred bushels. Applying yet more assumptions to ensure "perfect competition" it can be mathematically proven that the rent per acre set by this perfect market will be precisely the contribution of the land, that the market wage will be the contribution of the worker, and the market interest rate will be the contribution of capital. In addition, it can be shown that any monopoly power will enable a factor owner to receive more than it contributes, so exploiting the others.

While this is impressive, the problems are obvious. As we discuss in section C.2.5, this model does not (indeed, cannot) describe any actual real economy. However, there is a more fundamental issue than mere practicality or realism, namely that it confuses a **moral** principle (that factors should receive in accordance with their productive contributions) with an ownership issue. This is because even if we want to say that land and capital "contribute" to the final product, we cannot say the same for the landowner or the capitalist. Using our example above, it should be noted that neither the capitalist nor the landowner actually engages in anything that might be called a productive activity. Their roles are purely passive, they simply allow what they own to be used by the people who do the actual work, the labourers.

Marginal productivity theory shows that with declining marginal productivity, the contribution of labour is less than the total product. The difference is claimed to be precisely the contribution of capital and land. But what is this "contribution" of capital and land? Without any labourers there would be no output. In addition, in physical terms, the marginal product of, say, capital is simply the amount by which production would decline is one piece of capital were taken out of production. It does not reflect any productive activity whatsoever on the part of the owner of said capital. **It does not, therefore, measure his or her productive contribution**. In other words, capitalist economics tries to confuse the owners of capital with the machinery they own. Unlike labour, whose "ownership" cannot be separated from the productive activities being done, capital and land can be rewarded without their owners actually doing anything productive at all.

For all its amazing mathematics, the neo-classical solution fails simply because it is not only irrelevant to reality, it is not relevant ethically.

To see why, let us consider the case of land and labour (capital is more complex and will be discussed in the next two sections). Marginal productivity theory can show, given enough assumptions, that five acres of land can produce 100 bushels of wheat with the labour of ten men and that the contribution of land and labour are, respectively, 40 and 60 bushels each. In other words, that each worker receives a wage representing 6 bushels of wheat while the landlord receives an income of 40 bushels. As socialist David Schweickart notes, *"we have derived both the contribution of labour and the contribution of land from purely technical considerations. We have made no assumptions about ownership, competition, or any other social or political relationship. No covert assumptions about capitalism have been smuggled into the analysis."* [**After Capitalism**, p. 29]

Surely this means that economics has produced a defence of non-labour income? Not so, as it ignores the key issue of what represents a valid contribution. The conclusion that the landlord (or capitalist) is entitled to their income *"in no way follows from the technical premises of the argument. Suppose our ten workers had cultivated the five acres **as a worker collective**. In this, they would receive the entire product, all one hundred bushels, instead of sixty. Is this unfair? To whom should the other forty bushels go? To the land, for its 'contribution'? Should the collective perhaps burn forty bushels as an offering to the Land-God? (Is the Land-Lord the representative on Earth of this Land-God?)."* [**Op. Cit.**, p. 30] It should be noted that Schweickart is echoing the words of Proudhon:

> *"How much does the proprietor increase the utility of his tenant's products? Has he ploughed, sowed, reaped, mowed, winnowed, weeded? ... I admit that the land is an implement; but who made it? Did the proprietor? Did he — by the efficacious virtue of the right of property, by this* ***moral quality*** *infused into the soil — endow it with vigour and fertility? Exactly there lies the monopoly of the proprietor, though he did not make the implement, he asks pay for its use. When the Creator shall present himself and claim farm-rent, we will consider the matter with him; or even when the proprietor — his pretended representative — shall exhibit his power of attorney."* [**What is Property?**, pp. 166–7]

In other words, granting permission cannot be considered as a "contribution" or a "productive" act:

> *"We can see that a moral sleight-of-hand has been performed. A technical demonstration has passed itself off as a moral argument by its choice of terminology, namely, by calling a marginal product a 'contribution.' The 'contribution = ethical entitlement' of the landowner has been identified with the 'contribution = marginal product' of the land ... What is the nature of the landowner's 'contribution' here? We can say that the landlord* ***contributed the land*** *to the workers, but notice the qualitative difference between his 'contribution' and the contribution of his workforce. He 'contributes' his land — but the land remains intact and remains his at the end of the harvest, whereas the labour contributed by each labourer is gone. If the labourers do not expend* ***more*** *labour next harvest, they will get nothing more, whereas the landowner can continue to 'contribute' year after year (lifting not a finger), and be rewarded year after year for doing so."* [Schweickart, **Op. Cit.**, p. 30]

As the examples of the capitalist and co-operative farms shows, the "contribution" of land and capital can be rewarded without their owners doing anything at all. So what does it mean, "capital's share"? After all, no one has ever given money to a machine or land. That money goes to the owner, not the technology or resource used. When "land" gets its "reward" it involves money going to the landowner **not** fertiliser being spread on the land. Equally, if the land and the capital were owned by the labourers then "capital" and "land" would receive nothing despite both being used in the productive process and, consequently, having "aided" production. Which shows the fallacy of the idea that profits, interest and rent represent a form of "contribution" to the productive process by land and capital which needs rewarded. They only get a *"reward"* when they hire labour to work them, i.e. they give permission for others to use the property in question in return for telling them what to do and keeping the product of their labour.

As Proudhon put it, *"[w]ho is entitled to the rent of the land? The producer of the land, without doubt. Who made the land? God. Then, proprietor, retire!"* [**Op. Cit.**, p. 104] Much the same can be said of "capital" (workplaces, machinery, etc.) as well. The capitalist, argued Berkman, *"gives you a job; that is permission to work in the factory or mill which was not built by him but by other workers like yourself. And for that permission you help to support him for the rest of your life or as long as you work for him."* [**What is Anarchism?**, p. 14]

So non-labour income exists **not** because of the owners of capital and land "contribute" to production but because they, as a class, **own** the means of life and workers have to sell their labour and liberty to them to gain access:

> *"We cry shame on the feudal baron who forbade the peasant to turn a clod of earth unless he surrendered to his lord a fourth of his crop. We called those the barbarous times, But if the forms have changed, the relations have remained the same, and the worker is forced, under the name of free contract, to accept feudal obligations."* [Kropotkin, **The Conquest of Bread**, pp. 31–2]

It is capitalist property relations that allow this monopolisation of wealth by those who own (or boss) but do not produce. The workers do not get the full value of what they produce, nor do they have a say in how the surplus value produced by their labour gets used (e.g. investment decisions). Others have monopolised both the wealth produced by workers and the decision-making power within the company. This is a private form of taxation without representation, just as the company is a private form of statism.

Therefore, providing capital is **not** a productive act, and keeping the profits that are produced by those who actually do use capital is an act of theft. This does not mean, of course, that creating capital goods is not creative nor that it does not aid production. Far from it! But owning the outcome of such activity and renting it does not justify capitalism or profits. In other words, while we need machinery, workplaces, houses and raw materials to produce goods we do **not** need landlords and capitalists.

The problem with the capitalists' "contribution to production" argument is that one must either assume (a) a strict definition of who is the producer of something, in which case one must credit only the worker(s), or (b) a looser definition based on which individuals have contributed to the circumstances that made the productive work possible. Since the worker's productivity was made possible in part by the use of property supplied by the capitalist, one can thus credit the capitalist with "contributing to production" and so claim that he or she is entitled to a reward, i.e. profit.

However, if one assumes (b), one must then explain why the chain of credit should stop with the capitalist. Since all human activity takes place within a complex social network, many factors might be cited as contributing to the circumstances that allowed workers to produce — e.g. their upbringing and education, the contribution of other workers in providing essential products, services and infrastructure that permits their place of employment to operate, and so on (even the government, which funds infrastructure and education). Certainly the property of the capitalist contributed in this sense. But his contribution was less important than the work of, say, the worker's mother. Yet no capitalist, so far as we know, has proposed compensating workers' mothers with any share of the firm's revenues, and particularly not with a **greater** share than that received by capitalists! Plainly, however, if they followed their own logic consistently, capitalists would have to agree that such compensation would be fair.

In summary, while some may consider that profit is the capitalist's "contribution" to the value of a commodity, the reality is that it is nothing more than the reward for owning capital and giving permission for **others** to produce using it. As David Schweickart puts it, *"'providing capital' means nothing more than 'allowing it to be used.' But an act of granting permission, in and of itself, is not a productive activity. If labourers cease to labour, production ceases in any society. But if owners cease to grant permission, production is affected only if their **authority** over the means of production is respected."* [**Against Capitalism**, p. 11]

This authority, as discussed earlier, derives from the coercive mechanisms of the state, whose primary purpose is to ensure that capitalists have this ability to grant or deny workers access to the means of production. Therefore, not only is "providing capital" not a productive activity, it depends on a system of organised coercion which requires the appropriation of a considerable portion of the value produced by labour, through taxes, and hence is actually parasitic. Needless to say, rent can also be considered as "profit", being based purely on "granting permission" and so not a productive activity. The same can be said of interest, although the arguments are somewhat different (see section C.2.6).

So, even if we assume that capital and land **are** productive, it does not follow that owning those resources entitles the owner to an income. However, this analysis is giving too much credit to capitalist ideology. The simple fact is that capital is **not** productive at all. Rather, *"capital"* only contributes to production when used by labour (land does produce use values, of course, but these only become available once labour is used to pick the fruit, reap the corn or dig the coal). As such, profit is not the reward for the productivity of capital. Rather **labour** produces the marginal productivity of capital. This is discussed in the next section.

C.2.4 Is profit the reward for the productivity of capital?

In a word, no. As Proudhon pointed out, *"Capital, tools, and machinery are likewise unproductive… The proprietor who asks to be rewarded for the use of a tool or for the productive power of his land, takes for granted, then, that which is radically false; namely, that capital produces by its own effort — and, in taking pay for this imaginary product, he literally receives something for nothing."* [**What is Property?**, p. 169] In other words, only labour is productive and profit is not the reward for the productivity of capital.

Needless to say, capitalist economists disagree. *"Here again the philosophy of the economists is wanting. To defend usury they have pretended that capital was productive, and they have changed a metaphor into a reality,"* argued Proudhon. The socialists had *"no difficulty in overturning their sophistry; and through this controversy the theory of capital has fallen into such disfavour that today, in the minds of the people, **capitalist** and **idler** are synonymous terms."* [**System of Economical Contradictions**, p. 290]

Sadly, since Proudhon's time, the metaphor has become regained its hold, thanks in part to neo-classical economics and the "marginal productivity" theory. We explained this theory in the last section as part of our discussion on why, even if we assume that land and capital **are** productive this does not, in itself, justify capitalist profit. Rather, profits accrue to the capitalist simply because he or she gave their permission for others to use their property. However, the notion that profits represent that "productivity" of capital is deeply flawed for other reasons. The key one is that, by themselves, capital and land produce nothing. As Bakunin put it, *"neither property nor capital produces anything when not fertilised by labour."* [**The Political Philosophy of Bakunin**, p. 183]

In other words, capital is "productive" simply because people use it. This is hardly a surprising conclusion. Mainstream economics recognises it in its own way (the standard economic terminology for this is that *"factors usually do not work alone"*). Needless to say, the conclusions anarchists and defenders of capitalism draw from this obvious fact are radically different.

The standard defence of class inequalities under capitalism is that people get rich by producing what other people want. That, however, is hardly ever true. Under capitalism, people get rich by hiring other people to produce what other people want or by providing land, money or machinery to those who do the hiring. The number of people who have became rich purely by their own labour, without employing others, is tiny. When pressed, defenders of capitalism will admit the basic point and argue that, in a free market, everyone gets in income what their contribution in producing these goods indicates. Each factor of production (land, capital and labour) is treated in the same way and their marginal productivity indicates what their contribution to a finished product is and so their income. Thus wages represent the marginal productivity of labour, profit the marginal productivity of capital and rent the marginal productivity of land. As we have used land and labour in the previous section, we will concentrate on land and "capital" here. We must note, however, that marginal productivity theory has immense difficulties with capital and has been proven to be internally incoherent on this matter (see next section). However, as mainstream economics ignores this, so will we for the time being.

So what of the argument that profits represent the contribution of capital? The reason why anarchists are not impressed becomes clear when we consider ten men digging a hole with spades. Holding labour constant means that we add spades to the mix. Each new spade increases productivity by the same amount (because we assume that labour is homogenous) until we reach the eleventh spade. At that point, the extra spade lies unused and so the marginal contribution of the spade ("capital") is zero. This suggests that the socialists are correct, capital **is** unproductive and, consequently, does not deserve any reward for its use.

Of course, it will be pointed out that the eleventh spade cost money and, as a result, the capitalist would have stopped at ten spades and the marginal contribution of capital equals the amount the tenth spade added. Yet the only reason that spade added anything to production was because there was a worker to use it. In other words, as economist David Ellerman stresses, the *"point is that capital itself does not 'produce' at all; capital is used by Labour to produce the outputs … Labour produces the marginal product **of capital**."* [**Property and Contract in Economics**, p. 204] As such, to talk of the "marginal product" of capital is meaningless as holding labour constant is meaningless:

> *"Consider, for example, the 'marginal product of a shovel' in a simple production process wherein three workers use two shovels and a wheelbarrow to dig out a cellar. Two of the workers use two shovels to fill the wheelbarrow which the third worker pushes a certain distance to dump the dirt. The marginal productivity of a shovel is defined as the extra product produced when an extra shovel is added and the other factors, such as labour, are held constant. The labour is the human activity of carrying out this production process. If labour was held 'constant' is the sense of carrying out the same human activity, then any third shovel would just lie unused and the extra product would be identically zero.*
>
> *"'Holding labour constant' really means reorganising the human activity in a more capital intensive way so that the extra shovel will be optimally utilised. For instance, all three workers could use the three shovels to fill the wheelbarrow and then they could take turns emptying the wheelbarrow. In this manner, the workers would use the extra shovel and by so doing they would produce some extra product (additional earth moved during the same time period). This extra product would be called the 'marginal product of the shovel, but in fact it is produced by the workers who are also using the additional shovel … [Capital] does not 'produce' its marginal product. Capital does not 'produce' at all. Capital is used by Labour to produce the output. When capital is increased, Labour produces extra output by using up the extra capital … In short, **Labour produced the***

> ***marginal product of capital*** *(and used up the extra capital services)."* [**Op. Cit.**, pp. 207–9]

Therefore, the idea that profits equals the marginal productivity of capital is hard to believe. Capital, in this perspective, is not only a tree which bears fruit even if its owner leaves it uncultivated, it is a tree which also picks its own fruit, prepares it and serves it for dinner! Little wonder the classical economists (Smith, Ricardo, John Stuart Mill) considered capital to be unproductive and explained profits and interest in other, less obviously false, means.

Perhaps the "marginal productivity" of capital is simply what is left over once workers have been paid their "share" of production, i.e. once the marginal productivity of labour has been rewarded. Obviously the marginal product of labour and capital are related. In a production process, the contribution of capital will (by definition) be equal to total price minus the contribution of labour. You define the marginal product of labour, it is necessary to keep something else constant. This means either the physical inputs other than labour are kept constant, or the rate of profit on capital is kept constant. As economist Joan Robinson noted:

> *"I found this satisfactory, for it destroys the doctrine that wages are regulated by marginal productivity. In a short-period case, where equipment is given, at full-capacity operation the marginal physical product of labour is indeterminate. When nine men with nine spades are digging a hole, to add a tenth man could increase output only to the extent that nine dig better if they have a rest from time to time. On the other hand, to subtract the ninth man would reduce output by more or less the average amount. The wage must lie somewhere between the average value of output per head and zero, so that marginal product is greater or much less than the wage according as equipment is being worked below or above its designed capacity."* [**Contributions to Modern Economics**, p. 104]

If wages are not regulated by marginal productivity theory, then neither is capital (or land). Subtracting labour while keeping capital constant simply results in unused equipment and unused equipment, by definition, produces nothing. What the "contribution" of capital is dependent, therefore, on the economic power the owning class has in a given market situation (as we discuss in section C.3). As William Lazonick notes, the neo-classical theory of marginal productivity has two key problems which flow from its flawed metaphor that capital is "productive":

> *"The first flaw is the assumption that, at any point in time, the productivity of a technology is given to the firm, irrespective of the social context in which the firm attempts to utilise the technology … this assumption, typically implicit in mainstream economic analysis and [is] derived from an ignorance of the nature of the production process as much as everything else …"*
>
> *"The second flaw in the neo-classical theoretical structure is the assumption that factor prices are independent of factor productivities. On the basis of this assumption, factor productivities arising from different combinations of capital and labour can be taken as given to the firm; hence the choice of technique depends only on variations in relative factor prices. It is, however, increasingly recognised by economists who speak of 'efficiency wages' that factor prices and factor productivities may be linked, particularly*

> *for labour inputs ... the productivity of a technology depends on the amount of effort that workers choose to supply."* [**Competitive Advantage on the Shop Floor**, p. 130 and pp. 133–4]

In other words, neo-classical economics forgets that technology has to be used by workers and so its "productivity" depends on how it is applied. If profit did flow as a result of some property of machinery then bosses could do without autocratic workplace management to ensure profits. They would have no need to supervise workers to ensure that adequate amounts of work are done in excess of what they pay in wages. This means the idea (so beloved by pro-capitalist economics) that a worker's wage **is** the equivalent of what she produces is one violated everyday within reality:

> *"Managers of a capitalist enterprise are not content simply to respond to the dictates of the market by equating the wage to the value of the marginal product of labour. Once the worker has entered the production process, the forces of the market have, for a time at least, been superseded. The effort-pay relation will depend not only on market relations of exchange but also... on the hierarchical relations of production — on the relative power of managers and workers within the enterprise."* [William Lazonick, **Business Organisation and the Myth of the Market Economy**, pp. 184–5]

But, then again, capitalist economics is more concerned with justifying the status quo than being in touch with the real world. To claim that a workers wage represents her contribution and profit capital's is simply false. Capital cannot produce anything (never mind a surplus) unless used by labour and so profits do not represent the productivity of capital. In and of themselves, fixed costs do not create value. Whether value is created depends on how investments are developed and used once in place. Which brings us back to labour (and the social relationships which exist within an economy) as the fundamental source of surplus value.

Then there is the concept of profit sharing, whereby workers are get a share of the profits made by the company. Yet profits are the return to capital. This shatters the notion that profits represent the contribution of capital. **If** profits were the contribution of the productivity of equipment, then sharing profits would mean that capital was not receiving its full *"contribution"* to production (and so was being exploited by labour!). It is unlikely that bosses would implement such a scheme unless they knew they would get more profits out of it. As such, profit sharing is usually used as a technique to **increase** productivity and profits. Yet in neo-classical economics, it seems strange that such a technique would be required if profits, in fact, **did** represent capital's "contribution." After all, the machinery which the workers are using is the same as before profit sharing was introduced — how could this unchanged capital stock produce an increased "contribution"? It could only do so if, in fact, capital was unproductive and it was the unpaid efforts, skills and energy of workers' that actually was the source of profits. Thus the claim that profit equals capital's "contribution" has little basis in fact.

As capital is not autonomously productive and goods are the product of human (mental and physical) labour, Proudhon was right to argue that *"Capital, tools, and machinery are likewise unproductive ... The proprietor who asks to be rewarded for the use of a tool or for the productive power of his land, takes for granted, then, that which is radically false; namely, that capital produces by its own effort — and, in taking pay for this imaginary product, he literally receives something for nothing."* [**What is Property?**, p. 169]

It will be objected that while capital is not productive in itself, its use does make labour more productive. As such, surely its owner is entitled to some share of the larger output produced by its aid. Surely this means that the owners of capital deserve a reward? Is this difference not the "contribution" of capital? Anarchists are not convinced. Ultimately, this argument boils down to the notion that giving permission to use something is a productive act, a perspective we rejected in the last section. In addition, providing capital is unlike normal commodity production. This is because capitalists, unlike workers, get paid multiple times for one piece of work (which, in all likelihood, they paid others to do) and **keep** the result of that labour. As Proudhon argued:

> *"He [the worker] who manufactures or repairs the farmer's tools receives the price* ***once****, either at the time of delivery, or in several payments; and when this price is once paid to the manufacturer, the tools which he has delivered belong to him no more. Never can he claim double payment for the same tool, or the same job of repairs. If he annually shares in the products of the farmer, it is owing to the fact that he annually does something for the farmer.*
>
> *"The proprietor, on the contrary, does not yield his implement; eternally he is paid for it, eternally he keeps it."* [**Op. Cit.**, pp. 169–170]

While the capitalist, in general, gets their investment back plus something extra, the workers can never get their time back. That time has gone, forever, in return for a wage which allows them to survive in order to sell their time and labour (i.e. liberty) again. Meanwhile, the masters have accumulated more capital and their the social and economic power and, consequently, their ability to extract surplus value goes up at a higher rate than the wages they have to pay (as we discuss in section C.7, this process is not without problems and regularly causes economic crisis to break out).

Without labour nothing would have been produced and so, in terms of justice, **at best** it could be claimed that the owners of capital deserve to be paid only for what has been used of their capital (i.e. wear and tear and damages). While it is true that the value invested in fixed capital is in the course of time transferred to the commodities produced by it and through their sale transformed into money, this does not represent any actual labour by the owners of capital. Anarchists reject the ideological sleight-of-hand that suggests otherwise and recognise that (mental and physical) labour is the **only** form of contribution that can be made by humans to a productive process. Without labour, nothing can be produced nor the value contained in fixed capital transferred to goods. As Charles A. Dana pointed out in his popular introduction to Proudhon's ideas, *"[t]he labourer without capital would soon supply his wants by its production … but capital with no labourers to consume it can only lie useless and rot."* [**Proudhon and his "Bank of the People"**, p. 31] If workers do not control the full value of their contributions to the output they produce then they are exploited and so, as indicated, capitalism is based upon exploitation.

Of course, as long as "capital" **is** owned by a different class than as those who use it, this is extremely unlikely that the owners of capital will simply accept a "reward" of damages. This is due to the hierarchical organisation of production of capitalism. In the words of the early English socialist Thomas Hodgskin *"capital does not derive its utility from previous, but present labour; and does not bring its owner a profit because it has been stored up, but because it is a means of obtaining a command over labour."* [**Labour Defended against the Claims of Capital**] It is more than a strange coincidence that the people with power in a company, when working out who contributes most to a product, decide it is themselves!

This means that the notion that labour gets its "share" of the products created is radically false for, as *"a description of **property rights**, the distributive shares picture is quite misleading and false. The simple fact is that one legal party owns all the product. For example, General Motors doesn't just own 'Capital's share' of the GM cars produced; it owns all of them."* [Ellerman, **Op. Cit.**, p. 27] Or as Proudhon put it, *"Property is the right to enjoy and dispose of another's goods, — the fruit of another's industry and labour."* The only way to finally abolish exploitation is for workers to manage their own work and the machinery and tools they use. This is implied, of course, in the argument that labour is the source of property for *"if labour is the sole basis of property, I cease to be a proprietor of my field as soon as I receive rent for it from another ... It is the same with all capital."* Thus, *"all production being necessarily collective"* and *"all accumulated capital being social property, no one can be its exclusive proprietor."* [**What is Property?**, p. 171, p. 133 and p. 130]

The reason why capital gets a "reward" is simply due to the current system which gives capitalist class an advantage which allows them to refuse access to their property except under the condition that they command the workers to make more than they have to pay in wages and keep their capital at the end of the production process to be used afresh the next. So while capital is not productive and owning capital is not a productive act, under capitalism it is an enriching one and will continue to be so until such time as that system is abolished. In other words, profits, interest and rent are not founded upon any permanent principle of economic or social life but arise from a specific social system which produce specific social relationships. Abolish wage labour by co-operatives, for example, and the issue of the "productivity" of "capital" disappears as "capital" no longer exists (a machine is a machine, it only becomes capital when it is used by wage labour).

So rather that the demand for labour being determined by the technical considerations of production, it is determined by the need of the capitalist to make a profit. This is something the neo-classical theory implicitly admits, as the marginal productivity of labour is just a roundabout way of saying that labour-power will be bought as long as the wage is not higher than the profits that the workers produce. In other words, wages do not rise above the level at which the capitalist will be able to produce and realise surplus-value. To state that workers will be hired as long as the marginal productivity of their labour exceeds the wage is another way of saying that workers are exploited by their boss. So even if we do ignore reality for the moment, this defence of profits does **not** prove what it seeks to — it shows that labour **is** exploited under capitalism.

However, as we discuss in the next section, this whole discussion is somewhat beside the point. This is because marginal productivity theory has been conclusively proven to be flawed by dissident economics and has been acknowledged as such by leading neo-classical economists.

C.2.5 Do profits represent the contribution of capital to production?

In a word, no. While we have assumed the validity of "marginal productivity" theory in relation to capital in the previous two sections, the fact is that the theory is deeply flawed. This is on two levels. Firstly, it does not reflect reality in any way. Secondly, it is logically flawed and, even worse, this has been known to economists for decades. While the first objection will hardly bother most neo-classical economists (what part of that dogma **does** reflect reality?), the second should as intellectual coherence is what replaces reality in economics. However, in spite of "marginal productivity" theory being proven to be nonsense and admitted as such by leading neo-classical economists, it is still taught in economic classes and discussed in text books as if it were valid.

We will discuss each issue in turn.

The theory is based on a high level of abstraction and the assumptions used to allow the mathematics to work are so extreme that no real world example could possibly meet them. The first problem is determining the level at which the theory should be applied. Does it apply to individuals, groups, industries or the whole economy? For depending on the level at which it is applied, there are different problems associated with it and different conclusions to be drawn from it. Similarly, the time period over which it is to be applied has an impact. As such, the theory is so vague that it would be impossible to test as its supporters would simply deny the results as being inapplicable to **their** particular version of the model.

Then there are problems with the model itself. While it has to assume that factors are identical in order to invoke the necessary mathematical theory, none of the factors used are homogenous in the real world. Similarly, for Euler's theory to be applied, there must be constant returns to scale and this does not apply either (it would be fair to say that the assumption of constant returns to scale was postulated to allow the theorem to be invoked in the first place rather than as a result of a scientific analysis of real industrial conditions). Also, the model assumes an ideal market which cannot be realised and any real world imperfections make it redundant. In the model, such features of the real world as oligopolistic markets (i.e. markets dominated by a few firms), disequilibrium states, market power, informational imperfections of markets, and so forth do not exist. Including any of these real features invalidates the model and no "factor" gets its just rewards.

Moreover, like neo-classical economics in general, this theory just assumes the original distribution of ownership. As such, it is a boon for those who have benefited from previous acts of coercion — their ill-gotten gains can now be used to generate income for them!

Finally, "marginal productivity" theory ignores the fact that most production is collective in nature and, as a consequence, the idea of subtracting a single worker makes little or no sense. As soon as there is *"a division of labour and an interdependence of different jobs, as is the case generally in modern industry,"* its *"absurdity can immediately be shown."* For example, *"[i]f, in a coal-fired locomotive, the train's engineer is eliminated, one does not 'reduce a little' of the product (transportation), one eliminates it completely; and the same is true if one eliminates the fireman. The 'product' of this indivisible team of engineer and fireman obeys a law of all or nothing, and there is no 'marginal product' of the one that can be separated from the other. The same thing goes on the shop floor, and ultimately for the modern factory as a whole, where jobs are closely interdependent."* [Cornelius Castoriadis, **Political and Social Writings**, vol. 3, p. 213] Kropotkin made the same point, arguing it *"is utterly impossible to draw a distinction between the work"* of the individuals collectively producing a product as all *"contribute ... in proportion to their strength, their energy, their knowledge, their intelligence, and their skill."* [**The Conquest of Bread**, p. 170 and p. 169]

This suggests another explanation for the existence of profits than the "marginal productivity" of capital. Let us assume, as argued in marginal productivity theory, that a worker receives exactly what she has produced because if she ceases to work, the total product will decline by precisely the value of her wage. However, this argument has a flaw in it. This is because the total product will decline by more than that value if two or more workers leave. This is because the wage each worker receives under conditions of perfect competition is assumed to be the product of the

last labourer in neo-classical theory. The neo-classical argument presumes a "declining marginal productivity," i.e. the marginal product of the last worker is assumed to be less than the second last and so on. In other words, in neo-classical economics, all workers bar the mythical "last worker" do not receive the full product of their labour. They only receive what the **last** worker is claimed to produce and so everyone **bar** the last worker does not receive exactly what he or she produces. In other words, all the workers are exploited bar the last one.

However, this argument forgets that co-operation leads to increased productivity which the capitalists appropriate for themselves. This is because, as Proudhon argued, *"the capitalist has paid as many times one day's wages"* rather than the workers collectively and, as such, *"he has paid nothing for that immense power which results from the union and harmony of labourers, and the convergence and simultaneousness of their efforts. Two hundred grenadiers stood the obelisk of Luxor upon its base in a few hours; do you suppose that one man could have accomplished the same task in two hundred days? Nevertheless, on the books of the capitalist, the amount of wages would have been the same."* Therefore, the capitalist has *"paid all the individual forces"* but *"the collective force still remains to be paid. Consequently, there remains a right of collective property"* which the capitalist *"enjoy[s] unjustly."* [**What is Property?**, p. 127 and p. 130]

As usual, therefore, we must distinguish between the ideology and reality of capitalism. As we indicated in section C.1, the model of perfect competition has no relationship with the real world. Unsurprisingly, marginal productivity theory is likewise unrelated to reality. This means that the assumptions required to make "marginal productivity" theory work are so unreal that these, in themselves, should have made any genuine scientist reject the idea out of hand. Note, we are **not** opposing abstract theory, **every** theory abstracts from reality is some way. We are arguing that, to be valid, a theory has to reflect the real situation it is seeking to explain in some meaningful way. Any abstractions or assumptions used must be relatively trivial and, when relaxed, not result in the theory collapsing. This is not the case with marginal productivity theory. It is important to recognise that there are degrees of abstraction. There are *"negligibility assumptions"* which state that some aspect of reality has little or no effect on what is being analysed. Sadly for marginal productivity theory, its assumptions are not of this kind. Rather, they are *"domain assumptions"* which specify *"the conditions under which a particular theory will apply. If those conditions do not apply, then neither does the theory."* [Steve Keen, **Debunking Economics**, p. 151] This is the case here.

However, most economists will happily ignore this critique for, as noted repeatedly, basing economic theory on reality or realistic models is not considered a major concern by neoclassical economists. However, "marginal productivity" theory applied to capital is riddled with logical inconsistencies which show that it is simply wrong. In the words of the noted left-wing economist Joan Robinson:

> *"The neo-classicals evidently had not been told that the neo-classical theory did not contain a solution of the problems of profits or of the value of capital. They have erected a towering structure of mathematical theorems on a foundation that does not exist. Recently [in the 1960s, leading neo-classical economist] Paul Samuelson was sufficiently candid to admit that the basis of his system does not hold, but the theorems go on pouring out just the same."* [**Contributions to Modern Economics**, p. 186]

If profits **are** the result of private property and the inequality it produces, then it is unsurprising that neoclassical theory would be as foundationless as Robinson argues. After all, this is a

political question and neo-classical economics was developed to ignore such questions. Marginal productivity theory has been subject to intense controversy, precisely because it claims to show that labour is not exploited under capitalism (i.e. that each factor gets what it contributes to production). We will now summarise this successful criticism.

The first major theoretical problem is obvious: how do you measure capital? In neoclassical economics, capital is referred to as machinery of all sorts as well as the workplaces that house them. Each of these items is, in turn, made up of a multitude of other commodities and many of these are assemblies of other commodities. So what does it mean to say, as in marginal productivity theory, that "capital" is varied by one unit? The only thing these products have in common is a price and that is precisely what economists **do** use to aggregate capital. Sadly, though, shows *"that there is no meaning to be given to a 'quantity of capital' apart from the rate of profit, so that the contention that the 'marginal product of capital' determines the rate of profit is meaningless."* [Robinson, **Op. Cit**., p. 103] This is because argument is based on circular reasoning:

> *"For long-period problems we have to consider the meaning of the rate of profit on capital … the value of capital equipment, reckoned as its future earnings discounted at a rate of interest equal to the rate of profit, is equal to its initial cost, which involves prices including profit at the same rate on the value of the capital involved in producing it, allowing for depreciation at the appropriate rate over its life up to date.*
>
> *"The value of a stock of capital equipment, therefore, involves the rate of profit. There is no meaning in a 'quantity of capital' apart from the rate of profit."* [**Collected Economic Papers**, vol. 4, p. 125]

Looking at it another way, neo-classical economics seeks to simultaneously solve the problems of production and income distribution. It attempts to show how the level of employment of capital and labour is determined as well as how national income is divided between the two. The latter is done by multiplying the quantities of labour and capital by the equilibrium wage and interest rate, respectively. In the long term, equilibrium conditions are governed by the net marginal productivity of each factor, with each supplied until its net marginal revenue is zero. This is why the market rate of interest is used as capital is assumed to have marginal productivity and the existing market interest reflects that.

Yet in what sense can we say that capital has marginal productivity? How is the stock of capital to be measured? One measure is to take the present value of the income stream expected to accrue to capital owners. However, where does this discount rate and net income stream come from? To find a value for these, it is necessary to estimate a national income and the division of income between labour and capital but that is what the analysis was meant to produce. In other words, the neo-classical theory requires assumptions which are, in fact, the solution. This means that value of capital is dependent on the distribution of income. As there is no rationale offered for choosing one income distribution over another, the neo-classical theory does not solve the problem it set out to investigate but rather simply assumes it away. It is a tautology. It asks how the rate of profit is determined and answers by referencing the quantity of capital and its marginal revenue product. When asked how these are determined, the reply is based on assuming a division of future income and the discounting of the returns of capital with the market rate of interest. That is, it simply says that the market rate of interest is a function of the market rate of interest (and an assumed distribution of income).

In other words, according to neoclassical theory, the rate of profit and interest depends on the amount of capital, and the amount of capital depends on the rate of profit and interest. One has to assume a rate of profit in order to demonstrate the equilibrium rate of return is determined. This issue is avoided in neo-classical economics simply by ignoring it (it must be noted that the same can be said of the "Austrian" concept of *"roundaboutness"* as *"it is impossible to define one way of producing a commodity as 'more roundabout' than another independently of the rate of profit … Therefore the Austrian notion of roundaboutness is as internally inconsistent as the neoclassical concept of the marginal productivity of capital."* [Steve Keen, **Debunking Economics**, p. 302]).

The next problem with the theory is that "capital" is treated as something utterly unreal. Take, for example, leading neoclassical Dennis Robertson's 1931 attempt to explain the marginal productivity of labour when holding "capital" constant:

> *"If ten men are to be set out to dig a hole instead of nine, they will be furnished with ten cheaper spades instead of nine more expensive ones; or perhaps if there is no room for him to dig comfortably, the tenth man will be furnished with a bucket and sent to fetch beer for the other nine."* [*"Wage-grumbles"*, **Economic Fragments**, p. 226]

So to work out the marginal productivity of the factors involved, *"ten cheaper spades"* somehow equals nine more expensive spades? How is this keeping capital constant? And how does this reflect reality? Surely, any real world example would involve sending the tenth digger to get another spade? And how do nine expensive spades become nine cheaper ones? In the real world, this is impossible but in neoclassical economics this is not only possible but required for the theory to work. As Robinson argued, in neo-classical theory the *"concept of capital all the man-made factors are boiled into one, which we may call **leets** … [which], though all made up of one physical substance, is endowed with the capacity to embody various techniques of production … and a change of technique can be made simply by squeezing up or spreading out leets, instantaneously and without cost."* [**Contributions to Modern Economics**, p. 106]

This allows economics to avoid the obvious aggregation problems with "capital", make sense of the concept of adding an extra unit of capital to discover its "marginal productivity" and allows capital to be held "constant" so that the "marginal productivity" of labour can be found. For when *"the stock of means of production in existence can be represented as a quantity of ectoplasm, we can say, appealing to Euler's theorem, that the rent per unit of ectoplasm is equal to the marginal product of the given quantity of ectoplasm when it is fully utilised. This does seem to add anything of interest to the argument."* [**Op. Cit.**, p. 99] This ensures reality has to be ignored and so economic theory need not discuss any practical questions:

> *"When equipment is made of leets, there is no distinction between long and short-period problems … Nine spades are lumps of leets; when the tenth man turns up it is squeezed out to provide him with a share of equipment nine-tenths of what each man had before … There is no room for imperfect competition. There is no possibility of disappointed expectations … There is no problem of unemployment … Unemployed workers would bid down wages and the pre-existing quantity of leets would be spread out to accommodate them."* [**Op. Cit.**, p. 107]

The concept that capital goods are made of ectoplasm and can be remoulded into the profit maximising form from day to day was invented in order to prove that labour and capital both receive their contribution to society, to show that labour is not exploited. It is not meant to be taken literally, it is only a parable, but without it the whole argument (and defence of capitalism) collapses. Once capital equipment is admitted to being actual, specific objects that cannot be squeezed, without cost, into new objects to accommodate more or less workers, such comforting notions that profits equal the (marginal) contribution of "capital" or that unemployment is caused by wages being too high have to be discarded for the wishful thinking they most surely are.

The last problem arises when ignore these issues and assume that marginal productivity theory is correct. Consider the notion of the short run, where at least one factor of production cannot be varied. To determine its marginal productivity then capital has to be the factor which is varied. However, common sense suggests that capital is the least flexible factor and if that can be varied then every other one can be as well? As dissident economist Piero Sraffa argued, when a market is defined broadly enough, then the key neoclassical assumption that the demand and supply of a commodity are independent breaks down. This was applied by another economist, Amit Bhaduri, to the "capital market" (which is, by nature, a broadly defined industry). Steve Keen usually summarises these arguments, noting that *"at the aggregate level [of the economy as a whole], the desired relationship — the rate of profit equals the marginal productivity of capital — will not hold true"* as it only applies *"when the capital to labour ratio is the same in all industries — which is effectively the same as saying there is only one industry."* This *"proves Sraffa's assertion that, when a broadly defined industry is considered, changes in its conditions of supply and demand will affect the distribution of income."* This means that a *"change in the capital input will change output, but it also changes the wage, and the rate of profit ... As a result, the distribution of income is neither meritocratic nor determined by the market. The distribution of income is to some significant degree determined independently of marginal productivity and the impartial blades of supply and demand ... To be able to work out prices, it is first necessary to know the distribution of income ... There is therefore nothing sacrosanct about the prices that apply in the economy, and equally nothing sacrosanct about the distribution of income. It reflects the relative power of different groups in society."* [**Op. Cit.**, p. 135]

It should be noted that this critique bases itself on the neoclassical assumption that it is possible to define a factor of production called capital. In other words, even if we assume that neo-classical economics theory of capital is not circular reasoning, it's theory of distribution is still logically wrong.

So mainstream economics is based on a theory of distribution which is utterly irrelevant to the real world and is incoherent when applied to capital. This would not be important except that it is used to justify the distribution of income in the real world. For example, the widening gap between rich and poor (it is argued) simply reflects a market efficiently rewarding more productive people. Thus the compensation for corporate chief executives climbs so sharply because it reflects their marginal productivity. Except, of course, the theory supports no such thing — except in a make believe world which cannot exist (lassiez fairy land, anyone?).

It must be noted that this successful critique of neoclassical economics by dissident economists was first raised by Joan Robinson in the 1950s (it usually called the Cambridge Capital Controversy). It is rarely mentioned these days. While most economic textbooks simply repeat the standard theory, the fact is that this theory has been successfully debunked by dissident economists over four decades go. As Steve Keen notes, while leading neoclassical economists admitted that the critique was correct in the 1960s, today *"economic theory continues to use exactly the same concepts which Sraffa's critique showed to be completely invalid"* in spite the *"definitive capitulation* *by as significant an economist as Paul Samuelson."* As he concludes: *"There is no better sign of the intellectual bankruptcy of economics than this."* [**Op. Cit.**, p. 146, p. 129 and p. 147]

Why? Simply because the Cambridge Capital Controversy would expose the student of economics to some serious problems with neo-classical economics and they may start questioning the internal consistency of its claims. They would also be exposed to alternative economic theories and start to question whether profits **are** the result of exploitation. As this would put into jeopardy the role of economists as, to quote Marx, the *"hired prize-fighters"* for capital who replace *"genuine scientific research"* with *"the bad conscience and evil intent of apologetics."* Unsurprisingly, he characterised this as *"vulgar economics."* [**Capital**, vol. 1, p. 97]

C.2.6 Does interest represent the "time value" of money?

One defence of interest is the notion of the "time value" of money, that individuals have different "time preferences." Most individuals prefer, it is claimed, to consume now rather than later while a few prefer to save now on the condition that they can consume more later. Interest, therefore, is the payment that encourages people to defer consumption and so is dependent upon the subjective evaluations of individuals. It is, in effect, an exchange over time and so surplus value is generated by the exchange of present goods for future goods.

Based on this argument, many supporters of capitalism claim that it is legitimate for the person who provided the capital to get back **more** than they put in, because of the "time value of money." This is because investment requires savings and the person who provides those had to postpone a certain amount of current consumption and only agree to do this only if they get an increased amount later (i.e. a portion, over time, of the increased output that their saving makes possible). This plays a key role in the economy as it provide the funds from which investment can take place and the economy grow.

In this theory, interest rates are based upon this "time value" of money and the argument is rooted in the idea that individuals have different "time preferences." Some economic schools, like the Austrian school, argue that the actions by banks and states to artificially lower interest rates (by, for example, creating credit or printing money) create the business cycle as this distorts the information about people's willingness to consume now rather than later leading to over investment and so to a slump.

That the idea of doing nothing (i.e. not consuming) can be considered as productive says a lot about capitalist theory. However, this is beside the point as the argument is riddled with assumptions and, moreover, ignores key problems with the notion that savings always lead to investment.

The fundamental weakness of the theory of time preference must be that it is simply an unrealistic theory and does not reflect where the supply of capital does come from. It **may** be appropriate to the decisions of households between saving and consumption, but the main source of new capital is previous profit under capitalism. The motivation of making profits is not the provision of future means of consumption, it is profits for their own sake. The nature of capitalism requires profits to be accumulated into capital for if capitalists **did** only consume the system would break down. While from the point of view of the mainstream economics such profit-making for its own sake is irrational in reality it is imposed on the capitalist by capitalist competition. It is only by constantly investing, by introducing new technology, work practices and products, can the capitalists keep their capital (and income) intact. Thus the motivation of capitalists to invest is imposed on them by the capitalist system, not by subjective evaluations between consuming more later rather than now.

Ignoring this issue and looking at the household savings, the theory still raises questions. The most obvious problem is that an individual's psychology is conditioned by the social situation they find themselves in. Ones "time preference" is determined by ones social position. If one has more than enough money for current needs, one can more easily "discount" the future (for example, workers will value the future product of their labour less than their current wages simply because without those wages there will be no future). We will discuss this issue in more detail later and will not do so here (see section C.2.7).

The second thing to ask is why should the supply price of waiting be assumed to be positive? If the interest rate simply reflects the subjective evaluations of individuals then, surely, it could be negative or zero. Deferred gratification is as plausible a psychological phenomenon as the overvaluation of present satisfactions, while uncertainty is as likely to produce immediate consumption as it is to produce provision for the future (saving). Thus Joan Robinson:

> *"The rate of interest (excess of repayment over original loan) would settle at the level which equated supply and demand for loans. Whether it was positive or negative would depend upon whether spendthrifts or prudent family men happened to predominate in the community. There is no* ***a priori*** *presumption in favour of a positive rate. Thus, the rate of interest cannot be account for as the 'cost of waiting.'*
>
> *"The reason why there is always a demand for loans at a positive rate of interest, in an economy where there is property in the means of production and means of production are scarce, is that finance expended now can be used to employ labour in productive processes which will yield a surplus in the future over costs of production. Interest is positive because profits are positive (though at the same time the cost and difficulty of obtaining finance play a part in keeping productive equipment scarce, and so contribute to maintaining the level of profits)."* [**Contributions to Modern Economics**, p. 83]

It is only because money provides the authority to allocate resources and exploit wage labour that money now is more valuable (*"we know that mere saving itself brings in nothing, so long as the pence saved are not used to exploit."* [Kropotkin, **The Conquest of Bread**, p. 59]). The capitalist does not supply "time" (as the "time value" theory argues), the loan provides authority/power and so the interest rate does not reflect "time preference" but rather the utility of the loan to capitalists, i.e. whether it can be used to successfully exploit labour. If the expectations of profits by capitalists are low (as in, say, during a depression), loans would not be desired no matter how low the interest rate became. As such, the interest rate is shaped by the general profit level and so be independent of the "time preference" of individuals.

Then there is the problem of circularity. In any real economy, interest rates obviously shape people's saving decisions. This means that an individual's "time preference" is shaped by the thing it is meant to explain:

> *"But there may be some savers who have the psychology required by the text books and weigh a preference for present spending against an increment of income (interest, dividends and capital gains) to be had from an increment of wealth. But what then? Each*

> *individual goes on saving or dis-saving till the point where his individual subjective rate of discount is equal to the market rate of interest. There has to be a market rate of interest for him to compare his rate of discount to."* [Joan Robinson, **Op. Cit.**, pp. 11–12]

Looking at the individuals whose subjective evaluations allegedly determine the interest rate, there is the critical question of motivation. Looking at lenders, do they **really** charge interest because they would rather spend more money later than now? Hardly, their motivation is far more complicated than that. It is doubtful that many people actually sit down and work out how much their money is going to be "worth" to them a year or more from now. Even if they did, the fact is that they really have no idea how much it will be worth. The future is unknown and uncertain and, consequently, it is implausible that "time preference" plays the determining role in the decision making process.

In most economies, particularly capitalism, the saver and lender are rarely the same person. People save and the banks use it to loan it to others. The banks do not do this because they have a low "time preference" but because they want to make profits. They are a business and make their money by charging more interest on loans than they give on savings. Time preference does not enter into it, particularly as, to maximise profits, banks loan out more (on credit) than they have in savings and, consequently, make the actual interest rate totally independent of the rate "time preference" would (in theory) produce.

Given that it would be extremely difficult, indeed impossible, to stop banks acting in this way, we can conclude that even if "time preference" were true, it would be of little use in the real world. This, ironically, is recognised by the same free market capitalist economists who advocate a "time preference" perspective on interest. Usually associated with the "Austrian" school, they argue that banks should have 100% reserves (i.e. they loan out only what they have in savings, backed by gold). This implicitly admits that the interest rate does not reflect "time preference" but rather the activities (such as credit creation) of banks (not to mention other companies who extend business credit to consumers). As we discuss in section C.8, this is not due to state meddling with the money supply or the rate of interest but rather the way capitalism works.

Moreover, as the banking industry is marked, like any industry, by oligopolistic competition, the big banks will be able to add a mark up on services, so distorting any interest rates set even further from any abstract "time preference" that exists. Therefore, the structure of that market will have a significant effect on the interest rate. Someone in the same circumstances with the same "time preference" will get radically different interest rates depending on the "degree of monopoly" of the banking sector (see section C.5 for "degree of monopoly"). An economy with a multitude of small banks, implying low barriers of entry, will have different interest rates than one with a few big firms implying high barriers (if banks are forced to have 100% gold reserves, as desired by many "free market" capitalists, then these barriers may be even higher). As such, it is highly unlikely that "time preference" rather than market power is a more significant factor in determining interest rates in any **real** economy. Unless, of course, the rather implausible claim is made that the interest rate would be the same no matter how competitive the banking market was — which, of course, is what the "time preference" argument does imply.

Nor is "time preference" that useful when we look at the saver. People save money for a variety of motives, few (if any) of which have anything to do with "time preference." A common motive is, unsurprisingly, uncertainty about the future. Thus people put money into savings accounts to cover possible mishaps and unexpected developments (as in *"saving for a rainy day"*). Indeed, in an uncertain world future money may be its own reward for immediate consumption is often a risky thing to do as it reduces the ability to consumer in the future (for example, workers facing unemployment in the future could value the same amount of money more then than now). Given that the future is uncertain, many save precisely for precautionary reasons and increasing current consumption is viewed as a disutility as it is risky behaviour. Another common reason would be to save because they do not have enough money to buy what they want now. This is particularly the case with working class families who face stagnating or falling income or face financial difficulties.[Henwood, **Wall Street**, p. 65] Again, "time preference" does not come into it as economic necessity forces the borrowers to consume more now in order to be around in the future.

Therefore, money lending is, for the poor person, not a choice between more consumption now/less later and less consumption now/more later. If there is no consumption now, there will not be any later. So not everybody saves money because they want to be able to spend more at a future date. As for borrowing, the real reason for it is necessity produced by the circumstances people find themselves in. As for the lender, their role is based on generating a current and future income stream, like any business. So if "time preference" seems unlikely for the lender, it seems even more unlikely for the borrower or saver. Thus, while there is an element of time involved in decisions to save, lend and borrow, it would be wrong to see interest as the consequence of "time preference." Most people do not think in terms of it and, therefore, predicting their behaviour using it would be silly.

At the root of the matter is that for the vast majority of cases in a capitalist economy, an individual's "time preference" is determined by their social circumstances, the institutions which exist, uncertainty and a host of other factors. As inequality drives "time preference," there is no reason to explain interest rates by the latter rather than the former. Unless, of course, you are seeking to rationalise and justify the rich getting richer. Ultimately, interest is an expression of inequality, **not** exchange:

> *"If there is chicanery afoot in calling 'money now' a different good than 'money later,' it is by no means harmless, for the intended effect is to subsume money lending under the normative rubric of exchange ... [but] there are obvious differences ... [for in normal commodity exchange] both parties have something [while in loaning] he has something you don't ... [so] inequality dominates the relationship. He has more than you have now, and he will get back more than he gives."* [Schweickart, **Against Capitalism**, p. 23]

While the theory is less than ideal, the practice is little better. Interest rates have numerous perverse influences in any real economy. In neo-classical and related economics, saving does not have a negative impact on the economy as it is argued that non-consumed income must be invested. While this could be the case when capitalism was young, when the owners of firms ploughed their profits back into them, as financial institutions grew this became less so. Saving and investment became different activities, governed by the rate of interest. If the supply of savings increased, the interest rate would drop and capitalists would invest more. If the demand for loans increased, then the interest rate would rise, causing more savings to occur.

While the model is simple and elegant, it does have its flaws. These are first analysed by Keynes during the Great Depression of the 1930s, a depression which the neo-classical model said was impossible.

For example, rather than bring investment into line with savings, a higher interest can cause savings to fall as *"[h]ousehold saving, of course, is mainly saving up to spend later, and … it is likely to respond the wrong way. A higher rate of return means that 'less' saving is necessary to get a given pension or whatever."* [Robinson, **Op. Cit.**, p. 11] Similarly, higher interest rates need not lead to higher investment as higher interest payments can dampen profits as both consumers and industrial capitalists have to divert more of their finances away from real spending and towards debt services. The former causes a drop in demand for products while the latter leaves less for investing.

As argued by Keynes, the impact of saving is not as positive as some like to claim. Any economy is a network, where decisions affect everyone. In a nutshell, the standard model fails to take into account changes of income that result from decisions to invest and save (see Michael Stewart's **Keynes and After** for a good, if basic, introduction). This meant that if some people do not consume now, demand falls for certain goods, production is turned away from consumption goods, and this has an effect on all. Some firms will find their sales failing and may go under, causing rising unemployment. Or, to put it slightly differently, aggregate demand — and so aggregate supply — is changed when some people postpone consumption, and this affects others. The decrease in the demand for consumer goods affects the producers of these goods. With less income, the producers would reduce their expenditure and this would have repercussions on other people's incomes. In such circumstances, it is unlikely that capitalists would be seeking to invest and so rising savings would result in falling investment in spite of falling interest rates. In an uncertain world, investment will only be done if capitalists think that they will end up with more money than they started with and this is unlikely to happen when faced with falling demand.

Whether rising interest rates do cause a crisis is dependent on the strength of the economy. During a strong expansion, a modest rise in interest rates may be outweighed by rising wages and profits. During a crisis, falling rates will not counteract the general economic despair. Keynes aimed to save capitalism from itself and urged state intervention to counteract the problems associated with free market capitalism. As we discuss in section C.8.1, this ultimately failed partly due to the mainstream economics gutting Keynes' work of key concepts which were incompatible with it, partly due to Keynes' own incomplete escape from neoclassical economics, partly due the unwillingness of rentiers to agree to their own euthanasia but mostly because capitalism is inherently unstable due to the hierarchical (and so oppressive and exploitative) organisation of production.

Which raises the question of whether someone who saves deserve a reward for so doing? Simply put, no. Why? Because the act of saving is no more an act of production than is purchasing a commodity (most investment comes from retained profits and so the analogy is valid). Clearly the reward for purchasing a commodity is that commodity. By analogy, the reward for saving should be not interest but one's savings — the ability to consume at a later stage. Particularly as the effects of interest rates and savings can have such negative impacts on the rest of the economy. It seems strange, to say the least, to reward people for helping do so. Why should someone be rewarded for a decision which may cause companies to go bust, so **reducing** the available means of production as reduced demand results in job loses and idle factories? Moreover, this problem *"becomes ever more acute the richer or more inegalitarian the society becomes, since wealthy people tend to save more than poor people."* [Schweickart, **After Capitalism**, p. 43]

Supporters of capitalists assume that people will not save unless promised the ability to consume **more** at a later stage, yet close examination of this argument reveals its absurdity. People in many different economic systems save in order to consume later, but only in capitalism is it assumed that they need a reward for it beyond the reward of having those savings available for consumption later. The peasant farmer "defers consumption" in order to have grain to plant next year, even the squirrel "defers consumption" of nuts in order to have a stock through winter. Neither expects to see their stores increase in size over time. Therefore, saving is rewarded by saving, as consuming is rewarded by consuming. In fact, the capitalist "explanation" for interest has all the hallmarks of apologetics. It is merely an attempt to justify an activity without careful analysing it.

To be sure, there is an economic truth underlying this argument for justifying interest, but the formulation by supporters of capitalism is inaccurate and unfortunate. There is a sense in which 'waiting' is a condition for capital **increase**, though not for capital per se. Any society which wishes to increase its stock of capital goods may have to postpone some gratification. Workplaces and resources turned over to producing capital goods cannot be used to produce consumer items, after all. How that is organised differs from society to society. So, like most capitalist economics there is a grain of truth in it but this grain of truth is used to grow a forest of half-truths and confusion.

As such, this notion of "waiting" only makes sense in a 'Robinson Crusoe" style situation, **not** in any form of real economy. In a real economy, we do not need to "wait" for our consumption goods until investment is complete since the division of labour/work has replaced the succession in time by a succession in place. We are dealing with an already well developed system of **social** production and an economy based on a social distribution of labour in which there are available all the various stages of the production process. As such, the notion that "waiting" is required makes little sense. This can be seen from the fact that it is not the capitalist who grants an advance to the worker. In almost all cases the worker is paid by their boss **after** they have completed their work. That is, it is the worker who makes an advance of their labour power to the capitalist. This waiting is only possible because *"no species of labourer depends on any previously prepared stock, for in fact no such stock exists; but every species of labourer does constantly, and at all times, depend for his supplies on the co-existing labour of some other labourers."* [Thomas Hodgskin, **Labour Defended Against the Claims of Capital**] This means that the workers, as a class, creates the fund of goods out of which the capitalists pay them.

Ultimately, selling the use of money (paid for by interest) is not the same as selling a commodity. The seller of the commodity does not receive the commodity back as well as its price, unlike the typical lender of money. In effect, as with rent and profits, interest is payment for permission to use something and, therefore, not a productive act which should be rewarded. It is **not** the same as other forms of exchange. Proudhon pointed out the difference:

> *"Comparing a loan to a **sale**, you say: Your argument is as valid against the latter as against the former, for the hatter who sells hats does not **deprive** himself.*
>
> *"No, for he receives for his hats — at least he is reputed to receive for them — their exact value immediately, neither **more** nor **less**. But the capitalist lender not only is not deprived, since he recovers his capital intact, but he receives more than his capital, more than he contributes to the exchange; he receives in addition to his capital an interest which represents no positive product on his part. Now, a service which costs no labour to*

> *him who renders it is a service which may become gratuitous."* [**Interest and Principal: The Circulation of Capital, Not Capital Itself, Gives Birth to Progress**]

The reason why interest rates do not fall to zero is due to the class nature of capitalism, **not** "time preference." That it is ultimately rooted in social institutions can be seen from Böhm-Bawerk's acknowledgement that monopoly can result in exploitation by increasing the rate of interest above the rate specified by "time preference" (i.e. the market):

> *"Now, of course, the circumstances unfavourable to buyers may be corrected by active competition among sellers … But, every now and then, something will suspend the capitalists' competition, and then those unfortunates, whom fate has thrown on a local market ruled by monopoly, are delivered over to the discretion of the adversary. Hence direct usury, of which the poor borrower is only too often the victim; and hence the low wages forcibly exploited from the workers…*
>
> *"It is not my business to put excesses like these, where there actually is exploitation, under the aegis of that favourable opinion I pronounced above as to the essence of interest. But, on the other hand, I must say with all emphasis, that what we might stigmatise as 'usury' does not consist in the obtaining of a gain out of a loan, or out of the buying of labour, but in the immoderate extent of that gain … Some gain or profit on capital there would be if there were no compulsion on the poor, and no monopolising of property; and some gain there must be. It is only the height of this gain where, in particular cases, it reaches an excess, that is open to criticism, and, of course, the very unequal conditions of wealth in our modern communities bring us unpleasantly near the danger of exploitation and of usurious rates of interest."* [**The Positive Theory of Capital**, p. 361]

Little wonder, then, that Proudhon continually stressed the need for working people to organise themselves and credit (which, of course, they would have done naturally, if it were not for the state intervening to protect the interests, income and power of the ruling class, i.e. of itself and the economically dominant class). If, as Böhm-Bawerk admitted, interest rates could be high due to institutional factors then, surely, they do not reflect the "time preferences" of individuals. This means that they could be lower (effectively zero) if society organised itself in the appropriate manner. The need for savings could be replaced by, for example, co-operation and credit (as already exists, in part, in any developed economy). Organising these could ensure a positive cycle of investment, growth and savings (Keynes, it should be noted, praised Proudhon's follower Silvio Gesell in **The General Theory**. For a useful discussion see Dudley Dillard's essay *"Keynes and Proudhon"* [**The Journal of Economic History**, vol. 2, No. 1, pp. 63–76]).

Thus the key flaw in the theory is that of capitalist economics in general. By concentrating on the decisions of individuals, it ignores the social conditions in which these decisions are made. By taking the social inequalities and insecurities of capitalism as a given, the theory ignores the obvious fact that an individual's "time preference" will be highly shaped by their circumstances. Change those circumstances and their "time preference" will also change. In other words, working people have a different "time preference" to the rich because they are poorer. Similarly, by focusing on individuals, the "time preference" theory fails to take into account the institutions of a given society. If working class people have access to credit in other forms than those supplied by capitalists then their "time preference" will differ radically. As an example, we need only look at credit unions. In communities with credit unions the poor are less likely to agree to get into an agreement from a loan shark. It seems unlikely, to say the least, that the "time preference" of those involved have changed. They are subject to the same income inequalities and pressures as before, but by uniting with their fellows they give themselves better alternatives.

As such, "time preference" is clearly not an independent factor. This means that it cannot be used to justify capitalism or the charging of interest. It simply says, in effect, that in a society marked by inequality the rich will charge the poor as much interest as they can get away with. This is hardly a sound basis to argue that charging interest is a just or a universal fact. It reflects social inequality, the way a given society is organised and the institutions it creates. Put another way, there is no "natural" rate of interest which reflects the subjective "time preferences" of abstract individuals whose decisions are made without any social influence. Rather, the interest rate depends on the conditions and institutions within the economy as a whole. The rate of interest is positive under capitalism because it is a class society, marked by inequality and power, **not** because of the "time preference" of abstract individuals.

In summary, providing capital and charging interest are not productive acts. As Proudhon argued, *"all rent received (nominally as damages, but really as payment for a loan) is an act of property — of robbery."* [**What is Property**, p. 171]

C.2.7 Are interest and profit not the reward for waiting?

Another defence of surplus value by capitalist economics is also based on time. This argument is related to the "time preference" one we have discussed in the last section and is, likewise, rooted in the idea that money now is different than money later and, as a consequence, surplus value represents (in effect) an exchange of present goods for future ones. This argument has two main forms, depending on whether it is interest or profits which are being defended, but both are based on this perspective. We will discuss each in turn.

One of the oldest defences of interest is the "abstinence" theory first postulated by Nassau Senior in 1836. For Senior, abstinence is a sacrifice of present enjoyment for the purpose achieving some distant result. This demands the same heavy sacrifice as does labour, for to *"abstain from the enjoyment which is in our power, or to seek distant rather than immediate results, are among the most painful exertions of the human will."* Thus wages and interest/profit *"are to be considered as the rewards of peculiar sacrifices, the former the remuneration for labour, and the latter for abstinence from immediate enjoyment."* [**An Outline of the Science of Political Economy**, p. 60 and p. 91]

Today, the idea that interest is the reward for "abstinence" on the part of savers is still a common one in capitalist economics. However, by the end of the nineteenth century, Senior's argument had become known as the "waiting" theory while still playing the same role in justifying non-labour income. One of the leading neo-classical economists of his day, Alfred Marshall, argued that *"[i]f we admit [a commodity] is the product of labour alone, and not of labour and waiting, we can no doubt be compelled by an inexorable logic to admit that there is no justification of interest, the reward for waiting."* [**Principles of Economics**, p. 587] While implicitly recognising that labour is the source of all value in capitalism (and that abstinence is not the **source** of profits), it is claimed that interest is a justifiable claim on the surplus value produced by a worker.

Why is this the case? Capitalist economics claims that by "deferring consumption," the capitalist allows new means of production to be developed and so should be rewarded for this sacrifice. In other words, in order to have capital available as an input — i.e. to bear costs now for returns in the future — someone has to be willing to postpone his or her consumption. That is a real cost, and one that people will pay only if rewarded for it:

> *"human nature being what it is, we are justified in speaking of the interest on capital as the reward of the sacrifice involved in waiting for the enjoyment of material resources, because few people would save much without reward; just as we speak of wages as the reward of labour, because few people would work hard without reward."* [**Op. Cit.**, p. 232]

The interest rate is, in neo-classical economic theory, set when the demand for loans meets the supply of savings. The interest rate stems from the fact that people prefer present spending over future spending. If someone borrows £200 for one year at 5%, this is basically the same as saying that there would rather have £200 now than £210 a year from now. Thus interest is the cost of providing a service, namely time. People are able to acquire today what they would otherwise not have until sometime in the future. With a loan, interest is the price of the advantage obtained from having money immediately rather than having to wait for.

This, on first appears, seems plausible. If you accept the logic of capitalist economics and look purely at individuals and their preferences independently of their social circumstances then it can make sense. However, once you look wider you start to see this argument start to fall apart. Why is it that the wealthy are willing to save and provide funds while it is the working class who do not save and get into debt? Surely a person's *"time preference"* is dependent on their socio-economic position? As we argued in the last section, this means that any subjective evaluation of the present and future is dependent on, not independent of, the structure of market prices and income distribution. It varies with the income of individual and their class position, since the latter will condition the degree or urgency of present wants and needs.

So this theory appears ludicrous to a critic of capitalism — simply put, does the mine owner really sacrifice more than a miner, a rich stockholder more than an autoworker working in their car plant, a millionaire investor more than a call centre worker? As such, the notion that "waiting" explains interest is question begging in the extreme as it utterly ignores inequality within a society. After all, it is far easier for a rich person to "defer consumption" than for someone on an average income. This is borne out by statistics, for as Simon Kuznets has noted, *"only the upper income groups save; the total savings of groups below the top decile are fairly close to zero."* [**Economic Growth and Structure**, p. 263] Obviously, therefore, in modern society it is the capitalist class, the rich, who refrain from expending their income on immediate consumption and *"abstain."* Astonishingly, working class people show no such desire to abstain from spending their wages on immediate consumption. It does not take a genius to work out why, although many economists have followed Senior in placing the blame on working class lack of abstinence on poor education rather than, say, the class system they live in (for Senior, *"the worse educated"* classes *"are always the most improvident, and consequently the least abstinent."* [**Op. Cit.**, p. 60]).

Therefore, the plausibility of interest as payment for the pain of deferring consumption rests on the premise that the typical saving unit is a small or medium-income household. But in contemporary capitalist societies, this is not the case. Such households are not the source of most savings; the bulk of interest payments do not go to them. As such, interest is the dependent factor and so "waiting" cannot explain interest. Rather, interest is product of social inequality and the social relationships produced by an economy. Lenders lend because they have the funds to do so while borrowers borrow because without money now they may not be around later. As those with funds are hardly going without by lending, it does not make much sense to argue that they would spend even more today without the temptation of more income later.

To put this point differently, the capitalist proponents of interest only consider "postponing consumption" as an abstraction, without making it concrete. For example, a capitalist may "postpone consumption" of his 10th Rolls Royce because he needs the money to upgrade some machinery in his factory; whereas a single mother may have to "postpone consumption" of food or adequate housing in order to attempt to better take care of her children. The two situations are vastly different, yet the capitalist equates them. This equation implies that "not being able to buy anything you want" is the same as "not being able to buy things you need", and is thus skewing the obvious difference in costs of such postponement of consumption!

Thus Proudhon's comments that the loaning of capital *"does not involve an actual sacrifice on the part of the capitalist"* and so *"does not deprive himself… of the capital which be lends. He lends it, on the contrary, precisely because the loan is not a deprivation to him; he lends it because he has no use for it himself, being sufficiently provided with capital without it; be lends it, finally, because he neither intends nor is able to make it valuable to him personally, — because, if he should keep it in his own hands, this capital, sterile by nature, would remain sterile, whereas, by its loan and the resulting interest, it yields a profit which enables the capitalist to live without working. Now, to live without working is, in political as well as moral economy, a contradictory proposition, an impossible thing."* [**Interest and Principal: A Loan is a Service**]

In other words, contra Marshall, saving is **not** a sacrifice for the wealthy and, as such, not deserving a reward. Proudhon goes on:

> *"The proprietor who possesses two estates, one at Tours, and the other at Orleans, and who is obliged to fix his residence on the one which he uses, and consequently to abandon his residence on the other, can this proprietor claim that he deprives himself of anything, because he is not, like God, ubiquitous in action and presence? As well say that we who live in Paris are deprived of a residence in New York! Confess, then, that the privation of the capitalist is akin to that of the master who has lost his slave, to that of the prince expelled by his subjects, to that of the robber who, wishing to break into a house, finds the dogs on the watch and the inmates at the windows."*

Given how much income this "abstinence" or "waiting" results in, we can only conclude that it is the most painful of decisions possible for a multi-millionaire to decide **not** to buy that fifth house and instead save the money. The effort to restrain themselves from squandering their entire fortunes all at once must be staggering. In the capitalist's world, an industrialist who decides not to consume a part of their riches "suffers" a cost equivalent to that of someone who postpones consumption of their meagre income to save enough to get something they need. Similarly, if the industrialist "earns" hundred times more in interest than the wage of the worker who toils in their workplace, the industrialist "suffers" hundred times more discomfort living in his palace than, say, the coal miner does working at the coal face in dangerous conditions or the worker stuck in a boring McJob they hate. The "disutility" of postponing consumption while living in luxury is obviously 100 times greater than the "disutility" of, say, working for a living and so should be rewarded appropriately.

As there is no direct relationship between interest received and the "sacrifice" involved (if anything, it is an **inverse** relationship), the idea that interest is the reward for waiting is simply nonsense. You need be no anarchist to come to this obvious conclusion. It was admitted as much by a leading capitalist economist and his argument simply echoes Proudhon's earlier critique:

> *"the existence and height of interest by no means invariably correspond with the existence and the height of a 'sacrifice of abstinence.' Interest, in exceptional cases, is received where there has been no individual sacrifice of abstinence. High interest is often got where the sacrifice of the abstinence is very trifling — as in the case of [a] millionaire — and 'low interest' is often got where the sacrifice entailed by the abstinence is very great. The hardly saved sovereign which the domestic servant puts in the savings bank bears, absolutely and relatively, less interest than the lightly spared thousands which the millionaire puts to fructify in debenture and mortgage funds. These phenomena fit badly into a theory which explains interest quite universally as a 'wage of abstinence.'"* [Eugen von Böhm-Bawerk, **Capital and Interest**, p. 277]

All in all, as Joan Robinson pointed out, *"that the rate of interest is the 'reward for waiting' but 'waiting' only means owning wealth … In short, a man who refrains from blowing his capital in orgies and feasts can continue to get interest on it. This seems perfectly correct, but as a theory of distribution it is only a circular argument."* [**Contributions to Modern Economics**, p. 11] Interest is not the reward for "waiting," rather it is one of the (many) rewards for being rich. This was admitted as much by Marshall himself, who noted that the *"power to save depends on an excess of income over necessary expenditure; and this is greatest among the wealthy."* [**Op. Cit.**, p. 229]

Little wonder, then, that neo-classical economists introduced the term **waiting** as an "explanation" for returns to capital (such as interest). Before this change in the jargon of economics, mainstream economists used the notion of "abstinence" (the term used by Nassau Senior) to account for (and so justify) interest. Just as Senior's "theory" was seized upon to defend returns to capital, so was the term "waiting" after it was introduced in the 1880s. Interestingly, while describing **exactly** the same thing, "waiting" became the preferred term simply because it had a less apologetic ring to it. Both describe the *"sacrifice of present pleasure for the sake of future"* yet, according to Marshall, the term *"abstinence"* was *"liable to be misunderstood"* because there were just too many wealthy people around who received interest and dividends without ever having abstained from anything. As he admitted, the *"greatest accumulators of wealth are very rich persons, some [!] of whom live in luxury, and certainly do not practise abstinence in that sense of the term in which it is convertible with abstemiousness."* So he opted for the term "waiting" because there was *"advantage"* in its use to describe *"the accumulation of wealth"* as the *"result of a postponement of enjoyment."* [**Op. Cit.**, pp. 232–3] This is particularly the case as socialists had long been pointing out the obvious fact that capitalists do not *"abstain"* from anything.

The lesson is obvious, in mainstream economics if reality conflicts with your theory, do not reconsider the theory, change its name!

The problems of "waiting" and "abstinence" as the source of interest becomes even clearer when we look at inherited wealth. Talking about *"abstinence"* or "waiting" when discussing a capitalist inheriting a company worth millions is silly. Senior recognised this, arguing that income in this case is not profit, but rather *"has all the attributes of rent."* [**Op. Cit.**, p. 129] That such a huge portion of capitalist revenue would not be considered profit shows the bankruptcy of any theory which see profit as the reward for "waiting." However, Senior's argument does show that interest payments need not reflect any positive contribution to production by those who receive it. Like the landlord receiving payment for owning a gift of nature, the capitalist receives income for simply monopolising the work of previous generations and, as Smith put it, the *"rent of land, considered as the price paid for the use of land, is naturally a monopoly price."* [**The Wealth of Nations**, p. 131]

Even capitalist economists, while seeking to justify interest, admit that it *"arises independently of any personal act of the capitalist. It accrues to him even though he has not moved any finger in creating it … And it flows without ever exhausting that capital from which it arises, and therefore without any necessary limit to its continuance. It is, if one may use such an expression in mundane matters, capable of everlasting life."* [Böhm-Bawerk, **Op. Cit.**, p. 1] Little wonder we argued in section C.2.3 that simply owning property does not justify non-labour income.

In other words, due to **one** decision not to do anything (i.e. **not** to consume), a person (and his or her heirs) may receive **forever** a reward that is not tied to any productive activity. Unlike the people actually doing the work (who only get a reward every time they "contribute" to creating a commodity), the capitalist will get rewarded for just **one** act of abstention. This is hardly a just arrangement. As David Schweickart has pointed out, *"Capitalism does reward some individuals perpetually. This, if it is to be justified by the canon of contribution, one must defend the claim that some contributions are indeed eternal."* [**Against Capitalism**, p. 17] As we noted in section C.1.1, current and future generations should not be dominated by the actions of the long dead.

The "waiting" theory, of course, simply seeks to justify interest rather than explain its origin. If the capitalist really **did** deserve an income as a reward for their abstinence, where does it come from? It cannot be created passively, merely by the decision to save, so interest exists because the exploitation of labour exists. As Joan Robinson summarised:

> *"Obviously, the reward of saving is owning some more wealth. One of the advantages, though by no means the only one, of owning wealth is the possibility of getting interest on it.*
>
> *"But why is it possible to get interest? Because businesses make profits and are willing to borrow."* [**Collected Economic Papers**, vol. 5, p. 36]

This is the key. If ones ability and willingness to "wait" is dependent on social facts (such as available resources, ones class, etc.), then interest cannot be based upon subjective evaluations, as these are not the independent factor. In other words, saving does not express "waiting", it simply expresses the extent of inequality and interest expresses the fact that workers have to sell their labour to others in order to survive:

> *"The notion that human beings discount the future certainly seems to correspond to everyone's subjective experience, but the conclusion drawn from it is a* ***non sequitor****, for most people have enough sense to want to be able to exercise consuming power as long as fate permits, and many people are in the situation of having a higher income in the present than they expect in the future (salary earners will have to retire, business may be better now than it seems likely to be later, etc.) and many look beyond their own lifetime and wish to leave consuming power to their heirs. Thus a great many …*

are eagerly looking for a reliable vehicle to carry purchasing power into the future … It is impossible to say what price would rule if there were a market for present ***versus*** *future purchasing power, unaffected by any other influence except the desires of individuals about the time-pattern of their consumption. It might will be such a market would normally yield a negative rate of discount …*

"The rate of interest is normally positive for a quite different reason. Present purchasing power is valuable partly because, under the capitalist rules of the game, it permits its owner … to employ labour and undertake production which will yield a surplus of receipts over costs. In an economy in which the rate of profit is expected to be positive, the rate of interest is positive … [and so] the present value of purchasing power exceeds its future value to the corresponding extent… This is nothing whatever to do with the subjective ***rate of discount of the future*** *of the individual concerned…"* [**The Accumulation of Capital**, p. 395]

So, interest has little to do with "waiting" and a lot more to do with the inequalities associated with the capitalist system. In effect, the "waiting" theory assumes what it is trying to prove. Interest is positive simply because capitalists can appropriate surplus value from workers and so current money is more valuable than future money because of this fact. Ironically, therefore, the pro-capitalist theories of who abstains are wrong, *"since saving is mainly out of profits, and real wages tend to be lower the higher the rate of profit, the abstinence associated with saving is mainly done by the workers, who do not receive any share in the 'reward.'"* [Robinson, **Op. Cit.**, p. 393]

In other words, "waiting" does not produce a surplus, labour does. As such, to *"say that those who hold financial instruments can lay claim to a portion of the social product by abstaining or waiting provides no explanation of what makes the production process profitable, and hence to what extent interest claims or dividends can be paid. Reliance on a waiting theory of the return to capital represented nothing less than a reluctance of economists to confront the sources of value creation and analyse the process of economic development."* [William Lazonick, **Competitive Advantage on the Shop Floor**, p. 267] This would involve having to analyse the social relations between workers and managers/bosses on the shop floor, which would be to bring into question the whole nature of capitalism and any claims it was based upon freedom.

To summarise, the idea that interest is the "reward" for waiting simply ignores the reality of class society and, in effect, rewards the wealthy for being wealthy. Neo-classical economics implies that being rich is the ultimate disutility. The hardships ("sacrifices") of having to decide to consume or invest their riches weighs as heavily on the elite as they do on the scales of utility. Compared to, say, working in a sweatshop, fearing unemployment (sorry, maximising "leisure") or not having to worry about saving (as your income just covers your out-goings) it is clear which are the greatest sacrifices and which are rewarded accordingly under capitalism.

Much the same argument can be applied to "time-preference" theories of profit. These argue that profits are the result of individuals preferring present goods to future ones. Capitalists pay workers wages, allowing them to consumer now rather than later. This is the providing of time and this is rewarded by profits. This principle was first stated clearly by Eugen von Böhm-Bawerk and has been taken as the basis of the "Austrian" school of capitalist economics (see section C.1.6). After rejecting past theories of interest (including, as noted above, "abstinence" theories, which he concluded the socialists were right to mock), Böhm-Bawerk argued that profits could only by explained by means of time preference:

> *"**The loan is a real exchange of present goods against future goods** ... present goods invariably possess a greater value than future goods of the same number and kind, and therefore a definite sum of present goods can, as a rule, only be purchased by a larger sum of future goods. Present goods possess an agio in future goods. **This agio is interest**. It is not a separate equivalent for a separate and durable use of the loaned goods, for that is inconceivable; it is a part equivalent of the loaned sum, kept separate for practical reasons. The replacement of the capital + the interest constitutes the full equivalent."* [**Capital and Interest**, p. 259]

For him, time preference alone is the reason for profit/interest due to the relative low value of future goods, compared to present goods. Capital goods, although already present in their physical state, are really **future** goods in their *"economic nature"* as is labour. This means that workers are paid the amount their labour creates in terms of **future** goods, not **current** goods. This difference between the high value of current goods and low value of future goods is the source of surplus value:

> *"This, and nothing else, is the foundation of the so-called 'cheap' buying of production instruments, and especially of labour, which the Socialists rightly explain as the source of profit on capital, but wrongly interpret ... as the result of a robbery or exploitation of the working classes by the propertied classes."* [**The Positive Theory of Capital**, p. 301]

The capitalists are justified in keeping this surplus value because they provided the time required for the production process to occur. Thus surplus value is the product of an exchange, the exchange of present goods for future ones. The capitalist bought labour at its full present value (i.e. the value of its future product) and so there is no exploitation as the future goods are slowly maturing during the process of production and can then be sold at its full value as a present commodity. Profit, like interest, is seen as resulting from varying estimates of the present and future needs.

As should be obvious, our criticisms of the "waiting" theory of interest apply to this justification of profits. Money in itself does not produce profit any more than interest. It can only do that when invested in **actual** means of production which are put to work by actual people. As such, "time preference" only makes sense in an economy where there is a class of property-less people who are unable to "wait" for future goods as they would have died of starvation long before they arrived.

So it is the **class** position of workers which explains their time preferences, as Böhm-Bawerk **himself** acknowledged. Thus capitalism was marked by an *"enormous number of wage-earners who cannot employ their labour remuneratively by working on their own account, and are accordingly, as a body, inclined and ready to sell the future product of their labour for a considerably less amount of present goods."* So, being poor, meant that they lacked the resources to "wait" for "future" goods and so became dependent (as a class) on those who do. This was, in his opinion the *"sole ground of that much-talked-of and much-deplored dependence of labourer on capitalist."* It is *"only because the labourers cannot wait till the roundabout process ... delivers up its products ready for consumption, that they become economically dependent on the capitalists who already hold in their possession what we have called 'intermediate products.'"* [**Op. Cit.**, p. 330 and p. 83]

Böhm-Bawerk, ironically, simply repeats (although in different words) **and agrees** with the socialist critique of capitalism which, as we discussed in section C.2.2, is also rooted in the class dependence of workers to capitalists (Bakunin, for example, argued that the capitalists were *"profiting by the economic dependence of the worker"* in order to exploit them by *"turn[ing] the worker into a subordinate."* [**The Political Philosophy of Bakunin**, p. 188]). The difference is that Böhm-Bawerk thinks that the capitalists deserve their income from wealth while anarchists, like other socialists, argue they do not as they simply are being rewarded for being wealthy. Böhm-Bawerk simply cannot bring himself to acknowledge that an individual's psychology, their subjective evaluations, are conditioned by their social circumstances and so cannot comprehend the **class** character of capitalism and profit. After all, a landless worker will, of course, estimate the "sacrifice" or "disutility" of selling their labour to a master as much less than the peasant farmer or artisan who possesses their own land or tools. The same can be said of workers organised into a union.

As such, Böhm-Bawerk ignores the obvious, that the source of non-labour income is not in individual subjective evaluations but rather the **social** system within which people live. The worker does not sell her labour power because she "underestimates" the value of future goods but because she lacks the means of obtaining any sort of goods at all except by the selling of her labour power. There is no real choice between producing for herself or working for a boss — she has no real opportunity of doing the former at all and so **has** to do the latter. This means that workers sells their labour (future goods) "voluntarily" for an amount less than its value (present goods) because their class position ensures that they cannot "wait." So, if profit is the price of time, then it is a monopoly price produced by the class monopoly of wealth ownership under capitalism. Needless to say, as capital is accumulated from surplus value, the dependence of the working class on the capitalists will tend to grow over time as the "waiting" required to go into business will tend to increase also.

An additional irony of Böhm-Bawerk's argument is that is very similar to the "abstinence" theory he so rightly mocked and which he admitted the socialists were right to reject. This can be seen from one of his followers, right-"libertarian" Murray Rothbard:

> *"What has been the contribution of these product-owners, or 'capitalists', to the production process? It is this: the saving and restriction of consumption, instead of being done by the owners of land and labour, has been done by the* ***capitalists****. The capitalists originally saved, say, 95 ounces of gold which they could have then spent on consumers' goods. They refrained from doing so, however, and, instead,* ***advanced*** *the money to the original owners of the factors. They* ***paid*** *the latter for their services while they were working, thus advancing them money before the product was actually produced and sold to the consumers. The capitalists, therefore, made an essential contribution to production. They relieved the owners of the original factors from the necessity of sacrificing present goods and waiting for future goods."* [**Man, Economy, and State**, pp. 294–95]

This meant that without risk, *"[e]ven if financial returns and consumer demand are certain,* ***the capitalists are still providing present goods to the owners of labour and land*** *and thus relieving them of the burden of waiting until the future goods are produced and finally transformed into consumers' goods."* [**Op. Cit.**, p. 298] Capitalists pay out, say, £100,000 this year in wages and reap £200,000 next year not because of exploitation but because both parties prefer this amount of money this year rather than next year. Capitalists, in other words, pay out wages in advance and then wait for a sale. They will only do so if compensated by profit.

Rothbard's argument simply assumes a **class** system in which there is a minority of rich and a majority of property-less workers. The reason why workers cannot "wait" is because if they did they would starve to death. Unsurprisingly, then, they prefer their wages now rather than next year. Similarly, the reason why they do not save and form their own co-operatives is that they simply cannot "wait" until their workplace is ready and their products are sold before eating and paying rent. In other words, their decisions are rooted in their class position while the capitalists (the rich) have shouldered the "burden" of abstinence so that they can be rewarded with even more money in the future. Clearly, the time preference position and the "waiting" or "abstinence" perspective are basically the same (Rothbard even echoes Senior's lament about the improvident working class, arguing that *"the major problem with the lower-class poor is irresponsible present-mindedness."* [**For a New Liberty**, p. 154]). As such, it is subject to the same critique (as can be found in, say, the works of a certain Eugen von Böhm-Bawerk).

In other words, profit has a **social** basis, rooted in the different economic situation of classes within capitalism. It is not the fact of "waiting" which causes profits but rather the monopoly of the means of life by the capitalist class which is the basis of *"economic dependence."* Any economic theory which fails to acknowledge and analyse this social inequality is doomed to failure from the start.

To conclude, the arguments that "waiting" or "time preference" explain or justify surplus value are deeply flawed simply because they ignore the reality of class society. By focusing on individual subjective evaluations, they ignore the social context in which these decisions are made and, as a result, fail to take into account the class character of interest and profit. In effect, they argue that the wealthy deserve a reward for being wealthy. Whether it is to justify profits or interest, the arguments used simply show that we have an economic system that works only by bribing the rich!

C.2.8 Are profits the result of entrepreneurial activity and innovation?

One of the more common arguments in favour of profits is the notion that they are the result of innovation or entrepreneurial activity, that the creative spirit of the capitalist innovates profits into existence. This perspective is usually associated with the so-called "Austrian" school of capitalist economics but has become more common in the mainstream of economics, particularly since the 1970s.

There are two related themes in this defence of profits — innovation and entrepreneurial activity. While related, they differ in one key way. The former (associated with Joseph Schumpeter) is rooted in production while the former seeks to be of more general application. Both are based on the idea of "discovery", the subjective process by which people use their knowledge to identify gaps in the market, new products or services or new means of producing existing goods. When entrepreneurs discover, for example, a use of resources, they bring these resources into a new (economic) existence. Accordingly, they have created something **ex nihilo** (out of nothing) and therefore are entitled to the associated profit on generally accepted moral principle of *"finders keepers."*

Anarchists, needless to say, have some issues with such an analysis. The most obvious objection is that while *"finders keepers"* may be an acceptable ethical position on the playground, it is hardly a firm basis to justify an economic system marked by inequalities of liberty and wealth. Moreover, discovering something does **not** entitle you to an income from it. Take, for example, someone who discovers a flower in a wood. That, in itself, will generate no income of any kind. Unless the flower is picked and taken to a market, the discoverer cannot "profit" from discovering it. If the flower is left untouched then it is available for others to appropriate unless some means are used to stop them (such as guarding the flower). This means, of course, limiting the discovery potential of others, like the state enforcing copyright stops the independent discovery of the same idea, process or product.

As such, "discovery" is not sufficient to justify non-labour income as an idea remains an idea unless someone applies it. To generate an income (profit) from a discovery you need to somehow take it to the market and, under capitalism, this means getting funds to invest in machinery and workplaces. However, these in themselves do nothing and, consequently, workers need to be employed to produce the goods in question. If the costs of producing these goods is less than the market price, then a profit is made. Does this profit represent the initial "discovery"? Hardly for without funds the idea would have remained just that. Does the profit represent the contribution of "capital"? Hardly, for without the labour of the workers the workplace would have remained still and the product would have remained an idea.

Which brings us to the next obvious problem, namely that "entrepreneurial" activity becomes meaningless when divorced from owning capital. This is because any action which is taken to benefit an individual and involves "discovery" is considered entrepreneurial. Successfully looking for a better job? Your new wages are entrepreneurial profit. Indeed, successfully finding **any** job makes the wages entrepreneurial profit. Workers successfully organising and striking to improve their pay and conditions? An entrepreneurial act whose higher wages are, in fact, entrepreneurial profit. Selling your shares in one company and buying others? Any higher dividends are entrepreneurial profit. Not selling your shares? Likewise. What income flow could **not** be explained by *"entrepreneurial"* activity if we try hard enough?

In other words, the term becomes meaningless unless it is linked to owning capital and so any non-trivial notion of entrepreneurial activity requires private property, i.e. property which functions as capital. This can be seen from an analysis of whether entrepreneurship which is **not** linked to owning capital or land creates surplus value (profits) or not. It is possible, for example, that an entrepreneur can make a profit by buying cheap in one market and selling dear in another. However, this simply redistributes existing products and surplus value, it does not **create** them. This means that the entrepreneur does not create something from nothing, he takes something created by others and sells it at a higher price and so gains a slice of the surplus value created by others. If buying high and selling low **was** the cause of surplus value, then profits overall would be null as any gainer would be matched by a loser. Ironically, for all its talk of being concerned about process, this defence of entrepreneurial profits rests on the same a **static** vision of capitalism as does neo-classical economics.

Thus entrepreneurship is inherently related to inequalities in economic power, with those at the top of the market hierarchy having more ability to gain benefits of it than those at the bottom. Entrepreneurship, in other words, rather than an independent factor is rooted in social inequality. The larger one's property, the more able they are to gather and act on information advantages, i.e. act in as an entrepreneur. Moreover the ability to exercise the entrepreneurial spirit or innovate is restricted by the class system of capitalism. To implement a new idea, you need money. As it is extremely difficult for entrepreneurs to act on the opportunities they have observed without the ownership of property, so profits due to innovation simply becomes yet another reward for already being wealthy or, at best, being able to convince the wealthy to loan you money in the expectation of a return. Given that credit is unlikely to be forthcoming to those without collateral (and most working class people are asset-poor), entrepreneurs are almost always capitalists because of social inequality. Entrepreneurial opportunities are, therefore, not available to everyone and so it is inherently linked to private property (i.e. capital).

So while entrepreneurship in the abstract may help explain the distribution of income, it neither explains why surplus value exists in the first place nor does it justify the entrepreneur's appropriation of part of that surplus. To explain why surplus value exists and why capitalists may be justified in keeping it, we need to look at the other aspect of entrepreneurship, innovation as this is rooted in the actual production process.

Innovation occurs in order to expand profits and so survive competition from other companies. While profits can be redistributed in circulation (for example by oligopolistic competition or inflation) this can only occur at the expense of other people or capitals (see sections C.5 and C.7). Innovation, however, allows the generation of profits directly from the new or increased productivity (i.e. exploitation) of labour it allows. This is because it is in production that commodities, and so profits, are created and innovation results in new products and/or new production methods. New products mean that the company can reap excess profits until competitors enter the new market and force the market price down by competition. New production methods allow the intensity of labour to be increased, meaning that workers do more work relative to their wages (in other words, the cost of production falls relative to the market price, meaning extra profits).

So while competition ensures that capitalist firms innovate, innovation is the means by which companies can get an edge in the market. This is because innovation means that *"capitalist excess profits come from the production process… when there is an above-average rise in labour productivity; the reduced costs then enable firms to earn higher than average profits in their products. But this form of excess profits is only temporary and disappears again when improved production methods become more general."* [Paul Mattick, **Economics, Politics and the Age of Inflation**, p. 38] Capitalists, of course, use a number of techniques to stop the spread of new products or production methods in order to maintain their position, such as state enforced intellectual property rights.

Innovation as the source of profits is usually associated with economist Joseph Schumpeter who described and praised capitalism's genius for *"creative destruction"* caused by capitalists who innovate, i.e. introduce new goods and means of production. Schumpeter's analysis of capitalism is more realistic than the standard neo-classical perspective. He recognised that capitalism was marked by a business cycle which he argued flowed from cycles of innovation conducted by capitalists. He also rejected the neo-classical assumption of perfect competition, arguing that the *"introduction of new methods of production and new commodities is hardly compatible with perfect and perfectly prompt competition from the start … As a matter of fact, perfect competition has always been temporarily stemmed whenever anything new is being introduced."* [**Capitalism, Socialism and Democracy**, p. 104]

This analysis presents a picture of capitalism more like it actually is rather than what economics would like it to be. However, this does not mean that its justification for profits is correct, far from it. Anarchists do agree that it is true that individuals do see new potential and act in innovative ways to create new products or processes. However, this is not the source of surplus value. This is because an innovation only becomes a source of profits once it actually produced, i.e. once workers have toiled to create it (in the case of new goods) or used it (in the case of new production techniques). An idea in and of itself produces nothing unless it is applied. The reason why profits result from innovation is due to the way the capitalist firm is organised rather than any inherent aspect of innovation.

Ultimately, entrepreneurialism is just a fancy name for decision making and, as such, it is a **labour** income (labour refers to physical **and** mental activities). However, as noted above, there are two types of labour under capitalism, the labour of production and the labour of exploitation. Looking at entrepreneurialism in a workplace situation, it is obvious that it is **not** independent of owning or managing capital and so it is impossible to distinguish profits produced by "entrepreneurial" activity and profits resulting from a return on property (and so the labour of others). In other words, it is the labour of exploitation and any income from it is simply monopoly profit. This is because the capitalist or manager has a monopoly of power within the workplace and, consequently, can reap the benefits this privileged position ensures. The workers have their opportunities for entrepreneurialism restricted and monopolised by the few in power who, when deciding who contributes most to production, strangely enough decide it is themselves.

This can be seen from the fact that innovation in terms of new technology is used to help win the class war at the point of production for the capitalists. As the aim of capitalist production is to maximise the profits available for capitalists and management to control, it follows that capitalism will introduce technology that will allow more surplus value to be extracted from workers. As Cornelius Castoriadis argues, capitalism *"does not utilise a socially neutral technology for capitalist ends. Capitalism has created capitalist technology, which is by no means neutral. The real essence of capitalist technology is not to develop production for production's sake: It is to subordinate and dominate the producers."* [**Political and Social Writings**, vol. 2, p. 104] Therefore, "innovation" (technological improvement) can be used to increase the power of capital over the workforce, to ensure that workers will do as they are told. In this way innovation can maximise surplus value production by trying to increase domination during working hours as well as by increasing productivity by new processes.

These attempts to increase profits by using innovation is the key to capitalist expansion and accumulation. As such innovation plays a key role within the capitalist system. However, the source of profits does not change and remains in the labour, skills and creativity of workers in the workplace. As such, innovation results in profits because labour is exploited in the production process, **not** due to some magical property of innovation.

The question now arises whether profits are justified as a reward for those who made the decision to innovate in the first place. This, however, fails for the obvious reason that capitalism is marked by a hierarchical organisation of production. It is designed so that a few make all the decisions while the majority are excluded from power. As such, to say that capitalists or managers deserve their profits due to innovation is begging the question. Profits which are claimed to flow from innovation are, in fact, the reward for having a monopoly, namely the monopoly of decision making within the workplace, rather than some actual contribution to production. The only thing management does is decide which innovations to pursue and to reap the benefits they create. In other words, they gain a reward simply due to their monopoly of decision making power within a firm. Yet this hierarchy only exists because of capitalism and so can hardly be used to defend that system and the appropriation of surplus value by capitalists.

Thus, if entrepreneurial spirit is the source of profit then we can reply that under capitalism the means of exercising that spirit is monopolised by certain classes and structures. The monopoly of decision making power in the hands of managers and bosses in a capitalist firm ensure that they also monopolise the rewards of the entrepreneurialism their workforce produce. This, in turn, reduces the scope for innovation as this division of society into people who do mental and physical labour *"destroy[s] the love of work and the capacity for invention"* and under such a system, the worker *"lose[s] his intelligence and his spirit of invention."* [Kropotkin, **The Conquest of Bread**, p. 183 and p. 181]

These issues should be a key concern **if** entrepreneurialism **really** were considered as the unique source of profit. However, such issues as management power is rarely, if ever, discussed by the Austrian school. While they thunder against state restrictions on entrepreneurial activity, boss and management restrictions are always defended (if mentioned at all). Similarly, they argue that state intervention (say, anti-monopoly laws) can only harm consumers as it tends to discourage entrepreneurial activity yet ignore the restrictions to entrepreneurship imposed by inequality, the hierarchical structure of the capitalist workplace and negative effects both have on individuals and their development (as discussed in section B.1.1).

This, we must stress, is the key problem with the idea that innovation is the root of surplus value. It focuses attention to the top of the capitalist hierarchy, to business leaders. This implies that they, the bosses, create "wealth" and without them nothing would be done. For example, leading "Austrian" economist Israel Kirzner talks of *"the necessarily indivisible entrepreneur"* who *"is responsible for the entire product, The contributions of the factor inputs, being without an entrepreneurial component, are irrelevant for the ethical position being taken."* [*"Producer, Entrepreneur, and the Right to Property,"* pp. 185–199, **Perception**, **Opportunity**, **and Profit**, p. 195] The workforce is part of the *"factor inputs"* who are considered *"irrelevant."* He quotes economist Frank Knight to bolster this analysis that the entrepreneur solely creates wealth and, consequently, deserves his profits:

> *"Under the enterprise system, a special social class, the businessman, direct economic activity:* ***they are in the strict sense the producers, while the great mass of the population merely furnishes them with productive services, placing their persons and their property at the disposal of this class.****"* [quoted by Kirzner, **Op. Cit.**, p. 189]

If, as Chomsky stresses, the capitalist firm is organised in a fascist way, the "entrepreneurial" defence of profits is its ideology, its ***"Führerprinzip"*** (the German for *"leader principle"*). This ideology sees each organisation as a hierarchy of leaders, where every leader (Führer, in German) has absolute responsibility in his own area, demands absolute obedience from those below him and answers only to his superiors. This ideology was most infamously applied by fascism but its roots lie in military organisations which continue to use a similar authority structure today.

Usually defenders of capitalism contrast the joys of "individualism" with the evils of "collectivism" in which the individual is sub-merged into the group or collective and is made to work for the benefit of the group. Yet when it comes to capitalist industry, they stress the abilities of the people at the top of the company, the owner, the entrepreneur, and treat as unpeople those who do the actual work (and ignore the very real subordination of those lower down the hierarchy). The entrepreneur is considered the driving force of the market process and the organisations and people they govern are ignored, leading to the impression that the accomplishments of a firm are the personal triumphs of the capitalists, as though their subordinates are merely tools not unlike the machines on which they labour.

The ironic thing about this argument is that if it were true, then the economy would grind to a halt (we discuss this more fully in our critique of Engels's diatribe against anarchism *"On Authority"* in section H.4.4). It exposes a distinct contradiction within capitalism. While the advocates of entrepreneurialism assert that the entrepreneur is the only real producer of wealth in society, the fact is that the entrepreneurialism of the workforce industry is required to implement the decisions made by the bosses. Without this unacknowledged input, the entrepreneur would be impotent. Kropotkin recognised this fact when he talked of the workers *"who have added to the original invention"* little additions and contributions *"without which the most fertile idea would remain fruitless."* Nor does the idea itself develop out of nothing as *"every invention is a synthesis, the resultant of innumerable inventions which have preceded it."* [**Op. Cit.**, p. 30] Thus Cornelius Castoriadis:

> *"The capitalist organisation of production is profoundly contradictory … It claims to reduce the worker to a limited and determined set of tasks, but it is obliged at the same time to rely upon the universal capacities he develops both as a function of and in opposition to the situation in which he is placed … Production can be carried out only insofar as the worker himself organises his work and goes beyond his theoretical role of pure and simply executant,"* [**Political and Social Writings**, vol. 2, p. 181]

Moreover, such a hierarchical organisation cannot help but generate wasted potential. Most innovation is the cumulative effect of lots of incremental process improvements and the people most qualified to identify opportunities for such improvements are, obviously, those involved in the process. In the hierarchical capitalist firm, those most aware of what would improve efficiency have the least power to do anything about it. They also have the least incentive as well as any productivity increases resulting from their improvements will almost always enrich their bosses and investors, not them. Indeed, any gains may be translated into layoffs, soaring stock prices, and senior management awarding itself a huge bonus for "cutting costs." What worker in his right mind would do something to help their worst enemy? As such, capitalism hinders innovation:

> *"capitalism divides society into a narrow stratum of directors (whose function is to decide and organise everything) and the vast majority of the population, who are reduced to carrying out (executing) the decisions made by these directors. As a result of this very fact, most people experience their own lives as something alien to them … It is nonsensical to seek to organise people … as if they were mere objects … In real life, capitalism is obliged to base itself on people's capacity for self-organisation, on the individual and collective creativity of the producers. Without making use of these abilities the system would not survive a day. But the whole 'official' organisation of modern society both ignores and seeks to suppress these abilities to the utmost. The result is not only an enormous waste due to untapped capacity. The system does more: It* ***necessarily*** *engenders opposition, a struggle against it by those upon whom it seeks to impose itself … The net result is not only waste but perpetual conflict."* [Castoriadis, **Op. Cit.**, p. 93]

While workers make the product and make entrepreneurial decisions every day, in the face of opposition of the company hierarchy, the benefits of those decisions are monopolised by the few who take all the glory for themselves. The question now becomes, why should capitalists and managers have a monopoly of power and profits when, in practice, they do not and cannot have a monopoly of entrepreneurialism within a workplace? If the output of a workplace is the result of the combined mental and physical activity (entrepreneurialism) of all workers, there is no justification either for the product or "innovation" (i.e. decision making power) to be monopolised by the few.

We must also stress that innovation itself is a form of labour — mental labour. Indeed, many companies have Research and Development groups in which workers are paid to generate new and innovative ideas for their employers. This means that innovation is not related to property ownership at all. In most modern industries, as Schumpeter himself acknowledged, innovation and technical progress is conducted by *"teams of trained specialists, who turn out what is required and make it work in predictable ways"* and so *"[b]ureau and committee work tends to replace individual action."* This meant that *"the leading man … is becoming just another office worker — and one who is not always difficult to replace."* [**Op. Cit.**, p. 133] And we must also point out that many new innovations come from individuals who combine mental and physical labour outside of capitalist companies. Given this, it is difficult to argue that profits are the result of innovation of a few exceptional people rather than by workers when the innovations, as well as being worked or produced by workers are themselves are created by teams of workers.

As such, "innovation" and "entrepreneurialism" is not limited to a few great people but rather exists in all of us. While the few may currently monopolise "entrepreneurialism" for their own benefit, an economy does not need to work this way. Decision making need **not** be centralised in a few hands. Ordinary workers can manage their own productive activity, innovate and make decisions to meet social and individual needs (i.e. practice "entrepreneurialism"). This can be seen from various experiments in workers' control where increased equality within the workplace actually increases productivity and innovation. As these experiments show workers, when given the chance, can develop numerous "good ideas" **and**, equally as important, produce them. A capitalist with a "good idea," on the other hand, would be powerless to produce it without workers and it is this fact that shows that innovation, in and of itself, is not the source of surplus value.

So, contrary to much capitalist apologetics, innovation is not the monopoly of an elite class of humans. It is part of all of us, although the necessary social environment needed to nurture and develop it in all is crushed by the authoritarian workplaces of capitalism and the effects of inequalities of wealth and power within society as a whole. If workers were truly incapable of innovation, any shift toward greater control of production by workers should result in decreased productivity. What one actually finds, however, is just the opposite: productivity increased dramatically as ordinary people were given the chance, usually denied them, to apply their skills and talents. They show the kind of ingenuity and creativity people naturally bring to a challenging situation — if they are allowed to, if they are participants rather than servants or subordinates.

In fact, there is *"a growing body of empirical literature that is generally supportive of claims for the economic efficiency of the labour-managed firm. Much of this literature focuses on productivity, frequently finding it to be positively correlated with increasing levels of participation … Studies that encompass a range of issues broader than the purely economic also tend to support claims for the efficiency of labour managed and worker-controlled firms … In addition, studies that compare the economic preference of groups of traditionally and worker-controlled forms point to the stronger performance of the latter."* [Christopher Eaton Gunn, **Workers' Self-Management in the United States**, pp. 42–3] This is confirmed by David Noble, who points out that *"the self-serving claim"* that *"centralised management authority is the key to productivity"* is *"belied by nearly every sociological study of work."* [**Progress without People**, p. 65]

During the Spanish Revolution of 1936–39, workers self-managed many factories following the principles of participatory democracy. Productivity and innovation in the Spanish collectives was exceptionally high (particularly given the difficult economic and political situation they faced). As Jose Peirats notes, industry was *"transformed from top to bottom … there were achieved feats pregnant with significance for people who had always striven to deny the reality of the wealth of popular initiatives unveiled by revolutions."* Workers made suggestions and presented new inventions, *"offering the product of their discoveries, genius or imaginings."* [**The CNT in the Spanish Revolution**, vol. 2, p. 86]

The metal-working industry is a good example. As Augustine Souchy observes, at the outbreak of the Civil War, the metal industry in Catalonia was *"very poorly developed."* Yet within months, the Catalonian metal workers had rebuilt the industry from scratch, converting factories to the production of war materials for the anti-fascist troops. A few days after the July 19th revolution, the Hispano-Suiza Automobile Company was already converted to the manufacture of armoured cars, ambulances, weapons, and munitions for the fighting front. *"Experts were truly astounded,"* Souchy writes, *"at the expertise of the workers in building new machinery for the manufacture of arms and munitions. Very few machines were imported. In a short time, two hundred different hydraulic presses of up to 250 tons pressure, one hundred seventy-eight revolving lathes, and hundreds of milling machines and boring machines were built."* [**The Anarchist Collectives: Workers' Self-management in the Spanish Revolution, 1936–1939**, Sam Dolgoff (ed.), p. 96]

Similarly, there was virtually no optical industry in Spain before the July revolution, only some scattered workshops. After the revolution, the small workshops were voluntarily converted into a production collective. *"The greatest innovation,"* according to Souchy, *"was the construction of a new factory for optical apparatuses and instruments. The whole operation was financed by the voluntary contributions of the workers. In a short time the factory turned out opera glasses, telemeters, binoculars, surveying instruments, industrial glassware in different colours, and certain scientific instruments. It also manufactured and repaired optical equipment for the fighting fronts … What private capitalists failed to do was accomplished by the creative capacity of the members of the Optical Workers' Union of the CNT."* [**Op. Cit.**, pp. 98–99]

More recently, the positive impact of workers' control has been strikingly confirmed in studies of the Mondragon co-operatives in Spain, where workers are democratically involved in production decisions and encouraged to innovate. As George Bennello notes, *"Mondragon productivity is very high — higher than in its capitalist counterparts. Efficiency, measured as the ratio of utilised resources — capital and labour — to output, is far higher than in comparable capitalist factories."* [*"The Challenge of Mondragon"*, **Reinventing Anarchy, Again**, p. 216]

The example of Lucas Aerospace, during the 1970s indicates well the creative potential waiting to be utilised and wasted due to capitalism. Faced with massive job cuts and restructuring, the workers and their Shop Stewards SSCC in 1976 proposed an alternative Corporate Plan to Lucas's management. This was the product of two years planning and debate among Lucas workers. Everyone from unionised engineers, to technicians to production workers and secretaries was involved in drawing it up. It was based on detailed information on the machinery and equipment that all Lucas sites had, as well as the type of skills that were in the company. The workers designed the products themselves, using their own experiences of work and life. While its central aim was to head off Lucas's planned job cuts, it presented a vision of a better world by arguing that the concentration on military goods and markets was neither the best use of resources nor in itself desirable. It argued that if Lucas was to look away from military production it could expand into markets for socially useful goods (such as medical equipment) where it already had some expertise and sales. The management were not interested, it was their to *"manage"* Lucas and to decide where its resources would be used, including the 18,000 people working there. Management were more than happy to exclude the workforce from any say in such fundamental matter as implementing the workers' ideas would have shown how unnecessary they, the bosses, actually were.

Another example of wasted worker innovation is provided by the US car industry. In the 1960s, Walter Reuther, president of the United Auto Workers (UAW) had proposed to the Johnson Whitehouse that the government help the US car companies to produce small cars, competing with Volkswagen which had enjoyed phenomenal success in the U.S. market. The project, unsurprisingly, fell through as the executives of the car companies were uninterested. In the 1970s, higher petrol prices saw US buyers opt for smaller cars and the big US manufacturers were caught unprepared. This allowed Toyota, Honda and other Asian car companies to gain a crucial foothold in the American market. Unsurprisingly, resistance by the union and workforce were blamed for the industry's problems when, in fact, it was the bosses, not the unions, who were blind to a potential market niche and the industry's competitive challenges.

Therefore, far from being a threat to innovation, workers' self-management would increase it and, more importantly, direct it towards improving the quality of life for all as opposed to increasing the profits of the few (this aspect an anarchist society will be discussed in more detail in section I). This should be unsurprising, as vesting a minority with managerial authority and deciding that the others should be cogs results in a massive loss of social initiative and drive. In addition, see sections J.5.10, J.5.11 and J.5.12 for more on why anarchists support self-management and why, in spite of its higher efficiency and productivity, the capitalist market will select against it.

To conclude, capitalist workplace hierarchy actually hinders innovation and efficiency rather than fosters it. To defend profits by appealing to innovation is, in such circumstances, deeply ironic. Not only does it end up simply justifying profits in terms of monopoly power (i.e. hierarchical decision making rewarding itself), that power also wastes a huge amount of potential innovation in society — namely the ideas and experience of the workforce excluded from the decision making process. Given that power produces resistance, capitalism ensures that the *"creative faculties [the workers] are not allowed to exercise **on behalf** of a social order that rejects them (and which they reject) are now utilised **against** that social order"* and so *"work under capitalism"* is *"a perpetual waste of creative capacity, and a constant struggle between the worker and his own activity."* [Castoriadis, **Op. Cit.**, p. 93 and p. 94]

Therefore, rather than being a defence of capitalist profit taking (and the inequality it generates) innovation backfires against capitalism. Innovation flourishes best under freedom and this points towards libertarian socialism and workers' self-management. Given the chance, workers can manage their own work and this results in increased innovation and productivity, so showing that capitalist monopoly of decision making power hinders both. This is unsurprising, for only equality can maximise liberty and so workers' control (rather than capitalist power) is the key to innovation. Only those who confuse freedom with the oppression of wage labour would be surprised by this.

C.2.9 Do profits reflect a reward for risk?

Another common justification of surplus value is that of "risk taking", namely the notion that non-labour income is justified because its owners took a risk in providing money and deserve a reward for so doing.

Before discussing why anarchists reject this argument, it must be noted that in the mainstream neo-classical model, risk and uncertainty plays no role in generating profits. According to general equilibrium theory, there is no uncertainty (the present and future are known) and so there is no role for risk. As such, the concept of profits being related to risk is more realistic than the standard model. However, as we will argue, such an argument is unrealistic in many other ways, particularly in relation to modern-day corporate capitalism.

It is fair to say that the appeal of risk to explain and justify profits lies almost entirely in the example of the small investor who gambles their savings (for example, by opening a bar) and face a major risk if the investment does not succeed. However, in spite of the emotional appeal of such examples, anarchists argue that they are hardly typical of investment decisions and rewards within capitalism. In fact, such examples are used precisely to draw attention away from the way the system works rather than provide an insight into it. That is, the higher apparent realism of the argument hides an equally unreal model of capitalism as the more obviously unrealistic theories which seek to rationalise non-labour income.

So does "risk" explain or justify non-labour income? No, anarchists argue. This is for five reasons. Firstly, the returns on property income are utterly independent on the amount of risk involved. Secondly, all human acts involve risk of some kind and so why should property owners gain exclusively from it? Thirdly, risk as such it not rewarded, only **successful** risks are and what constitutes success is dependent on production, i.e. exploiting labour. Fourthly, most "risk" related non-labour income today plays **no** part in aiding production and, indeed, is simply not that risky due to state intervention. Fifthly, risk in this context is not independent of owning capital and, consequently, the arguments against "waiting" and innovation apply equally to this rationale. In other words, "risk" is simply yet another excuse to reward the rich for being wealthy.

The first objection is the most obvious. It is a joke to suggest that capitalism rewards in proportion to risk. There is little or no relationship between income and the risk that person faces. Indeed, it would be fairer to say that return is **inversely** proportional to the amount of risk a person faces. The most obvious example is that of a worker who wants to be their own boss and sets up their own business. That is a genuine risk, as they are risking their savings and are willing to go into debt. Compare this to a billionaire investor with millions of shares in hundreds of companies. While the former struggles to make a living, the latter gets a large regular flow of income without raising a finger. In terms of risk, the investor is wealthy enough to have spread their money so far that, in practical terms, there is none. Who has the larger income?

As such, the risk people face is dependent on their existing wealth and so it is impossible to determine any relationship between it and the income it is claimed to generate. Given that risk is inherently subjective, there is no way of discovering its laws of operation except by begging the question and using the actual rate of profits to measure the cost of risk-bearing.

The second objection is equally as obvious. The suggestion that risk taking is the source and justification for profits ignores the fact that virtually all human activity involves risk. To claim that capitalists should be paid for the risks associated with investment is to implicitly state that money is more valuable that human life. After all, workers risk their health and often their lives in work and often the most dangerous workplaces are those associated with the lowest pay. Moreover, providing safe working conditions can eat into profits and by cutting health and safety costs, profits can rise. This means that to reward capitalist "risk", the risk workers face may actually increase. In the inverted world of capitalist ethics, it is usually cheaper (or more "efficient") to replace an individual worker than a capital investment. Unlike investors, bosses and the corporate elite, workers **do** face risk to life or limb daily as part of their work. Life is risky and no life is more risky that that of a worker who may be ruined by the "risky" decisions of management, capitalists and investors seeking to make their next million. While it is possible to diversify the risk in holding a stock portfolio that is not possible with a job. A job cannot be spread across a wide array of companies diversifying risk.

In other words, workers face much greater risks than their employers and, moreover, they have no say in what risks will be taken with their lives and livelihoods. It is workers who pay the lion's share of the costs of failure, not management and stockholders. When firms are in difficulty, it is the workers who are asked to pay for the failures of management though pay cuts and the elimination of health and other benefits. Management rarely get pay cuts, indeed they often get bonuses and "incentive" schemes to get them to do the work they were (over) paid to do in the first. When a corporate manager makes a mistake and their business actually fails, his workers will suffer far more serious consequences than him. In most cases, the manager will still live comfortably (indeed, many will receive extremely generous severance packages) while workers will face the fear, insecurity and hardship of having to find a new job. Indeed, as we argued in section C.2.1, it is the risk of unemployment that is a key factor in ensuring the exploitation of labour in the first place.

As production is inherently collective under capitalism, so must be the risk. As Proudhon put it, it may be argued that the capitalist *"alone runs the risk of the enterprise"* but this ignores the fact that capitalist cannot *"alone work a mine or run a railroad"* nor *"alone carry on a factory, sail a ship, play a tragedy, build the Pantheon."* He asked: *"Can anybody do such things as these, even if he has all the capital necessary?"* And so *"association"* becomes *"absolutely necessary and right"* as the *"work to be accomplished"* is *"the common and undivided property of all those who take part therein."* If not, shareholders would *"plunder the bodies and souls of the wage-workers"* and it would be *"an outrage upon human dignity and personality."* [**The General Idea of the Revolution**, p. 219] In other words, as production is collective, so is the risk faced and, consequently, risk cannot be used to justify excluding people from controlling their own working lives or the fruit of their labour.

This brings us to the third reason, namely how "risk" contributes to production. The idea that "risk" is a contribution to production is equally flawed. Obviously, no one argues that **failed** investments should result in investors being rewarded for the risks they took. This means that **successful** risks are what counts and this means that the company has produced a desired good or service. In other words, the argument for risk is dependent on the investor providing capital which the workers of the company used productivity to create a commodity. However, as we discussed in section C.2.4 capital is **not** productive and, as a result, an investor may expect the return of their initial investment but no more. At best, the investor has allowed others to use their money but, as section C.2.3 indicated, giving permission to use something is not a productive act.

However, there is another sense in which risk does not, in general, contribute to production within capitalism, namely finance markets. This bring us to our fourth objection, namely that most kinds of *"risks"* within capitalism do **not** contribute to production and, thanks to state aid, not that risky.

Looking at the typical "risk" associated with capitalism, namely putting money into the stock market and buying shares, the idea that *"risk"* contributes to production is seriously flawed. As David Schweickart points out, *"[i]n the vast majority of cases, when you buy stock, you give your money not to the company but to another private individual. You buy your share of stock from someone who is cashing in his share. Not a nickel of your money goes to the company itself. The company's profits would have been exactly the same, with or without your stock purchase."* [**After Capitalism**, p. 37] In fact between 1952 and 1997, about 92% of investment was paid for by firms' own internal funds and so *"the stock market contributes virtually nothing to the financing of outside investment."* Even new stock offerings only accounted for 4% of non-financial corporations capital expenditures. [Doug Henwood, **Wall Street**, p. 72] *"In spite of the stock market's large symbolic value, it is notorious that it has relatively little to do with the production of goods and services,"* notes David Ellerman, *"The overwhelming bulk of stock transactions are in second-hand shares so the capital paid for shares usually goes to other stock traders, not to productive enterprises issuing new shares."* [**The Democratic worker-owned firm**, p. 199]

In other words, most investment is simply the "risk" associated with buying a potential income stream in an uncertain world. The buyer's action has not contributed to producing that income stream in any way whatsoever yet it results in a claim on the labour of others. At best, it could be said that a previous owner of the shares at some time in the past has *"contributed"* to production by providing money but this does not justify non-labour income. As such, investing in shares may rearrange existing wealth (often to the great advantage of the rearrangers) but it does produce anything. New wealth flows from production, the use of labour on existing wealth to create new wealth.

Ironically, the stock market (and the risk it is based on) harms this process. The notion that dividends represent the return for "risk" may be faulted by looking at how the markets operate in reality, rather than in theory. Stock markets react to recent movements in the price of stock markets, causing price movements to build upon price movements. According to academic finance economist Bob Haugen, this results in finance markets having endogenous instability, with such price-driven volatility accounting for over three-quarters of all volatility in finance markets. This leads to the market directing investments very badly as some investment is wasted in over-valued companies and under-valued firms cannot get finance to produce useful goods. The market's endogenous volatility reduces the overall level of investment as investors will only fund projects which return a sufficiently high level of return. This results in a serious drag on economic growth. As such, "risk" has a large and negative impact on the real economy and it seems ironic to reward such behaviour. Particularly as the high rate of return is meant to compensate for the risk of investing in the stock market, but in fact most of this risk results from the endogenous stability of the market itself. [Steve Keen, **Debunking Economics**, pp. 249–50]

Appeals to "risk" to justify capitalism are somewhat ironic, given the dominant organisational form within capitalism — the corporation. These firms are based on *"limited liability"* which was designed explicitly to reduce the risk faced by investors. As Joel Bakan notes, before this *"no matter how much, or how little, a person had invested in a company, he or she was* ***personally*** *liable, without limit, for the company's debts. Investors' homes, savings, and other personal assess would be exposed to claims by creditors if a company failed, meaning that a person risked finance ruin simply by owning shares in a company. Stockholding could not becomes a truly attractive option*

… until that risk was removed, which it soon was. By the middle of the nineteenth century, business leaders and politicians broadly advocated changing the law to limit the liability of shareholders to the amounts they had invested in a company. If a person bought $100 worth of shares, they reasoned, he or she should be immune to liability for anything beyond that, regardless of what happened to the company." Limited liability's *"sole purpose … is to shield them from legal responsibility for corporations' actions"* as well as reducing the risks of investing (unlike for small businesses). [**The Corporation**, p. 11 and p. 79]

This means that stock holders (investors) in a corporation hold no liability for the corporation's debts and obligations. As a result of this state granted privilege, potential losses cannot exceed the amount which they paid for their shares. The rationale used to justify this is the argument that without limited liability, a creditor would not likely allow any share to be sold to a buyer of at least equivalent creditworthiness as the seller. This means that limited liability allows corporations to raise funds for riskier enterprises by reducing risks and costs from the owners and shifting them onto other members of society (i.e. an externality). It is, in effect, a state granted privilege to trade with a limited chance of loss but with an unlimited chance of gain.

This is an interesting double-standard. It suggests that corporations are not, in fact, owned by shareholders at all since they take on none of the responsibility of ownership, especially the responsibility to pay back debts. Why should they have the privilege of getting profit during good times when they take none of the responsibility during bad times? Corporations are creatures of government, created with the social privileges of limited financial liability of shareholders. Since their debts are ultimately public, why should their profits be private?

Needless to say, this reducing of risk is not limited to within a state, it is applied internationally as well. Big banks and corporations lend money to developing nations but *"the people who borrowed the money [i.e. the local elite] aren't held responsible for it. It's the people … who have to pay [the debts] off … The lenders are protected from risk. That's one of the main functions of the IMF, to provide risk free insurance to people who lend and invest in risky loans. They earn high yields because there's a lot of risk, but they don't have to take the risk, because it's socialised. It's transferred in various ways to Northern taxpayers through the IMP and other devices … The whole system is one in which the borrowers are released from the responsibility. That's transferred to the impoverished mass of the population in their own countries. And the lenders are protected from risk."* [Noam Chomsky, **Propaganda and the Public Mind**, p. 125]

Capitalism, ironically enough, has developed precisely by externalising risk and placing the burden onto other parties — suppliers, creditors, workers and, ultimately, society as a whole. *"Costs and risks are socialised,"* in other words, *"and the profit is privatised."* [Noam Chomsky, **Op. Cit.**, p. 185] To then turn round and justify corporate profits in terms of risk seems to be hypocritical in the extreme, particularly by appealing to examples of small business people whom usually face the burdens caused by corporate externalising of risk! Doug Henwood states the obvious when he writes shareholder *"liabilities are limited by definition to what they paid for the shares"* and *"they can always sell their shares in a troubled firm, and if they have diversified portfolios, they can handle an occasional wipe-out with hardly a stumble. Employees, and often customers and suppliers, are rarely so well-insulated."* Given that the *"signals emitted by the stock market are either irrelevant or harmful to real economic activity, and that the stock market itself counts for little or nothing as a source of finance"* and the argument for risk as a defence of profits is extremely weak. [**Op. Cit.**, p. 293 and p. 292]

Lastly, the risk theory of profit fails to take into account the different risk-taking abilities of that derive from the unequal distribution of society's wealth. As James Meade puts it, while *"property owners can spread their risks by putting small bits of their property into a large number of concerns, a worker cannot easily put small bits of his effort into a large number of different jobs. This presumably is the main reason we find risk-bearing capital hiring labour"* and not vice versa. [quoted by David Schweickart, **Against Capitalism**, pp. 129–130]

It should be noted that until the early nineteenth century, self-employment was the normal state of affairs and it has declined steadily to reach, at best, around 10% of the working population in Western countries today. It would be inaccurate, to say the least, to explain this decline in terms of increased unwillingness to face potential risks on the part of working people. Rather, it is a product of increased costs to set up and run businesses which acts as a very effect **natural** barrier to competition (see section C.4). With limited resources available, most working people simply **cannot** face the risk as they do not have sufficient funds in the first place and, moreover, if such funds are found the market is hardly a level playing field.

This means that going into business for yourself is always a possibility, but that option is very difficult without sufficient assets. Moreover, even if sufficient funds are found (either by savings or a loan), the risk is extremely high due to the inability to diversify investments and the constant possibility that larger firms will set-up shop in your area (for example, Wal-Mart driving out small businesses or chain pubs, cafes and bars destroying local family businesses). So it is true that there is a small flow of workers into self-employment (sometimes called the petit bourgeoisie) and that, of these, a small amount become full-scale capitalists. However, these are the exceptions that prove the rule — there is a greater return into wage slavery as enterprises fail.

Simply put, the distribution of wealth (and so ability to take risks) is so skewed that such possibilities are small and, in spite being highly risky, do not provide sufficient returns to make most of them a success. That many people **do** risk their savings and put themselves through stress, insecurity and hardship in this way is, ironically, hardly a defence of capitalism as it suggests that wage labour is so bad that many people will chance everything to escape it. Sadly, this natural desire to be your own boss generally becomes, if successful, being someone else's boss! Which means, in almost all cases, it shows that to become rich you need to exploit other people's labour.

So, as with "waiting" (see section C.2.7), taking a risk is much easier if you are wealthy and so risk is simply another means for rewarding the wealthy for being wealthy. In other words, risk aversion is the dependent, not the independent, factor. The distribution of wealth determines the risks people willing to face and so cannot explain or justify that wealth. Rather than individual evaluations determining "risk", these evaluations will be dependent on the class position of the individuals involved. As Schweickart notes, *"large numbers of people simply do not have any discretionary funds to invest. They can't play at all … among those who can play, some are better situated than others. Wealth gives access to information, expert advice, and opportunities for diversification that the small investor often lacks."* [**After Capitalism**, p. 34] As such, profits do not reflect the real cost of risk but rather the scarcity of people with anything to risk (i.e. inequality of wealth).

Similarly, given that the capitalists (or their hired managers) have a monopoly of decision making power within a firm, any risks made by a company reflects that hierarchy. As such, risk and the ability to take risks are monopolised in a few hands. If profit **is** the product of risk then, ultimately, it is the product of a hierarchical company structure and, consequently, capitalists are simply rewarding themselves because they have power within the workplace. As with "innovation" and "entrepreneurialism" (see section C.2.8), this rationale for surplus value depends on ignoring how the workplace is structured. In other words, because managers monopolise decision making ("risk") they also monopolise the surplus value produced by workers. However, the former in no way justifies this appropriation nor does it create it.

As risk is not an independent factor and so cannot be the source of profit. Indeed other activities can involve far more risk and be rewarded less. Needless to say, the most serious consequences of "risk" are usually suffered by working people who can lose their jobs, health and even lives all depending on how the risks of the wealthy turn out in an uncertain world. As such, it is one thing to gamble your own income on a risky decision but quite another when that decision can ruin the lives of others. If quoting Keynes is not too out of place: *"Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."* [**The General Theory of Employment, Interest and Money**, p. 159]

Appeals of risk to justify capitalism simply exposes that system as little more than a massive casino. In order for such a system to be fair, the participants must have approximately equal chances of winning. However, with massive inequality the wealthy face little chance of loosing. For example, if a millionaire and a pauper both repeatedly bet a pound on the outcome of a coin toss, the millionaire will always win as the pauper has so little reserve money that even a minor run of bad luck will bankrupt him.

Ultimately, *"the capitalist investment game (as a whole and usually in its various parts) is positive sum. In most years more money is made in the financial markets than is lost. How is this possible? It is possible only because those who engage in real productive activity receive less than that to which they would be entitled were they fully compensated for what they produce. The reward, allegedly for risk, derives from this discrepancy."* [David Schweickart, **Op. Cit.**, p. 38] In other words, people would not risk their money unless they could make a profit and the willingness to risk is dependent on current and expected profit levels and so cannot explain them. To focus on risk simply obscures the influence that property has upon the ability to enter a given industry (i.e. to take a risk in the first place) and so distracts attention away from the essential aspects of how profits are actually generated (i.e. away from production and its hierarchical organisation under capitalism).

So risk does not explain how surplus value is generated nor is its origin. Moreover, as the risk people face and the return they get is dependent on the wealth they have, it cannot be used to justify this distribution. Quite the opposite, as return and risk are usually inversely related. If risk was the source of surplus value or justified it, the riskiest investment and poorest investor would receive the highest returns and this is not the case. In summary, the "risk" defence of capitalism does not convince.

C.3 What determines the distribution between labour and capital?

In short, class struggle determines the distribution of income between classes (As Proudhon put it, the expression *"the relations of profits to wages"* means *"the war between labour and capital."* [**System of Economical Contradictions**, p. 130]). This, in turn, is dependent on the balance of power within any given economy at any given time.

Given our analysis of the source of surplus value in section C.2.2, this should come as no surprise. Given the central role of labour in creating both goods (things with value) and surplus value, production prices determine market prices. This means that market prices are governed, however indirectly, by what goes on in production. In any company, wages determine a large percentage of the production costs. Looking at other costs (such as raw materials), again wages play a large role in determining their price. Obviously the division of a commodity's price into costs and profits is not a fixed ratio, which mean that prices are the result of complex interactions of wage levels and productivity. Within the limits of a given situation, the class struggle between employers and employees over wages, working conditions and benefits determines the degree of exploitation within a society and so the distribution of income, i.e. the relative amount of money which goes to labour (i.e. wages) and capital (surplus value).

To quote libertarian socialist Cornelius Castoriadis:

> *"Far from being completely dominated by the will of the capitalist and forced to increase indefinitely the yield of labour, production is determined just as much by the workers' individual and collective resistance to such increases. The extraction of 'use value form labour power' is not a technical operation; it is a process of bitter struggle in which half the time, so to speak, the capitalists turn out to be losers.*
>
> *"The same thing holds true for living standards, i.e., real wage levels. From its beginnings, the working class has fought to reduce the length of the workday and to raise wage levels. It is this struggle that has determined how these levels have risen and fallen over the years …*
>
> *"Neither the actual labour rendered during an hour of labour time nor the wage received in exchange for this work can be determined by any kind of 'objective' law, norm, or calculation … What we are saying does not mean that specifically economic or even 'objective' factors play no real in determining wage levels. Quite the contrary. At any given instant, the class struggle comes into play only within a given economic — and, more generally, objective — framework, and it acts not only directly but also through the intermediary of a series of partial 'economic mechanisms.' To give only one example among thousands, an economic victory for workers in one sector has a ripple effect on overall wage levels, not only because it can encourage other workers to be more combative, but also because sectors with lower wage levels will experience greater difficulties*

> *recruiting manpower. None of these mechanisms, however, can effectively act on its own and have its own significance if taken separately from the class struggle. And the economic context itself is always gradually affected one way or another by this struggle."* [**Political and Social Writings**, vol. 2, p. 248]

The essential point is that the extraction of surplus value from workers is not a simple technical operation, as implied by the neo-classical perspective (and, ironically, classical Marxism as Castoriadis explains in his classic work *"Modern Capitalism and Revolution"* [**Op. Cit.**, pp. 226–343]). As noted previously, unlike the extraction of so many joules from a ton of coal, extracting surplus value ("use value") from labour power involves conflict between people, between classes. Labour power is unlike all other commodities — it is and remains inseparably embodied in human beings. This means that the division of profits and wages in a company and in the economy as a whole is dependent upon and modified by the actions of workers (and capitalists), both as individuals and as a class. It is this struggle which, ultimately, drives the capitalist economy, it is this conflict between the human and commodity aspects of labour power that ultimately brings capitalism into repeated crisis (see section C.7).

From this perspective, the neo-classical argument that a factor in production (labour, capital or land) receives an income share that indicates its productive power "at the margin" is false. Rather, it is a question of power — and the willingness to use it. As Christopher Eaton Gunn points out, the neo-classical argument *"take[s] no account of power — of politics, conflict, and bargaining — as more likely indicators of relative shares of income in the real world."* [**Workers' Self-Management in the United States**, p. 185] Ultimately, working class struggle is an *"indispensable means of raising their standard of living or defending their attained advantages against the concerted measures of the employers."* It is *"not only a means for the defence of immediate economic interests, it is also a continuous schooling for their powers of resistance, showing them every day that every last right has to be won by unceasing struggle against the existing system."* [Rocker, **Anarcho-Syndicalism**, p. 78]

If the power of labour is increasing, its share in income will tend to increase and, obviously, if the power of labour decreased it would fall. And the history of the post-war economy supports such an analysis, with labour in the advanced countries share of income falling from 68% in the 1970s to 65.1% in 1995 (in the EU, it fell from 69.2% to 62%). In the USA, labour's share of income in the manufacturing sector fell from 74.8% to 70.6% over the 1979–89 period, reversing the rise in labour's share that occurred over the 1950s, 1960s and 1970s. The reversal in labour's share occurred at the same time as labour's power was undercut by right-wing governments who have pursued business friendly "free market" policies to combat "inflation" (an euphemism for working class militancy and resistance) by undermining working class power and organisation by generating high unemployment.

Thus, for many anarchists, the relative power between labour and capital determines the distribution of income between them. In periods of full employment or growing workplace organisation and solidarity, workers wages will tend to rise faster. In periods where there is high unemployment and weaker unions and less direct action, labour's share will fall. From this analysis anarchists support collective organisation and action in order to increase the power of labour and ensure we receive more of the value we produce.

The neo-classical notion that rising productivity allows for increasing wages is one that has suffered numerous shocks since the early 1970s. Usually wage increases lag behind productivity.

For example, during Thatcher's reign of freer markets, productivity rose by 4.2%, 1.4% higher than the increase in real earnings between 1980–88. Under Reagan, productivity increased by 3.3%, accompanied by a fall of 0.8% in real earnings. Remember, though, these are averages and hide the actual increases in pay differentials between workers and managers. To take one example, the real wages for employed single men between 1978 and 1984 in the UK rose by 1.8% for the bottom 10% of that group, for the highest 10%, it was a massive 18.4%. The average rise (10.1%) hides the vast differences between top and bottom. In addition, these figures ignore the starting point of these rises — the often massive differences in wages between employees (compare the earnings of the CEO of McDonalds and one of its cleaners). In other words, 2.8% of nearly nothing is still nearly nothing!

Looking at the USA again, we find that workers who are paid by the hour (the majority of employees) saw their average pay peak in 1973. Since then, it had declined substantially and stood at its mid-1960s level in 1992. For over 80 per cent of the US workforce (production and non-supervisory workers), real wages have fallen by 19.2 per cent for weekly earnings and 13.4 per cent for hourly earnings between 1973 and 1994. Productivity had risen by 23.2 per cent. Combined with this drop in real wages in the USA, we have seen an increase in hours worked. In order to maintain their current standard of living, working class people have turned to both debt and longer working hours. Since 1979, the annual hours worked by middle-income families rose from 3 020 to 3 206 in 1989, 3 287 in 1996 and 3 335 in 1997. In Mexico we find a similar process. Between 1980 and 1992, productivity rose by 48 per cent while salaries (adjusted for inflation) fell by 21 per cent.

Between 1989 to 1997, productivity increased by 9.7% in the USA while median compensation decreased by 4.2%. In addition, median family working hours grew by 4% (or three weeks of full-time work) while its income increased by only 0.6 % (in other words, increases in working hours helped to create this slight growth). If the wages of workers were related to their productivity, as argued by neo-classical economics, you would expect wages to increase as productivity rose, rather than fall. However, if wages are related to economic power, then this fall is to be expected. This explains the desire for "flexible" labour markets, where workers' bargaining power is eroded and so more income can go to profits rather than wages.

It is amazing how far the US in 2005, the paradigm for neo-liberalism, is from the predictions of neo-classical economic textbooks. Since the 1970s, there has only been one period of sustained good times for working people, the late 1990s. Before and after this period, there has been wage stagnation (between 2000 and 2004, for example, the real median family income **fell** by 3%). While the real income of households in the lowest fifth grew by 6.1% between 1979 and 2000, the top fifth saw an increase of 70% and the average income of the top 1% grew by 184%. This rising inequality was fuelled by the expansion of income from capital and an increased concentration of capital income in the top 1% (who received 57.5% of all capital income in 2003, compared to 37.8% in 1979). This reflected the increased share of income flowing to corporate profits (profits rates in 2005 were the highest in 36 years). If the pre-tax return to capital had remained at its 1979 level, then hourly compensation would have been 5% higher. In 2005 dollars, this represents an annual transfer of $235 billion from labour to capital. [Lawrence Mishel, Jered Bernstein, and Sylvia Allegretto, **The State of Working America 2006/7**, pp. 2–3]

Labour's share of income in the corporate sector fell from 82.1% in 179 to 81.1% in 1989, and then to 79.1% in 2005. However, this fall is even worse for labour as labour income *"includes the pay of Chief Executive Officers (CEOs), thereby overstating the income share going to 'workers' and* *understating 'profits,' since the bonuses and stock options given CEOs are more akin to profits than wages"* and so *"some of the profits are showing up in CEO paychecks and are counted as worker pay."* [**Op. Cit.**, p. 83 and p. 84]

Unsurprisingly, there has been a *"stunning disconnect between the rapid productivity growth and pay growth,"* along with a *"tremendous widening of the wage gap between those at the top of the wage scale, particularly corporate chief executive officers [CEO], and other wage earners."* Between 1979 and 1995, wages *"were stagnant or fell for the bottom 60% of wage earners"* and grew by 5% for the 80th percentile. Between 1992 and 2005, saw median CEO pay rise by 186.2% while the media worker saw only a 7.2% rise in their wages. Wealth inequality was even worse, with the wealth share of the bottom 80% shrinking by 3.8 percentage points (which was gained by the top 5% of households). Using the official standard of poverty, 11.3% of Americans were in poverty in 2000, rising to 12.7% in 2004 (*"This is the first time that poverty rose through each of the first three years of a recovery"*). However, the official poverty line is hopelessly out of date (for a family of four it was 48% of median family income in 1960, in 2006 it is 29%). Using a threshold of twice the official value sees an increase in poverty from 29.3% to 31.2% [**Op. Cit.**, p. 4, p. 5, p. 7, p. 9 and p. 11]

Of course, it will be argued that only in a perfectly competitive market (or, more realistically, a truly "free" one) will wages increase in-line with productivity. However, you would expect that a regime of **freer** markets would make things better, not worse. This has not happened. The neo-classical argument that unions, struggling over wages and working conditions will harm workers in the "long run" has been dramatically refuted since the 1970s — the decline of the labour movement in the USA has been marked by falling wages, not rising ones, for example. Despite of rising productivity, wealth has **not** "trickled down" — rather it has flooded up (a situation only surprising to those who believe economic textbooks or what politicians say). In fact, between 1947 and 1973, the median family income rose by 103.9% while productivity rose by 103.7% and so wages and productivity went hand-in-hand. Since the mid-1970s this close mapping broke down. From 1973 to 2005, productivity rose by 75.5% while income increased by a mere 21.8%, less than one-third the rate of productivity (from 2000 to 2004, productivity rose by 14% while family income fell by 2.9%). This wedge is the source of rising inequality, with the upper classes claiming most of the income growth. [**Op. Cit.**, p. 46]

All of which refutes those apologists for capitalism who cite the empirical fact that, in a modern capitalist economy, a large majority of all income goes to "labour," with profit, interest and rent adding up to something under twenty percent of the total. Of course, even if surplus value were less than 20% of a workers' output, this does not change its exploitative nature (just as, for the capitalist apologist, taxation does not stop being "theft" just because it is around 10% of all income). However, this value for profit, interest and rent is based on a statistical sleight-of-hand, as "worker" is defined as including everyone who has a salary in a company, including managers and CEOs. The large incomes which many managers and all CEOs receive would, of course, ensure that a large majority of all income does go to "labour." Thus this "fact" ignores the role of most managers as de facto capitalists and their income represents a slice of surplus value rather than wages. This sleight-of-hand also obscures the results of this distribution for while the 70% of "labour" income goes into many hands, the 20% representing surplus value goes into the hands of a few. So even if we ignore the issue of CEO "wages", the fact is that a substantial amount of money is going into the hands of a small minority which will, obviously, skew income, wealth and economic power away from the vast majority.

To get a better picture of the nature of exploitation within modern capitalism we have to compare workers wages to their productivity. According to the World Bank, in 1966, US manufacturing wages were equal to 46% of the value-added in production (value-added is the difference between selling price and the costs of raw materials and other inputs to the production process). In 1990, that figure had fallen to 36% and by 1993, to 35%. Figures from the 1992 Economic Census of the US Census Bureau indicate it had reached 19.76% (39.24% if we take the **total** payroll which includes managers and so on). In the US construction industry, wages were 35.4% of value added in 1992 (with total payroll, 50.18%). Therefore the argument that because a large percentage of income goes to "labour" capitalism is fine hides the realities of that system and the exploitation its hierarchical nature creates.

Overall, since the 1970s working class America has seen stagnating income, rising working hours and falling social (i.e. income-class) mobility while, at the same time, productivity has been rising and inequality soaring. While this may come as a surprise (or be considered a paradox by capitalist economics, a paradox usually to be justified and rationalised id acknowledged at all) anarchists consider this to be a striking confirmation of their analysis. Unsurprisingly, in a hierarchical system those at the top do better than those at the bottom. The system is set up so that the majority enrich the minority. That is way anarchists argue that workplace organisation and resistance is essential to maintain — and even increase — labour's income. For if the share of income between labour and capital depends on their relative power — and it does — then only the actions of workers themselves can improve their situation and determine the distribution of the value they create.

This analysis obviously applied **within** classes as well. At any time, there is a given amount of unpaid labour in circulation in the form of goods or services representing more added value than workers were paid for. This given sum of unpaid labour (surplus value) represents a total over which the different capitalists, landlords and bankers fight over. Each company tries to maximise its share of that total, and if a company does realise an above-average share, it means that some other companies receive less than average.

The key to distribution within the capitalist class is, as between that class and the working class, power. Looking at what is normally, although somewhat inaccurately, called monopoly this is obvious. The larger the company with respect to its market, the more likely it is to obtain a larger share of the available surplus, for reasons discussed later (see section C.5). While this represents a distribution of surplus value **between** capitalists based on market power, the important thing to note here is that while companies compete on the market to realise their share of the total surplus (unpaid labour) the **source** of these profits does not lie in the market, but in production. One cannot buy what does not exist and if one gains, another loses.

Market power also plays a key role in producing inflation, which has its roots in the ability of firms to pass cost increases to consumers in the form of higher prices. This represents a distribution of income from lenders to borrowers, i.e. from finance capital to industrial capital and labour to capital (as capital "borrows" labour, i.e. the workers are paid **after** they have produced goods for their bosses). How able capitalists are to pass on costs to the general population depends on how able they are to withstand competition from other companies, i.e. how much they dominate their market and can act as a price setter. Of course, inflation is not the only possible outcome of rising costs (such as wage rises). It is always possible to reduce profits or increase the productivity of labour (i.e. increase the rate of exploitation). The former is rarely raised as a possibility, as the underlying assumption seems to be that profits are sacrosanct, and the latter is dependent, of course, on the balance of forces within the economy.

In the next section, we discuss why capitalism is marked by big business and what this concentrated market power means to the capitalist economy.

C.4 Why does the market become dominated by Big Business?

As noted in section C.1.4, the standard capitalist economic model assumes an economy made up of a large number of small firms, none of which can have any impact on the market. Such a model has no bearing to reality:

> *"The facts show … that capitalist economies tend over time and with some interruptions to become more and more heavily concentrated."* [M.A. Utton, **The Political Economy of Big Business**, p. 186]

As Bakunin argued, capitalist production *"must ceaselessly expand at the expense of the smaller speculative and productive enterprises devouring them."* Thus *"[c]ompetition in the economic field destroys and swallows up the small and even medium-sized enterprises, factories, land estates, and commercial houses for the benefit of huge capital holdings."* [**The Political Philosophy of Bakunin**, p. 182] The history of capitalism has proven him right. while the small and medium firm has not disappeared, economic life under capitalism is dominated by a few big firms.

This growth of business is rooted in the capitalist system itself. The dynamic of the "free" market is that it tends to becomes dominated by a few firms (on a national, and increasingly, international, level), resulting in oligopolistic competition and higher profits for the companies in question (see next section for details and evidence). This occurs because only established firms can afford the large capital investments needed to compete, thus reducing the number of competitors who can enter or survive in a given the market. Thus, in Proudhon's words, *"competition kills competition."* [**System of Economical Contradictions**, p. 242] In other words, capitalist markets evolve toward oligopolistic concentration.

This *"does not mean that new, powerful brands have not emerged [after the rise of Big Business in the USA after the 1880s]; they have, but in such markets… which were either small or non-existent in the early years of this century."* The dynamic of capitalism is such that the *"competitive advantage [associated with the size and market power of Big Business], once created, prove[s] to be enduring."* [Paul Ormerod, **The Death of Economics**, p. 55]

For people with little or no capital, entering competition is limited to new markets with low start-up costs (*"In general, the industries which are generally associated with small scale production… have low levels of concentration"* [Malcolm C. Sawyer, **The Economics of Industries and Firms**, p. 35]). Sadly, however, due to the dynamics of competition, these markets usually in turn become dominated by a few big firms, as weaker firms fail, successful ones grow and capital costs increase (*"Each time capital completes its cycle, the individual grows smaller in proportion to it."* [Josephine Guerts, **Anarchy: A Journal of Desire Armed** no. 41, p. 48]).

For example, between 1869 and 1955 *"there was a marked growth in capital per person and per number of the labour force. Net capital per head rose… to about four times its initial level … at a* *rate of about 17% per decade."* The annual rate of gross capital formation rose *"from $3.5 billion in 1869–1888 to $19 billion in 1929–1955, and to $30 billion in 1946–1955. This long term rise over some three quarters of a century was thus about nine times the original level"* (in constant, 1929, dollars). [Simon Kuznets, **Capital in the American Economy**, p. 33 and p. 394] To take the steel industry as an illustration: in 1869 the average cost of steel works in the USA was $156,000, but by 1899 it was $967,000 — a 520% increase. From 1901 to 1950, gross fixed assets increased from $740,201 to $2,829,186 in the steel industry as a whole, with the assets of Bethlehem Steel increasing by 4,386.5% from 1905 ($29,294) to 1950 ($1,314,267). These increasing assets are reflected both in the size of workplaces and in the administration levels in the company as a whole (i.e. **between** individual workplaces).

The reason for the rise in capital investment is rooted in the need for capitalist firms to gain a competitive edge on their rivals. As noted in section C.2, the source of profit is the unpaid labour of workers and this can be increased by one of two means. The first is by making workers work longer for less on the same machinery (the generation of absolute surplus value, to use Marx's term). The second is to make labour more productive by investing in new machinery (the generation of relative surplus value, again using Marx's terminology). The use of technology drives up the output per worker relative to their wages and so the workforce is exploited at a higher rate (how long before workers force their bosses to raise their wages depends on the balance of class forces as we noted in the last section). This means that capitalists are driven by the market to accumulate capital. The first firm to introduce new techniques reduces their costs relative to the market price, so allowing them to gain a surplus profit by having a competitive advantage (this addition profit disappears as the new techniques are generalised and competition invests in them).

As well as increasing the rate of exploitation, this process has an impact on the structure of the economy. With the increasing ratio of capital to worker, the cost of starting a rival firm in a given, well-developed, market prohibits all but other large firms from doing so (and here we ignore advertising and other distribution expenses, which increase start-up costs even more — *"advertising raises the capital requirements for entry into the industry"* [Sawyer, **Op. Cit.**, p. 108]). J. S. Bain (in **Barriers in New Competition**) identified three main sources of entry barrier: economies of scale (i.e. increased capital costs and their more productive nature); product differentiation (i.e. advertising); and a more general category he called *"absolute cost advantage."*

This last barrier means that larger companies are able to outbid smaller companies for resources, ideas, etc. and put more money into Research and Development and buying patents. Therefore they can have a technological and material advantage over the small company. They can charge "uneconomic" prices for a time (and still survive due to their resources) — an activity called *"predatory pricing"* — and/or mount lavish promotional campaigns to gain larger market share or drive competitors out of the market. In addition, it is easier for large companies to raise external capital, and risk is generally less.

In addition, large firms can have a major impact on innovation and the development of technology — they can simply absorb newer, smaller, enterprises by way of their economic power, buying out (and thus controlling) new ideas, much the way oil companies hold patents on a variety of alternative energy source technologies, which they then fail to develop in order to reduce competition for their product (of course, at some future date they may develop them when it becomes profitable for them to do so). Also, when control of a market is secure, oligopolies will usually delay innovation to maximise their use of existing plant and equipment or introduce spurious innovations to maximise product differentiation. If their control of a market is challenged (usually by other big firms, such as the increased competition Western oligopolies faced from Japanese ones in the 1970s and 1980s), they can speed up the introduction of more advanced technology and usually remain competitive (due, mainly, to the size of the resources they have available).

These barriers work on two levels — **absolute** (entry) barriers and **relative** (movement) barriers. As business grows in size, the amount of capital required to invest in order to start a business also increases. This restricts entry of new capital into the market (and limits it to firms with substantial financial and/or political backing behind them):

> *"Once dominant organisations have come to characterise the structure of an industry, immense barriers to entry face potential competitors. Huge investments in plant, equipment, and personnel are needed ... [T]he development and utilisation of productive resources* ***within*** *the organisation takes considerable time, particularly in the face of formidable incumbents ... It is therefore one thing for a few business organisations to emerge in an industry that has been characterised by ... highly competitive conditions. It is quite another to break into an industry... [marked by] oligopolistic market power."* [William Lazonick, **Business Organisation and the Myth of the Market Economy**, pp. 86–87]

Moreover, **within** the oligopolistic industry, the large size and market power of the dominant firms mean that smaller firms face expansion disadvantages which reduce competition. The dominant firms have many advantages over their smaller rivals — significant purchasing power (which gains better service and lower prices from suppliers as well as better access to resources), privileged access to financial resources, larger amounts of retained earnings to fund investment, economies of scale both within and **between** workplaces, the undercutting of prices to "uneconomical" levels and so on (and, of course, they can **buy** the smaller company — IBM paid $3.5 billion for Lotus in 1995. That is about equal to the entire annual output of Nepal, which has a population of 20 million). The large firm or firms can also rely on its established relationships with customers or suppliers to limit the activities of smaller firms which are trying to expand (for example, using their clout to stop their contacts purchasing the smaller firms products).

Little wonder Proudhon argued that *"[i]n competition... victory is assured to the heaviest battalions."* [**Op. Cit.**, p. 260]

As a result of these entry/movement barriers, we see the market being divided into two main sectors — an oligopolistic sector and a more competitive one. These sectors work on two levels — within markets (with a few firms in a given market having very large market shares, power and excess profits) and within the economy itself (some markets being highly concentrated and dominated by a few firms, other markets being more competitive). This results in smaller firms in oligopolistic markets being squeezed by big business along side firms in more competitive markets. Being protected from competitive forces means that the market price of oligopolistic markets is **not** forced down to the average production price by the market, but instead it tends to stabilise around the production price of the smaller firms in the industry (which do not have access to the benefits associated with dominant position in a market). This means that the dominant firms get super-profits while new capital is not tempted into the market as returns would not make the move worthwhile for any but the biggest companies, who usually get comparable returns in their own oligopolised markets (and due to the existence of market power in a few hands, entry can potentially be disastrous for small firms if the dominant firms perceive expansion as a threat).

Thus whatever super-profits Big Business reap are maintained due to the advantages it has in terms of concentration, market power and size which reduce competition (see section C.5 for details).

And, we must note, that the processes that saw the rise of national Big Business is also at work on the global market. Just as Big Business arose from a desire to maximise profits and survive on the market, so *"[t]ransnationals arise because they are a means of consolidating or increasing profits in an oligopoly world."* [Keith Cowling and Roger Sugden, **Transnational Monopoly Capitalism**, p. 20] So while a strictly national picture will show a market dominated by, say, four firms, a global view shows us twelve firms instead and market power looks much less worrisome. But just as the national market saw a increased concentration of firms over time, so will global markets. Over time a well-evolved structure of global oligopoly will appear, with a handful of firms dominating most global markets (with turnovers larger than most countries GDP — which is the case even now. For example, in 1993 Shell had assets of US$ 100.8 billion, which is more than double the GDP of New Zealand and three times that of Nigeria, and total sales of US$ 95.2 billion).

Thus the very dynamic of capitalism, the requirements for survival on the market, results in the market becoming dominated by Big Business (*"the more competition develops, the more it tends to reduce the number of competitors."* [P-J Proudhon, **Op. Cit.**, p. 243]). The irony that competition results in its destruction and the replacement of market co-ordination with planned allocation of resources is one usually lost on supporters of capitalism.

C.4.1 How extensive is Big Business?

The effects of Big Business on assets, sales and profit distribution are clear. In the USA, in 1985, there were 14,600 commercial banks. The 50 largest owned 45.7 of all assets, the 100 largest held 57.4%. In 1984 there were 272,037 active corporations in the manufacturing sector, 710 of them (one-fourth of 1 percent) held 80.2 percent of total assets. In the service sector (usually held to be the home of small business), 95 firms of the total of 899,369 owned 28 percent of the sector's assets. In 1986 in agriculture, 29,000 large farms (only 1.3% of all farms) accounted for one-third of total farm sales and 46% of farm profits. In 1987, the top 50 firms accounted for 54.4% of the total sales of the **Fortune** 500 largest industrial companies. [Richard B. Du Boff, **Accumulation and Power**, p. 171] Between 1982 and 1992, the top two hundred corporations increased their share of global Gross Domestic Product from 24.2% to 26.8%, *"with the leading ten taking almost half the profits of the top two hundred."* This underestimates economic concentration as it *"does not take account of privately owned giants."* [Chomsky, **World Orders, Old and New**, p. 181]

The process of market domination is reflected by the increasing market share of the big companies. In Britain, the top 100 manufacturing companies saw their market share rise from 16% in 1909, to 27% in 1949, to 32% in 1958 and to 42% by 1975. In terms of net assets, the top 100 industrial and commercial companies saw their share of net assets rise from 47% in 1948 to 64% in 1968 to 80% in 1976 [R.C.O. Matthews (ed.), **Economy and Democracy**, p. 239]. Looking wider afield, we find that in 1995 about 50 firms produce about 15 percent of the manufactured goods in the industrialised world. There are about 150 firms in the world-wide motor vehicle industry. But the two largest firms, General Motors and Ford, together produce almost one-third of all vehicles.

The five largest firms produce half of all output and the ten largest firms produce three-quarters. Four appliance firms manufacture 98 percent of the washing machines made in the United States. In the U. S. meatpacking industry, four firms account for over 85 percent of the output of beef, while the other 1,245 firms have less than 15 percent of the market.

While the concentration of economic power is most apparent in the manufacturing sector, it is not limited to that sector. We are seeing increasing concentration in the service sector — airlines, fast-food chains ,and the entertainment industry are just a few examples. In America Coke, Pepsi, and Cadbury-Schweppes dominate soft drinks while Budweiser, Miller, and Coors share the beer market. Nabisco, Keebler and Pepperidge Farms dominate the cookie industry. Expansions and mergers play their role in securing economic power and dominance. In 1996 the number three company in the US cookie industry was acquired by Keebler, which (in turn) was acquired by Kellogg in 2000. Nabisco is a division of Kraft/Philip Morris and Pepperidge Farm is owned by relatively minor player Campbell. Looking at the US airline industry, considered the great hope for deregulation in 1978, it has seen the six largest companies control of the market rise from 73% in 1978 to 85% in 1987 (and increasing fares across the board). [*"Unexpected Result of Airline Decontrol is Return to Monopolies,"* **Wall Street Journal**, 20/07/1987] By 1998, the top six's share had increased by 1% but control was effectively higher with three code-sharing alliances now linking all six in pairs.[Amy Taub, *"Oligopoly!"* **Multinational Monitor**, November 1998, p. 9]

This process of concentration is happening in industries historically considered arenas of small companies. In the UK, a few big supermarkets are driving out small corner shops (the four-firm concentration ratio of the supermarket industry is over 70%) while the British brewing industry has a staggering 85% ratio. In American, the book industry is being dominated by a few big companies, both in production and distribution. A few large conglomerates publish most leading titles while a few big chains (Barnes & Nobles and Borders) have the majority of retail sales. On the internet, Amazon dominates the field in competition with the online versions of the larger bookshops. This process occurs in market after market. As such, it should be stressed that increasing concentration afflicts most, if not all sectors of the economy. There are exceptions, of course, and small businesses never disappear totally but even in many relatively de-centralised and apparently small-scale businesses, the trend to consolidation has unmistakable:

> *"The latest data available show that in the manufacturing sector the four largest companies in a given industry controlled an average of 40 percent of the industry's output in 1992, and the top eight had 52 percent. These shares were practically unchanged from 1972, but they are two percentage points higher than in 1982. Retail trade (department stores, food stores, apparel, furniture, building materials and home supplies, eating and drinking places, and other retail industries) also showed a jump in market concentration since the early 1980s. The top four firms accounted for an average of 16 percent of the retail industry's sales in 1982 and 20 percent in 1992; for the eight largest, the average industry share rose from 22 to 28 percent. Some figures now available for 1997 suggest that concentration continued to increase during the 1990s; of total sales receipts in the overall economy, companies with 2,500 employees or more took in 47 percent in 1997, compared with 42 percent in 1992.*
>
> *"In the financial sector, the number of commercial banks fell 30 percent between 1990 and 1999, while the ten largest were increasing their share of loans and other industry assets from 26 to 45 percent. It is well established that other sectors, including agriculture and*

> *telecommunications, have also become more concentrated in the 1980s and 1990s. The overall rise in concentration has not been great-although the new wave may yet make a major mark-but the upward drift has taken place from a starting point of highly concentrated economic power across the economy."* [Richard B. Du Boff and Edward S. Herman, *"Mergers, Concentration, and the Erosion of Democracy"*, **Monthly Review**, May 2001]

So, looking at the **Fortune** 500, even the 500th firm is massive (with sales of around $3 billion). The top 100 firms usually have sales significantly larger than bottom 400 put together. Thus the capitalist economy is marked by a small number of extremely large firms, which are large in both absolute terms and in terms of the firms immediately below them. This pattern repeats itself for the next group and so on, until we reach the very small firms (where the majority of firms are).

The other effect of Big Business is that large companies tend to become more diversified as the concentration levels in individual industries increase. This is because as a given market becomes dominated by larger companies, these companies expand into other markets (using their larger resources to do so) in order to strengthen their position in the economy and reduce risks. This can be seen in the rise of "subsidiaries" of parent companies in many different markets, with some products apparently competing against each other actually owned by the same company!

Tobacco companies are masters of this diversification strategy; most people support their toxic industry without even knowing it! Don't believe it? Well, if are an American and you ate any Jell-O products, drank Kool-Aid, used Log Cabin syrup, munched Minute Rice, quaffed Miller beer, gobbled Oreos, smeared Velveeta on Ritz crackers, and washed it all down with Maxwell House coffee, you supported the tobacco industry, all without taking a puff on a cigarette! Similarly, in other countries. Simply put, most people have no idea which products and companies are owned by which corporations, which goods apparently in competition with others in fact bolster the profits of the same transnational company.

Ironically, the reason why the economy becomes dominated by Big Business has to do with the nature of competition itself. In order to survive (by maximising profits) in a competitive market, firms have to invest in capital, advertising, and so on. This survival process results in barriers to potential competitors being created, which results in more and more markets being dominated by a few big firms. This oligopolisation process becomes self-supporting as oligopolies (due to their size) have access to more resources than smaller firms. Thus the dynamic of competitive capitalism is to negate itself in the form of oligopoly.

C.4.2 What are the effects of Big Business on society?

Unsurprisingly many pro-capitalist economists and supporters of capitalism try to downplay the extensive evidence on the size and dominance of Big Business in capitalism.

Some deny that Big Business is a problem — if the market results in a few companies dominating it, then so be it (the "Chicago" and "Austrian" schools are at the forefront of this kind of position — although it does seem somewhat ironic that "market advocates" should be, at best, indifferent, at worse, celebrate the suppression of market co-ordination by **planned** co-ordination within the economy that the increased size of Big Business marks). According to this perspective, oligopolies and cartels usually do not survive very long, unless they are doing a good job of serving the customer.

We agree — it is oligopolistic **competition** we are discussing here. Big Business has to be responsive to demand (when not manipulating/creating it by advertising, of course), otherwise they lose market share to their rivals (usually other dominant firms in the same market, or big firms from other countries). However, the response to demand can be skewed by economic power and, while responsive to some degree, an economy dominated by big business can see super-profits being generated by externalising costs onto suppliers and consumers (in terms of higher prices). As such, the idea that the market will solve all problems is simply assuming that an oligopolistic market will respond "as if" it were made up of thousands and thousands of firms with little market power. An assumption belied by the reality of capitalism since its birth.

Moreover, the "free market" response to the reality of oligopoly ignores the fact that we are more than just consumers and that economic activity and the results of market events impact on many different aspects of life. Thus our argument is not focused on the fact we pay more for some products than we would in a more competitive market — it is the **wider** results of oligopoly we should be concerned with, not just higher prices, lower "efficiency" and other economic criteria. If a few companies receive excess profits just because their size limits competition the effects of this will be felt **everywhere**.

For a start, these "excessive" profits will tend to end up in few hands, so skewing the income distribution (and so power and influence) within society. The available evidence suggests that *"more concentrated industries generate a lower wage share for workers"* in a firm's value-added. [Keith Cowling, **Monopoly Capitalism**, p. 106] The largest firms retain only 52% of their profits, the rest is paid out as dividends, compared to 79% for the smallest ones and *"what might be called rentiers share of the corporate surplus — dividends plus interest as a percentage of pretax profits and interest — has risen sharply, from 20–30% in the 1950s to 60–70% in the early 1990s."* The top 10% of the US population own well over 80% of stock and bonds owned by individuals while the top 5% of stockowners own 94.5% of all stock held by individuals. Little wonder wealth has become so concentrated since the 1970s [Doug Henwood, **Wall Street**, p. 75, p. 73 and pp. 66–67]. At its most basic, this skewing of income provides the capitalist class with more resources to fight the class war but its impact goes much wider than this.

Moreover, the *"level of aggregate concentration helps to indicate the degree of centralisation of decision-making in the economy and the economic power of large firms."* [Malcolm C. Sawyer, **Op. Cit.**, p. 261] Thus oligopoly increases and centralises economic power over investment decisions and location decisions which can be used to play one region/country and/or workforce against another to lower wages and conditions for all (or, equally likely, investment will be moved away from countries with rebellious work forces or radical governments, the resulting slump teaching them a lesson on whose interests count). As the size of business increases, the power of capital over labour and society also increases with the threat of relocation being enough to make workforces accept pay cuts, worsening conditions, "down-sizing" and so on and communities increased pollution, the passing of pro-capital laws with respect to strikes, union rights, etc. (and increased corporate control over politics due to the mobility of capital).

Also, of course, oligopoly results in political power as their economic importance and resources gives them the ability to influence government to introduce favourable policies — either directly, by funding political parties or lobbying politicians, or indirectly by investment decisions (i.e. by pressuring governments by means of capital flight — see section D.2). Thus concentrated economic power is in an ideal position to influence (if not control) political power and ensure state aid (both direct and indirect) to bolster the position of the corporation and allow it to expand further and faster than otherwise. More money can also be plowed into influencing the media and funding political think-tanks to skew the political climate in their favour. Economic power also extends into the labour market, where restricted labour opportunities as well as negative effects on the work process itself may result. All of which shapes the society we live in; the laws we are subject to; the "evenness" and "levelness" of the "playing field" we face in the market and the ideas dominant in society (see section D.3).

So, with increasing size, comes the increasing power, the power of oligopolies to *"influence the terms under which they choose to operate. Not only do they **react** to the level of wages and the pace of work, they also **act** to determine them... The credible threat of the shift of production and investment will serve to hold down wages and raise the level of effort [required from workers] ... [and] may also be able to gain the co-operation of the state in securing the appropriate environment ... [for] a redistribution towards profits"* in value/added and national income. [Keith Cowling and Roger Sugden, **Transnational Monopoly Capitalism**, p. 99]

Since the market price of commodities produced by oligopolies is determined by a mark-up over costs, this means that they contribute to inflation as they adapt to increasing costs or falls in their rate of profit by increasing prices. However, this does not mean that oligopolistic capitalism is not subject to slumps. Far from it. Class struggle will influence the share of wages (and so profit share) as wage increases will not be fully offset by price increases — higher prices mean lower demand and there is always the threat of competition from other oligopolies. In addition, class struggle will also have an impact on productivity and the amount of surplus value in the economy as a whole, which places major limitations on the stability of the system. Thus oligopolistic capitalism still has to contend with the effects of social resistance to hierarchy, exploitation and oppression that afflicted the more competitive capitalism of the past.

The distributive effects of oligopoly skews income, thus the degree of monopoly has a major impact on the degree of inequality in household distribution. The flow of wealth to the top helps to skew production away from working class needs (by outbidding others for resources and having firms produce goods for elite markets while others go without). The empirical evidence presented by Keith Cowling *"points to the conclusion that a redistribution from wages to profits will have a depressive impact on consumption"* which may cause depression. [**Op. Cit.**, p. 51] High profits also means that more can be retained by the firm to fund investment (or pay high level managers more salaries or increase dividends, of course). When capital expands faster than labour income over-investment is an increasing problem and aggregate demand cannot keep up to counteract falling profit shares (see section C.7 on more about the business cycle). Moreover, as the capital stock is larger, oligopoly will also have a tendency to deepen the eventual slump, making it last long and harder to recover from.

Looking at oligopoly from an efficiency angle, the existence of super profits from oligopolies means that the higher price within a market allows inefficient firms to continue production. Smaller firms can make average (non-oligopolistic) profits **in spite** of having higher costs, sub-optimal plant and so on. This results in inefficient use of resources as market forces cannot work to eliminate firms which have higher costs than average (one of the key features of capitalism according to its supporters). And, of course, oligopolistic profits skew allocative efficiency as a handful of firms can out-bid all the rest, meaning that resources do not go where they are most needed but where the largest effective demand lies. This impacts on incomes as well, for market power can be used to bolster CEO salaries and perks and so drive up elite income and so skew resources to meeting their demand for luxuries rather than the needs of the general population.

Equally, they also allow income to become unrelated to actual work, as can be seen from the sight of CEO's getting massive wages while their corporation's performance falls.

Such large resources available to oligopolistic companies also allows inefficient firms to survive on the market even in the face of competition from other oligopolistic firms. As Richard B. Du Boff points out, efficiency can also be *"impaired when market power so reduces competitive pressures that administrative reforms can be dispensed with. One notorious case was … U.S. Steel [formed in 1901]. Nevertheless, the company was hardly a commercial failure, effective market control endured for decades, and above normal returns were made on the watered stock … Another such case was Ford. The company survived the 1930s only because of cash reserves stocked away in its glory days. 'Ford provides an excellent illustration of the fact that a really large business organisation can withstand a surprising amount of mismanagement.'"* [**Accumulation and Power**, p. 174]

This means that the market power which bigness generates can counteract the costs of size, in terms of the bureaucratic administration it generates and the usual wastes associated with centralised, top-down hierarchical organisation. The local and practical knowledge so necessary to make sensible decision cannot be captured by capitalist hierarchies and, as a result, as bigness increases, so does the inefficiencies in terms of human activity, resource use and information. However, this waste that workplace bureaucracy creates can be hidden in the super-profits which big business generates which means, by confusing profits with efficiency, capitalism helps mis-allocate resources. This means, as price-setters rather than price-takers, big business can make high profits even when they are inefficient. Profits, in other words, do not reflect "efficiency" but rather how effectively they have secured market power. In other words, the capitalist economy is dominated by a few big firms and so profits, far from being a signal about the appropriate uses of resources, simply indicate the degree of economic power a company has in its industry or market.

Thus Big Business reduces efficiency within an economy on many levels as well as having significant and lasting impact on society's social, economic and political structure.

The effects of the concentration of capital and wealth on society are very important, which is why we are discussing capitalism's tendency to result in big business. The impact of the wealth of the few on the lives of the many is indicated in section D of the FAQ. As shown there, in addition to involving direct authority over employees, capitalism also involves indirect control over communities through the power that stems from wealth.

Thus capitalism is not the free market described by such people as Adam Smith — the level of capital concentration has made a mockery of the ideas of free competition.

C.4.3 What does the existence of Big Business mean for economic theory and wage labour?

Here we indicate the impact of Big Business on economic theory itself and wage labour. In the words of Michal Kalecki, perfect competition is "a most unrealistic assumption" and *"when its actual status of a handy model is forgotten becomes a dangerous myth."* [quoted by Malcolm C. Sawyer, **The Economics of Michal Kalecki**, p. 8] Unfortunately mainstream capitalist economics is **built** on this myth. Ironically, it was against a *"background [of rising Big Business in the 1890s] that the grip of marginal economics, an imaginary world of many small firms… was consolidated in the economics profession."* Thus, *"[a]lmost from its conception, the theoretical postulates of marginal* *economics concerning the nature of companies [and of markets, we must add] have been a travesty of reality."* [Paul Ormerod, **Op. Cit.**, pp. 55–56]

This can be seen from the fact that mainstream economics has, for most of its history, effectively ignored the fact of oligopoly for most of its history. Instead, economics has refined the model of "perfect competition" (which cannot exist and is rarely, if ever, approximated) and developed an analysis of monopoly (which is also rare). Significantly, an economist could still note in 1984 that *"traditional economy theory … offers very little indeed by way of explanation of oligopolistic behaviour"* in spite (or, perhaps, **because**) it was *"the most important market situation today"* (as *"instances of monopoly"* are *"as difficult to find as perfect competition."*). In other words, capitalist economics does *"not know how to explain the most important part of a modern industrial economy."* [Peter Donaldson, **Economics of the Real World** p. 141, p. 140 and p. 142]

Over two decades later, the situation had not changed. For example, one leading introduction to economics notes *"the prevalence of oligopoly"* and admits it *"is far more common than either perfect competition or monopoly."* However, *"the analysis of oligopoly turns out to present some puzzles for which they is no easy solution"* as *"the analysis of oligopoly is far more difficult and messy than that of perfect competition."* Why? *"When we try to analyse oligopoly, the economists usual way of thinking — asking how self-interested individuals would behave, then analysing their interaction — does not work as well as we might hope."* Rest assured, though, there is not need to reconsider the *"usual way"* of economic analysis to allow it to analyse something as marginal as the most common market form for, by luck, *"the industry behaves 'almost' as if it were perfectly competitive."* [Paul Krugman and Robin Wells, **Economics**, p. 383, p. 365 and p. 383] Which is handy, to say the least.

Given that oligopoly has marked capitalist economics since, at least, the 1880s it shows how little concerned with reality mainstream economics is. In other words, neoclassicalism was redundant when it was first formulated (if four or five large firms are responsible for most of the output of an industry, avoidance of price competition becomes almost automatic and the notion that all firms are price takers is an obvious falsehood). That mainstream economists were not interested in including such facts into their models shows the ideological nature of the "science" (see section C.1 for more discussion of the non-scientific nature of mainstream economics).

This does not mean that reality has been totally forgotten. Some work was conducted on "imperfect competition" in the 1930s independently by two economists (Edward Chamberlin and Joan Robinson) but these were exceptions to the rule and even these models were very much in the traditional analytical framework, i.e. were still rooted in the assumptions and static world of neo-classical economics. These models assume that there are many producers and many consumers in a given market and that there are no barriers to entry and exit, that is, the characteristics of a monopolistically competitive market are almost exactly the same as in perfect competition, with the exception of heterogeneous products. This meant that monopolistic competition involves a great deal of non-price competition. This caused Robinson to later distance herself from her own work and look for more accurate (non-neoclassical) ways to analyse an economy.

As noted, neo-classical economics **does** have a theory on "monopoly," a situation (like perfect competition) which rarely exists. Ignoring that minor point, it is as deeply flawed as the rest of that ideology. It argues that "monopoly" is bad because it produces a lower output for a higher price. Unlike perfect competition, a monopolist can set a price above marginal cost and so exploit consumers by over pricing. In contrast, perfectly competitive markets force their members to set price to be equal to marginal cost. As it is rooted in the assumptions we exposed as nonsense as section C.1, this neo-classical theory on free competition and monopoly is similarly invalid. As Steve Keen notes, there is *"no substance"* to the neo-classical *"critique of monopolies"* as it *"erroneously assumes that the perfectly competitive firm faces a horizontal demand curve,"* which is impossible given a downward sloping market demand curve. This means that *"the individual firm and the market level aspects of perfect competition are inconsistent"* and the apparent benefits of competition in the model are derived from *"a mathematical error of confusing a very small quantity with zero."* While *"there are plenty of good reasons to be wary of monopolies ... economic theory does not provide any of them."* [**Debunking Economics**, p. 108, p. 101, p. 99, p. 98 and p. 107]

This is not to say that economists have ignored oligopoly. Some have busied themselves providing rationales by which to defend it, rooted in the assumption that *"the market can do it all, and that regulation and antitrust actions are misconceived. First, theorists showed that efficiency gains from mergers might reduce prices even more than monopoly power would cause them to rise. Economists also stressed 'entry,' claiming that if mergers did not improve efficiency any price increases would be wiped out eventually by new companies entering the industry. Entry is also the heart of the theory of 'contestable markets,' developed by economic consultants to AT&T, who argued that the ease of entry in cases where resources (trucks, aircraft) can be shifted quickly at low cost, makes for effective competition."* By pure co-incidence, AT&T had hired economic consultants as part of their hundreds of millions of dollars antitrust defences, in fact some 30 economists from five leading economics departments during the 1970s and early 1980s. [Edward S. Herman, *"The Threat From Mergers: Can Antitrust Make a Difference?"*, **Dollars and Sense**, no. 217, May/June 1998]

Needless to say, these new "theories" are rooted in the same assumptions of neo-classical economists and, as such, are based on notions we have already debunked. As Herman notes, they *"suffer from over-simplification, a strong infusion of ideology, and lack of empirical support."* He notes that mergers *"often are motivated by factors other than enhancing efficiency — such as the desire for monopoly power, empire building, cutting taxes, improving stock values, and even as a cover for poor management (such as when the badly-run U.S. Steel bought control of Marathon Oil)."* The conclusion of these models is usually, by way of co-incidence, that an oligopolistic market acts "as if" it were a perfectly competitive one and so we need not be concerned by rising market dominance by a few firms. Much work by the ideological supporters of "free market" capitalism is based on this premise, namely that reality works "as if" it reflected the model (rather than vice versa, in a real science) and, consequently, market power is nothing to be concerned about (that many of these "think tanks" and university places happen to be funded by the super-profits generated by big business is, of course, purely a co-incidence as these "scientists" act "as if" they were neutrally funded). In Herman's words: *"Despite their inadequacies, the new apologetic theories have profoundly affected policy, because they provide an intellectual rationale for the agenda of the powerful."* [**Op. Cit.**]

It may be argued (and it has) that the lack of interest in analysing a real economy by economists is because oligopolistic competition is hard to model mathematically. Perhaps, but this simply shows the limitations of neo-classical economics and if the tool used for a task are unsuitable, surely you should change the tool rather than (effectively) ignore the work that needs to be done. Sadly, most economists have favoured producing mathematical models which can say a lot about theory but very little about reality. That economics can become much broader and more relevant is always a possibility, but to do so would mean to take into account an unpleasant reality marked by market power, class, hierarchy and inequality rather than logical deductions derived from Robinson Crusoe. While the latter can produce mathematical models to reach the conclusions that the market is already doing a good job (or, at best, there are some imperfections which can be fixed by minor state interventions), the former cannot. Which, of course, is makes it hardly a surprise that neo-classical economists favour it so (particularly given the origins, history and role of that particular branch of economics).

This means that economics is based on a model which assumes that firms have no impact on the markets they operate it. This assumption is violated in most real markets and so the neo-classical conclusions regarding the outcomes of competition cannot be supported. That the assumptions of economic ideology so contradicts reality also has important considerations on the "voluntary" nature of wage labour. If the competitive model assumed by neo-classical economics held we would see a wide range of ownership types (including co-operatives, extensive self-employment and workers hiring capital) as there would be no "barriers of entry" associated with firm control. This is not the case — workers hiring capital is non-existent and self-employment and co-operatives are marginal. The dominant control form is capital hiring labour (wage slavery).

With a model based upon "perfect competition," supporters of capitalism could build a case that wage labour is a voluntary choice — after all, workers (in such a market) could hire capital or form co-operatives relatively easily. But the **reality** of the "free" market is such that this model does not exist — and as an assumption, it is seriously misleading. If we take into account the actuality of the capitalist economy, we soon have to realise that oligopoly is the dominant form of market and that the capitalist economy, by its very nature, restricts the options available to workers — which makes the notion that wage labour is a "voluntary" choice untenable.

If the economy is so structured as to make entry into markets difficult and survival dependent on accumulating capital, then these barriers are just as effective as government decrees. If small businesses are squeezed by oligopolies then chances of failure are increased (and so off-putting to workers with few resources) and if income inequality is large, then workers will find it very hard to find the collateral required to borrow capital and start their own co-operatives. Thus, looking at the **reality** of capitalism (as opposed to the textbooks) it is clear that the existence of oligopoly helps to maintain wage labour by restricting the options available on the "free market" for working people. Chomsky states the obvious:

> *"If you had equality of power, you could talk about freedom, but when all the power is concentrated in one place, then freedom's a joke. People talk about a 'free market.' Sure. You and I are perfectly free to set up an automobile company and compete with General Motors. Nobody's stopping us. That freedom is meaningless … It's just that power happens to be organised so that only certain options are available. Within that limited range of options, those who have the power say, 'Let's have freedom.' That's a very skewed form of freedom. The principle is right. How freedom works depends on what the social structures are. If the freedoms are such that the only choices you have objectively are to conform to one or another system of power, there's no freedom."* [**Language and Politics**, pp. 641–2]

As we noted in section C.4, those with little capital are reduced to markets with low set-up costs and low concentration. Thus, claim the supporters of capitalism, workers still have a choice. However, this choice is (as we have indicated) somewhat limited by the existence of oligopolistic markets — so limited, in fact, that less than 10% of the working population are self-employed workers. Moreover, it is claimed, technological forces may work to increase the number of markets that require low set-up costs (the computing market is often pointed to as an example). However, similar predictions were made over 100 years ago when the electric motor began to replace the steam engine in factories. *"The new technologies [of the 1870s] may have been compatible with small production units and decentralised operations… That… expectation was not fulfilled."* [Richard B. Du Boff, **Op. Cit.**, p. 65] From the history of capitalism, we imagine that markets associated with new technologies will go the same way (and the evidence seems to support this).

The reality of capitalist development is that even **if** workers invested in new markets, one that require low set-up costs, the dynamic of the system is such that over time these markets will also become dominated by a few big firms. Moreover, to survive in an oligopolised economy small cooperatives will be under pressure to hire wage labour and otherwise act as capitalist concerns. Therefore, even if we ignore the massive state intervention which created capitalism in the first place (see section F.8), the dynamics of the system are such that relations of domination and oppression will always be associated with it — they cannot be "competed" away as the actions of competition creates and re-enforces them (also see sections J.5.11 and J.5.12 on the barriers capitalism places on co-operatives and self-management even though they are more efficient).

So the effects of the concentration of capital on the options open to us are great and very important. The existence of Big Business has a direct impact on the "voluntary" nature of wage labour as it produces very effective "barriers of entry" for alternative modes of production. The resultant pressures big business place on small firms also reduces the viability of co-operatives and self-employment to survive **as** co-operatives and non-employers of wage labour, effectively marginalising them as true alternatives. Moreover, even in new markets the dynamics of capitalism are such that **new** barriers are created all the time, again reducing our options.

Overall, the **reality** of capitalism is such that the equality of opportunity implied in models of "perfect competition" is lacking. And without such equality, wage labour cannot be said to be a "voluntary" choice between available options — the options available have been skewed so far in one direction that the other alternatives have been marginalised.

C.5 Why does Big Business get a bigger slice of profits?

As described in the last section, due to the nature of the capitalist market, large firms soon come to dominate. Once a few large companies dominate a particular market, they form an oligopoly from which a large number of competitors have effectively been excluded, thus reducing competitive pressures. In this situation there is a tendency for prices to rise above what would be the "market" level, as the oligopolistic producers do not face the potential of new capital entering "their" market (due to the relatively high capital costs and other entry/movement barriers).

The domination of a market by a few big firms results in exploitation, but of a different kind than that rooted in production. Capitalism is based on the extraction of surplus value of workers in the production process. When a market is marked by oligopoly, this exploitation is supplemented by the exploitation of **consumers** who are charged higher prices than would be the case in a more competitive market. This form of competition results in Big Business having an "unfair" slice of available profits as oligopolistic profits are *"created at the expense of individual capitals still caught up in competition."* [Paul Mattick, **Economics, Politics, and the Age of Inflation**, p. 38]

To understand why big business gets a bigger slice of the economic pie, we need to look at what neo-classical economics tries to avoid, namely production and market power. Mainstream economics views capitalism as a mode of distribution (the market), not a mode of production. Rather than a world of free and equal exchanges, capitalism is marked by hierarchy, inequality and power. This reality explains what regulates market prices and the impact of big business. In the long term, market price cannot be viewed independently of production. As David Ricardo put it:

> *"It is the cost of production which must ultimately regulate the price of commodities, and not, as has been often said, the proportion between the supply and demand: the proportion between supply and demand may, indeed, for a time, affect the market value of a commodity, until it is supplied in greater or less abundance, according as the demand may have increased or diminished; but this effect will be only of temporary duration."* [**The Principles of Political Economy and Taxation**, p. 260]

Market prices, in this (classical) analysis, are the prices that prevail at any given time on the market (and change due to transient and random variations). Natural prices are the cost of production and act as centres of gravitational attraction for market prices. Over time, market prices are tend towards natural prices but are considered unlikely to exactly meet them. Natural prices can only change due to changes in the productive process (for example, by introducing new, more productive, machinery and/or by decreasing the wages of the workforce relative to its output). Surplus value (the difference between market and natural prices) are the key to understanding how supply changes to meet demand. This produces the dynamic of market forces:

"Let us suppose that all commodities are at their natural price, and consequently that the profits of capital in all employments are exactly at the same rate … Suppose now that a change of fashion should increase the demand for silks, and lessen that for woollens; their natural price, the quantity of labour necessary to their production, would continue unaltered, but the market price of silks would rise, and that of woollens would fall; and consequently the profits of the silk manufacturer would be above, whilst those of the woollen manufacturer would be below, the general and adjusted rate of profits … This increased demand for silks would however soon be supplied, by the transference of capital and labour from the woollen to the silk manufacture; when the market prices of silks and woollens would again approach their natural prices, and then the usual profits would be obtained by the respective manufacturers of those commodities. It is then the desire, which every capitalist has, of diverting his funds from a less to a more profitable employment, that prevents the market price of commodities from continuing for any length of time either much above, or much below their natural price." [**Op. Cit.**, p. 50]

This means that *"capital moves from relatively stagnating into rapidly developing industries … The extra profit, in excess of the average profit, won at a given price level disappears again, however, with the influx of capital from profit-poor into profit-rich industries,"* so increasing supply and reducing prices, and thus profits. In other words, *"market relations are governed by the production relations."* [Paul Mattick, **Economic Crisis and Crisis Theory**, p. 49 and p. 51]

In a developed capitalist economy it is not as simple as this — there are various "average" profits depending on what Michal Kalecki termed the ***"degree of monopoly"*** within a market. This theory *"indicates that profits arise from monopoly power, and hence profits accrue to firms with more monopoly power … A rise in the degree of monopoly caused by the growth of large firms would result in the shift of profits from small business to big business."* [Malcolm C. Sawyer, **The Economics of Michal Kalecki**, p. 36] This means that a market with a high "degree of monopoly" will have a few firms in it with higher than average profit levels (or rate of return) compared to the smaller firms in the sector or to those in more competitive markets.

The "degree of monopoly" reflects such factors as level of market concentration and power, market share, extent of advertising, barriers to entry/movement, collusion and so on. The higher these factors, the higher the degree of monopoly and the higher the mark-up of prices over costs (and so the share of profits in value added). Our approach to this issue is similar to Kalecki's in many ways although we stress that the degree of monopoly affects how profits are distributed **between** firms, **not** how they are created in the first place (which come, as argued in section C.2, from the *"unpaid labour of the poor"* — to use Kropotkin's words).

There is substantial evidence to support such a theory. J.S Bain in **Barriers in New Competition** noted that in industries where the level of seller concentration was very high and where entry barriers were also substantial, profit rates were higher than average. Research has tended to confirm Bain's findings. Keith Cowling summarises this later evidence:

"[A]s far as the USA is concerned… there are grounds for believing that a significant, but not very strong, relationship exists between profitability and concentration… [along with] a significant relationship between advertising and profitability [an important factor in a market's "degree of monopoly"]… [Moreover w]here the estimation is restricted to an appropriate cross-section [of industry] … both concentration and advertising appeared significant [for the UK]. By focusing on the impact of changes in concentration

overtime ... [we are] able to circumvent the major problems posed by the lack of appropriate estimates of price elasticities of demand ... [to find] a significant and positive concentration effect... It seems reasonable to conclude on the basis of evidence for both the USA and UK that there is a significant relationship between concentration and price-cost margins." [**Monopoly Capitalism**, pp. 109–110]

We must note that the price-cost margin variable typically used in these studies subtracts the wage and **salary** bill from the value added in production. This would have a tendency to reduce the margin as it does not take into account that most management salaries (particularly those at the top of the hierarchy) are more akin to profits than costs (and so should **not** be subtracted from value added). Also, as many markets are regionalised (particularly in the USA) nation-wide analysis may downplay the level of concentration existing in a given market.

The argument is not that big business charges "high prices" in respect to smaller competitors but rather they charge high prices in comparison to their costs. This means that a corporation can sell at the standard market price (or even undercut the prices of small business) and still make higher profits than average. In other words, market power ensures that prices do not fall to cost. Moreover, market power ensures that "costs" are often inflicted on others as big business uses its economic clout to externalise costs onto suppliers and its workers. For example, this means that farmers and other small producers will agree to lower prices for goods when supplying large supermarkets while the employees have to put up with lower wages and benefits (which extend through the market, creating lower wages and fewer jobs for retail workers in the surrounding area). Possibly, lower prices can be attributed to lower quality products (which workers are forced to buy in order to make their lower wages go further).

This means that large firms can maintain their prices and profits above "normal" (competitive) levels without the assistance of government simply due to their size and market power (and let us not forget the important fact that Big Business rose during the period in which capitalism was closest to "laissez faire" and the size and activity of the state was small). As much of mainstream economics is based on the idea of "perfect competition" (and the related concept that the free market is an efficient allocater of resources when it approximates this condition) it is clear that such a finding cuts to the heart of claims that capitalism is a system based upon equal opportunity, freedom and justice. The existence of Big Business and the impact it has on the rest of the economy and society at large exposes capitalist economics as a house built on sand.

Another side effect of oligopoly is that the number of mergers will tend to increase in the run up to a slump. Just as credit is expanded in an attempt to hold off the crisis (see section C.8), so firms will merge in an attempt to increase their market power and so improve their profit margins by increasing their mark-up over costs. As the rate of profit levels off and falls, mergers are an attempt to raise profits by increasing the degree of monopoly in the market/economy. However, this is a short term solution and can only postpone, but stop, the crisis as its roots lie in production, **not** the market (see section C.7) — there is only so much surplus value around and the capital stock cannot be wished away. Once the slump occurs, a period of cut-throat competition will start and then, slowly, the process of concentration will start again (as weak firms go under, successful firms increase their market share and capital stock and so on).

The development of oligopolies within capitalism thus causes a redistribution of profits away from small capitalists to Big Business (i.e. small businesses are squeezed by big ones due to the latter's market power and size). Moreover, the existence of oligopoly can and does result in increased costs faced by Big Business being passed on in the form of price increases, which can force other companies, in unrelated markets, to raise **their** prices in order to realise sufficient profits. Therefore, oligopoly has a tendency to create price increases across the market as a whole and can thus be inflationary.

For these (and other) reasons many small businessmen and members of the middle-class wind up hating Big Business (while trying to replace them!) and embracing ideologies which promise to wipe them out. Hence we see that both ideologies of the "radical" middle-class — Libertarianism and fascism — attack Big Business, either as "the socialism of Big Business" targeted by Libertarianism or the "International Plutocracy" by Fascism. As Peter Sabatini notes:

> *"At the turn of the century, local entrepreneurial (proprietorship/partnership) business [in the USA] was overshadowed in short order by transnational corporate capitalism… The various strata comprising the capitalist class responded differentially to these transpiring events as a function of their respective position of benefit. Small business that remained as such came to greatly resent the economic advantage corporate capitalism secured to itself, and the sweeping changes the latter imposed on the presumed ground rules of bourgeois competition. Nevertheless, because capitalism is liberalism's raison d'etre, small business operators had little choice but to blame the state for their financial woes, otherwise they moved themselves to another ideological camp (anti-capitalism). Hence, the enlarged state was imputed as the primary cause for capitalism's 'aberration' into its monopoly form, and thus it became the scapegoat for small business complaint."* [**Libertarianism: Bogus Anarchy**]

However, despite the complaints of small capitalists, the tendency of markets to become dominated by a few big firms is an obvious side-effect of capitalism itself. *"If the home of 'Big Business' was once the public utilities and manufacturing it now seems to be equally comfortable in any environment."* [M.A. Utton, **Op. Cit.**, p. 29] This is because in their drive to expand (which they must do in order to survive), capitalists invest in new machinery and plants in order to reduce production costs and so increase profits. Hence a successful capitalist firm will grow in size over time in order to squeeze out competitors and, in so doing, it naturally creates formidable natural barriers to competition — excluding all but other large firms from undermining its market position.

C.5.1 Aren't the super-profits of Big Business due to its higher efficiency?

Obviously the analysis of Big Business profitability presented in section C.5 is denied by supporters of capitalism. H. Demsetz of the pro-"free" market "Chicago School" of economists (which echoes the "Austrian" school's position that whatever happens on a free market is for the best) argues that **efficiency** (not degree of monopoly) is the cause of the super-profits for Big Business. His argument is that if oligopolistic profits are due to high levels of concentration, then the big firms in an industry will not be able to stop smaller ones reaping the benefits of this in the form of higher profits. So if concentration leads to high profits (due, mostly, to collusion between the dominant firms) then smaller firms in the same industry should benefit too.

However, his argument is flawed as it is not the case that oligopolies practice overt collusion. The barriers to entry/mobility are such that the dominant firms in a oligopolistic market do not have to compete by price and their market power allows a mark-up over costs which market forces cannot undermine. As their only possible competitors are similarly large firms, collusion is not required as these firms have no interest in reducing the mark-up they share and so they "compete" over market share by non-price methods such as advertising (advertising, as well as being a barrier to entry, reduces price competition and increases mark-up).

In his study, Demsetz notes that while there is a positive correlation between profit rate and market concentration, smaller firms in the oligarchic market are **not** more profitable than their counterparts in other markets. [M.A. Utton, **The Political Economy of Big Business**, p. 98] From this Demsetz concludes that oligopoly is irrelevant and that the efficiency of increased size is the source of excess profits. But this misses the point — smaller firms in concentrated industries will have a similar profitability to firms of similar size in less concentrated markets, **not** higher profitability. The existence of super profits across **all** the firms in a given industry would attract firms to that market, so reducing profits. However, because profitability is associated with the large firms in the market the barriers of entry/movement associated with Big Business stops this process happening. **If** small firms were as profitable, then entry would be easier and so the "degree of monopoly" would be low and we would see an influx of smaller firms.

While it is true that bigger firms may gain advantages associated with economies of scale the question surely is, what stops the smaller firms investing and increasing the size of their companies in order to reap economies of scale within and between workplaces? What is stopping market forces eroding super-profits by capital moving into the industry and increasing the number of firms, and so increasing supply? If barriers exist to stop this process occurring, then concentration, market power and other barriers to entry/movement (not efficiency) is the issue. Competition is a **process**, not a state, and this indicates that "efficiency" is not the source of oligopolistic profits (indeed, what creates the apparent "efficiency" of big firms is likely to be the barriers to market forces which add to the mark-up!).

It is important to recognise what is "small" and "big" is dependent on the industry in question and so size advantages obviously differ from industry to industry. The optimum size of plant may be large in some sectors but relatively small in others (some workplaces have to be of a certain size in order to be technically efficient in a given market). However, this relates to technical efficiency, rather than overall "efficiency" associated with a firm. This means that technological issues cannot, by themselves, explain the size of modern corporations. Technology may, at best, explain the increase in size of the factory, but it does not explain why the modern large firm comprises multiple factories. In other words, the company, the **administrative** unit, is usually much larger than the workplace, the **production** unit. The reasons for this lie in the way in which production technologies interacted with economic institutions and market power.

It seems likely that large firms gather "economies of scale" due to the size of the firm, not plant, as well as from the level of concentration within an industry: *"Considerable evidence indicates that economies of scale [at plant level] … do not account for the high concentration levels in U.S. industry"* [Richard B. Du Boff, **Accumulation and Power**, p. 174] Further, *"the explanation for the enormous growth in aggregate concentration must be found in factors other than economies of scale at plant level."* [M.A. Utton, **Op. Cit.**, p. 44] Co-ordination of individual plants by the visible hand of management seems to play a key role in creating and maintaining dominant positions within a market. And, of course, these structures are costly to create and maintain as well as taking time to build up. Thus the size of the firm, with the economies of scale **beyond** the workplace associated with the economic power this produces within the marke creates formidable barriers to entry/movement.

So an important factor influencing the profitability of Big Business is the clout that market power provides. This comes in two main forms — horizontal and vertical controls:

> *"Horizontal controls allow oligopolies to control necessary steps in an economic process from material supplies to processing, manufacturing, transportation and distribution. Oligopolies... [control] more of the highest quality and most accessible supplies than they intend to market immediately... competitors are left with lower quality or more expensive supplies... [It is also] based on exclusive possession of technologies, patents and franchises as well as on excess productive capacity ...*
>
> *"Vertical controls substitute administrative command for exchange between steps of economic processes. The largest oligopolies procure materials from their own subsidiaries, process and manufacture these in their own refineries, mills and factories, transport their own goods and then market these through their own distribution and sales network."* [Allan Engler, **Apostles of Greed**, p. 51]

Moreover, large firms reduce their costs due to their privileged access to credit and resources. Both credit and advertising show economies of scale, meaning that as the size of loans and advertising increase, costs go down. In the case of finance, interest rates are usually cheaper for big firms than small ones and while *"firms of all sizes find most [about 70% between 1970 and 1984] of their investments without having to resort to [financial] markets or banks"* size does have an impact on the *"importance of banks as a source of finance"*: *"Firms with assets under $100 million relied on banks for around 70% of their long-term debt... those with assets from $250 million to $1 billion, 41%; and those with over $1 billion in assets, 15%."* [Doug Henwood, **Wall Street**, p. 75] Also dominant firms can get better deals with independent suppliers and distributors due to their market clout and their large demand for goods/inputs, also reducing their costs.

This means that oligopolies are more "efficient" (i.e. have higher profits) than smaller firms due to the benefits associated with their market power rather than vice versa. Concentration (and firm size) leads to "economies of scale" which smaller firms in the same market cannot gain access to. Hence the claim that any positive association between concentration and profit rates is simply recording the fact that the largest firms tend to be most efficient, and hence more profitable, is wrong. In addition, *"Demsetz's findings have been questioned by non-Chicago [school] critics"* due to the inappropriateness of the evidence used as well as some of his analysis techniques. Overall, *"the empirical work gives limited support"* to this "free-market" explanation of oligopolistic profits and instead suggest market power plays the key role. [William L. Baldwin, **Market Power, Competition and Anti-Trust Policy**, p. 310, p. 315]

Unsurprisingly we find that the *"bigger the corporation in size of assets or the larger its market share, the higher its rate of profit: these findings confirm the advantages of market power... Furthermore, 'large firms in concentrated industries earn systematically higher profits than do all other firms, about 30 percent more... on average,' and there is less variation in profit rates too."* Thus, concentration, not efficiency, is the key to profitability, with those factors what create "efficiency" themselves being very effective barriers to entry which helps maintain the "degree of monopoly" (and so mark-up and profits for the dominant firms) in a market. Oligopolies have varying degrees of administrative efficiency and market power, all of which consolidate its position. Thus the *"barriers to entry posed by decreasing unit costs of production and distribution and by national organisations of managers, buyers, salesmen, and service personnel made oligopoly advantages cumulative — and were as global in their implications as they were national."* [Richard B. Du Boff, **Accumulation and Power**, p. 175 and p. 150]

This explains why capitalists always seek to acquire monopoly power, to destroy the assumptions of neo-classical economics, so they can influence the price, quantity and quality of the product. It also ensures that in the real world there are, unlike the models of mainstream economics, entrenched economic forces and why there is little equal opportunity. Why, in other words, the market in most sectors is an oligopoly.

This recent research confirms Kropotkin's analysis of capitalism found in his classic work **Fields, Factories and Workshops**. Kropotkin, after extensive investigation of the actual situation within the economy, argued that *"it is not the superiority of the **technical** organisation of the trade in a factory, nor the economies realised on the prime-mover, which militate against the small industry … but the more advantageous conditions for **selling** the produce and for **buying** the raw produce which are at the disposal of big concerns."* Since the *"manufacture being a strictly private enterprise, its owners find it advantageous to have all the branches of a given industry under their own management: they thus cumulate the profits of the successful transformations of the raw material… [and soon] the owner finds his advantage in being able to hold the command of the market. But from a **technical** point of view the advantages of such an accumulation are trifling and often doubtful."* He sums up by stating that *"[t]his is why the 'concentration' so much spoken of is often nothing but an amalgamation of capitalists for the purpose of **dominating the market,** not for cheapening the technical process."* [**Fields, Factories and Workshops Tomorrow**, p. 147, p. 153 and p. 154]

It should be stressed that Kropotkin, like other anarchists, recognised that technical efficiencies differed from industry to industry and so the optimum size of plant may be large in some sectors but relatively small in others. As such, he did not fetishise "smallness" as some Marxists assert (see section H.2.3). Rather, Kropotkin was keenly aware that capitalism operated on principles which submerged technical efficiency by the price mechanism which, in turn, was submerged by economic power. While not denying that "economies of scale" existed, Kropotkin recognised that what counts as "efficient" under capitalism is specific to that system. Thus whatever increases profits is "efficient" under capitalism, whether it is using market power to drive down costs (credit, raw materials or labour) or internalising profits by building suppliers. Under capitalism profit is used as a (misleading) alternative for efficiency (influenced, as it is, by market power) and this distorts the size of firms/workplaces. In a sane society, one based on economic freedom, workplaces would be re-organised to take into account technical efficiency and the needs of the people who used them rather than what maximises the profits and power of the few.

All this means is that the "degree of monopoly" within an industry helps determine the distribution of profits within an economy, with some of the surplus value "created" by other companies being realised by Big Business. Hence, the oligopolies reduce the pool of profits available to other companies in more competitive markets by charging consumers higher prices than a more competitive market would. As high capital costs reduce mobility within and exclude most competitors from entering the oligopolistic market, it means that only if the oligopolies raise their prices **too** high can real competition become possible (i.e. profitable) again and so *"it should not be concluded that oligopolies can set prices as high as they like. If prices are set too high, dominant firms from other industries would be tempted to move in and gain a share of the exceptional returns.*

Small producers — using more expensive materials or out-dated technologies — would be able to increase their share of the market and make the competitive rate of profit or better." [Allan Engler, **Op. Cit.**, p. 53]

Big Business, therefore, receives a larger share of the available surplus value in the economy, due to its size advantage and market power, not due to "higher efficiency".

C.6 Can market dominance by Big Business change?

Capital concentration, of course, does not mean that in a given market, dominance will continue forever by the same firms, no matter what. However, the fact that the companies that dominate a market can change over time is no great cause for joy (no matter what supporters of free market capitalism claim). This is because when market dominance changes between companies all it means is that **old** Big Business is replaced by **new** Big Business:

> *"Once oligopoly emerges in an industry, one should not assume that sustained competitive advantage will be maintained forever... once achieved in any given product market, oligopoly creates barriers to entry that can be overcome only by the development of even more powerful forms of business organisation that can plan and co-ordinate even more complex specialised divisions of labour."* [William Lazonick, **Business Organisation and the Myth of the Market Economy**, p. 173]

The assumption that the "degree of monopoly" will rise over time is an obvious one to make and, in general, the history of capitalism has tended to support doing so. While periods of rising concentration will be interspersed with periods of constant or falling levels, the general trend will be upwards (we would expect the degree of monopoly to remain the same or fall during booms and rise to new levels in slumps). Yet even if the "degree of monopoly" falls or new competitors replace old ones, it is hardly a great improvement as changing the company hardly changes the impact of capital concentration or Big Business on the economy. While the faces may change, the system itself remains the same. As such, it makes little real difference if, for a time, a market is dominated by 6 large firms rather than, say, 4. While the **relative** level of barriers may fall, the **absolute** level may increase and so restrict competition to established big business (either national or foreign) and it is the absolute level which maintains the class monopoly of capital over labour.

Nor should we expect the "degree of monopoly" to constantly increase, there will be cycles of expansion and contraction in line with the age of the market and the business cycle. It is obvious that at the start of a specific market, there will be a relative high "degree of monopoly" as a few pioneering create a new industry. Then the level of concentration will fall as competitors entry the market. Over time, the numbers of firms will drop due to failure and mergers. This process is accelerated during booms and slumps. In the boom, more companies feel able to try setting up or expanding in a specific market, so driving the "degree of monopoly" down. However, in the slump the level of concentration will rise as more and more firms go to the wall or try and merge to survive (for example, there were 100 car producers in the USA in 1929, ten years later there were only three). So our basic point is **not** dependent on any specific tendency of the degree of monopoly. It can fall somewhat as, say, five large firms come to dominate a market rather than, say, three over a period of a few years. The fact remains that barriers to competition remain strong and deny any claims that any real economy reflects the "perfect competition" of the textbooks.

So even in a in a well-developed market, one with a high degree of monopoly (i.e. high market concentration and capital costs that create barriers to entry into it), there can be decreases as well as increases in the level of concentration. However, how this happens is significant. New companies can usually only enter under four conditions:

1) They have enough capital available to them to pay for set-up costs and any initial losses. This can come from two main sources, from other parts of their company (e.g. Virgin going into the cola business) or large firms from other areas/nations enter the market. The former is part of the diversification process associated with Big Business and the second is the globalisation of markets resulting from pressures on national oligopolies (see section C.4). Both of which increases competition within a given market for a period as the number of firms in its oligopolistic sector has increased. Over time, however, market forces will result in mergers and growth, increasing the degree of monopoly again.

2) They get state aid to protect them against foreign competition until such time as they can compete with established firms and, critically, expand into foreign markets: *"Historically,"* notes Lazonick, *"political strategies to develop national economies have provided critical protection and support to overcome … barriers to entry."* [**Op. Cit.**, p. 87] An obvious example of this process is, say, the 19th century US economy or, more recently the South East Asian "Tiger" economies (these having *"an intense and almost unequivical commitment on the part of government to build up the international competitiveness of domestic industry"* by creating *"policies and organisations for governing the market."* [Robert Wade, **Governing the Market**, p. 7]).

3) Demand exceeds supply, resulting in a profit level which tempts other big companies into the market or gives smaller firms already there excess profits, allowing them to expand. Demand still plays a limiting role in even the most oligopolistic market (but this process hardly decreases barriers to entry/mobility or oligopolistic tendencies in the long run).

4) The dominant companies raise their prices too high or become complacent and make mistakes, so allowing other big firms to undermine their position in a market (and, sometimes, allow smaller companies to expand and do the same). For example, many large US oligopolies in the 1970s came under pressure from Japanese oligopolies because of this. However, as noted in section C.4.2, these declining oligopolies can see their market control last for decades and the resulting market will still be dominated by oligopolies (as big firms are generally replaced by similar sized, or bigger, ones).

Usually some or all of these processes are at work at once and some can have contradictory results. Take, for example, the rise of "globalisation" and its impact on the "degree of monopoly" in a given national market. On the national level, "degree of monopoly" may fall as foreign companies invade a given market, particularly one where the national producers are in decline (which has happened to a small degree in UK manufacturing in the 1990s, for example). However, on the international level the degree of concentration may well have risen as only a few companies can actually compete on a global level. Similarly, while the "degree of monopoly" within a specific national market may fall, the balance of (economic) power within the economy may shift towards capital and so place labour in a weaker position to advance its claims (this has, undoubtedly, been the case with "globalisation" — see section D.5.3).

Let us consider the US steel industry as an example. The 1980s saw the rise of the so-called "mini-mills" with lower capital costs. The mini-mills, a new industry segment, developed only after the US steel industry had gone into decline due to Japanese competition. The creation of Nippon Steel, matching the size of US steel companies, was a key factor in the rise of the Japanese steel industry, which invested heavily in modern technology to increase steel output by 2,216% in 30 years (5.3 million tons in 1950 to 122.8 million by 1980). By the mid 1980s, the mini-mills and imports each had a quarter of the US market, with many previously steel-based companies diversifying into new markets.

Only by investing $9 billion to increase technological competitiveness, cutting workers wages to increase labour productivity, getting relief from stringent pollution control laws and (very importantly) the US government restricting imports to a quarter of the total home market could the US steel industry survive. The fall in the value of the dollar also helped by making imports more expensive. In addition, US steel firms became increasingly linked with their Japanese "rivals," resulting in increased centralisation (and so concentration) of capital.

Therefore, only because competition from foreign capital created space in a previously dominated market, driving established capital out, combined with state intervention to protect and aid home producers, was a new segment of the industry able to get a foothold in the local market. With many established companies closing down and moving to other markets, and once the value of the dollar fell which forced import prices up and state intervention reduced foreign competition, the mini-mills were in an excellent position to increase US market share. It should also be noted that this period in the US steel industry was marked by increased "co-operation" between US and Japanese companies, with larger companies the outcome. This meant, in the case of the mini-mills, that the cycle of capital formation and concentration would start again, with bigger companies driving out the smaller ones through competition.

Nor should we assume that an oligopolistic markets mean the end of all small businesses. Far from it. Not only do small firms continue to exist, big business itself may generate same scale industry around it (in the form of suppliers or as providers of services to its workers). We are not arguing that small businesses do not exist, but rather than their impact is limited compared to the giants of the business world. In fact, within an oligopolistic market, existing small firms always present a problem as some might try to grow beyond their established niches. However, the dominant firms will often simply purchase the smaller one firm, use its established relationships with customers or suppliers to limit its activities or stand temporary losses and so cut its prices below the cost of production until it runs competitors out of business or establishes its price leadership, before raising prices again.

As such, our basic point is **not** dependent on any specific tendency of the degree of monopoly. It can fall somewhat as, say, six large firms come to dominate a market rather than, say, four. The fact remains that barriers to competition remain strong and deny any claims that any real economy reflects the "perfect competition" of the textbooks. So, while the actual companies involved may change over time, the economy as a whole will always be marked by Big Business due to the nature of capitalism. That's the way capitalism works — profits for the few at the expense of the many.

C.7 What causes the capitalist business cycle?

The business cycle is the term used to describe the boom and slump nature of capitalism. Sometimes there is full employment, with workplaces producing more and more goods and services, the economy grows and along with it wages. However, as Proudhon argued, this happy situation does not last:

> *"But industry, under the influence of property, does not proceed with such regularity… As soon as a demand begins to be felt, the factories fill up, and everybody goes to work. Then business is lively… Under the rule of property, the flowers of industry are woven into none but funeral wreaths. The labourer digs his own grave… [the capitalist] tries… to continue production by lessening expenses. Then comes the lowering of wages; the introduction of machinery; the employment of women and children … the decreased cost creates a larger market… [but] the productive power tends to more than ever outstrip consumption… To-day the factory is closed. Tomorrow the people starve in the streets… In consequence of the cessation of business and the extreme cheapness of merchandise… frightened creditors hasten to withdraw their funds [and] Production is suspended, and labour comes to a standstill."* [**What is Property**, pp. 191–192]

Why does this happen? For anarchists, as Proudhon noted, it's to do with the nature of capitalist production and the social relationships it creates (*"the rule of property"*). The key to understanding the business cycle is to understand that, to use Proudhon's words, *"Property sells products to the labourer for more than it pays him for them; therefore it is impossible."* [**Op. Cit.**, p. 194] In other words, the need for the capitalist to make a profit from the workers they employ is the underlying cause of the business cycle. If the capitalist class cannot make enough surplus value (profit, interest, rent) then it will stop production, sack people, ruin lives and communities until such time as enough can once again be extracted from working class people. As Proudhon put it (using the term *"interest"* to cover all forms of surplus value):

> *"The primary cause of commercial and industrial stagnations is, then, interest on capital, — that interest which the ancients with one accord branded with the name of usury, whenever it was paid for the use of money, but which they did not dare to condemn in the forms of house-rent, farm-rent, or profit: as if the nature of the thing lent could ever warrant a charge for the lending; that is, robbery."* [**Op. Cit.**, p. 193]

So what influences the level of surplus value? There are two main classes of pressure on surplus value production, what we will call the ***"subjective"*** and ***"objective"*** (we will use the term profits to cover surplus value from now on as this is less cumbersome and other forms of surplus value depend on the amount extracted from workers on the shopfloor). The "subjective" pressures are to do with the nature of the social relationships created by capitalism, the relations of domination and subjection which are the root of exploitation and the resistance to them. In other words the subjective pressures are the result of the fact that *"property is despotism"* (to use Proudhon's expression) and are a product of the class struggle. This will be discussed in section C.7.1. The objective pressures are related to how capitalism works and fall into two processes. The first is the way in which markets do not provide enough information to producers avoid disproportionalities within the market. In other words, that the market regularly produces situations where there is too much produced for specific markets leading to slumps The second objective factor is related to the process by which *"productive power tends more and more to outstrip consumption"* (to use Proudhon's words), i.e. over-investment or over-accumulation. These are discussed in sections C.7.2 and C.7.3, respectively.

Before continuing, we would like to stress here that all three factors operate together in a real economy and we have divided them purely to help explain the issues involved in each one. The class struggle, market "communication" creating disproportionalities and over-investment all interact. Due to the needs of the internal (class struggle) and external (inter-company) competition, capitalists have to invest in new means of production. As workers' power increases during a boom, capitalists innovate and invest in order to try and counter it. Similarly, to get market advantage (and so increased profits) over their competitors, a company invests in new machinery. While this helps increase profits for individual companies in the short term, it leads to collective over-investment and falling profits in the long term. Moreover, due to lack of effective communication within the market caused by the price mechanism firms rush to produce more goods and services in specific boom markets, so leading to over-production and the resulting gluts result in slumps. This process is accelerated by the incomplete information provided by the interest rate, which results in investment becoming concentrated in certain parts of the economy. Relative over-investment can occur, increasing and compounding any existing tendencies for over-production and so creating the possibility of crisis. In addition, the boom encourages new companies and foreign competitors to try and get market share, so decreasing the *"degree of monopoly"* in an industry, and so reducing the mark-up and profits of big business (which, in turn, can cause an increase in mergers and take-overs towards the end of the boom).

Meanwhile, as unemployment falls workers' power, confidence and willingness to stand up for their rights increases, causing profit margins to be eroded at the point of production. This has the impact of reducing tendencies to over-invest as workers resist the introduction of new technology and techniques. The higher wages also maintain and even increase demand for the finished goods and services produced, allowing firms to realise the potential profits their workers have created. Rising wages, therefore, harms the potential for **producing** profits by increasing costs yet it increases the possibility for **realising** profits on the market as firms cannot make profits if there is no demand for their goods and their inventories of unsold goods pile up. In other words, wages are costs for any specific firm but the wages other companies pay are a key factor in the demand for what it produces. This contradictory effect of class struggle matches the contradictory effect of investment. Just as investment causes crisis because it is useful, the class struggle both hinders over-accumulation of capital and maintains aggregate demand (so postponing the crisis) while at the same time eroding capitalist power and so profit margins at the point of production (so accelerating it).

And we should note that these factors work in reverse during a slump, creating the potential for a new boom. In terms of workers, rising unemployment empower the capitalists who take advantage of the weakened position of their employees to drive through wage cuts or increase productivity in order to improve the profitability of their companies (i.e. increase surplus value).

Labour will, usually, accept the increased rate of exploitation this implies to remain in work. This results in wages falling and so, potentially, allows profit margins to rise. However, wage cuts result in falling demand for goods and services and so, overall, the net effect of cutting wages may be an overall **drop** in demand which would make the slump worse. There is a contradictory aspect to the objective pressures as well during a slump. The price mechanism hinders the spread of knowledge required for production and investment decisions to be made. While collectively it makes sense for firms to start producing and investing more, individual firms are isolated from each other. Their expectations are negative, they expect the slump to continue and so will be unwilling to start investing again. In the slump, many firms go out of business so reducing the amount of fixed capital in the economy and so over-investment is reduced. As overall investment falls, so the average rate of profit in the economy can increase. Yet falling investment means that firms in that sector of the economy will face stagnant demand and in the face of an uncertain future will be a drag on other sectors. In addition, as firms go under the *"degree of monopoly"* of each industry increases which increases the mark-up and profits of big business yet the overall market situation is such that their goods cannot be sold.

Eventually, however, the slump will end (few anarchists accept the notion that capitalism will self-destruct due to internal economic processes). The increased surplus value production made possible by high unemployment is enough relative to the (reduced) fixed capital stock to increase the rate of profit. This encourages capitalists to start investing again and a boom begins (a boom which contains the seeds of its own end). How long this process takes cannot be predicted in advance (which is why Keynes stressed that in the long run we are all dead). It depends on objective circumstances, how excessive the preceding boom was, government policy and how willing working class people are to pay the costs for the capitalist crisis.

Thus subjective and objective factors interact and counteract with each other, but in the end a crisis will result simply because the system is based upon wage labour and the producers are not producing for themselves. Ultimately, a crisis is caused because capitalism is production for profit and when the capitalist class does not (collectively) get a sufficient rate of profit for whatever reason then a slump is the result. If workers produced for themselves, this decisive factor would not be an issue as no capitalist class would exist. Until that happens the business cycle will continue, driven by "subjective" and "objective" pressures — pressures that are related directly to the nature of capitalist production and the wage labour on which it is based. Which pressure will predominate in any given period will be dependent on the relative power of classes. One way to look at it is that slumps can be caused when working class people are "too strong" or "too weak." The former means that we are able to reduce the rate of exploitation, squeezing the profit rate by keeping an increased share of the surplus value we produce. The later means we are too weak to stop income distribution being shifted in favour of the capitalist class, which results in over-accumulation and rendering the economy prone to a failure in aggregate demand. The 1960s and 1970s are the classic example of what happens when "subjective" pressures predominate while the 1920s and 1930s show the "objective" ones at work.

Finally, it must be stressed that this analysis does **not** imply that anarchists think that capitalism will self-destruct. In spite of crises being inevitable and occurring frequently, revolution is not. Capitalism will only be eliminated by working class revolution, when people see the need for social transformation and not imposed on people as the by-product of an economic collapse.

C.7.1 What role does class struggle play in the business cycle?

At its most basic, the class struggle (the resistance to hierarchy in all its forms) is the main cause of the business cycle. As we argued in sections B.1.2 and C.2, capitalists in order to exploit a worker must first oppress them. But where there is oppression, there is resistance; where there is authority, there is the will to freedom. Hence capitalism is marked by a continuous struggle between worker and boss at the point of production as well as struggle outside of the workplace against other forms of hierarchy.

This class struggle reflects a conflict between workers attempts at liberation and self-empowerment and capital's attempts to turn the individual worker into a small cog in a big machine. It reflects the attempts of the oppressed to try to live a fully human life, when the *"worker claims his share in the riches he produces; he claims his share in the management of production; and he claims not only some additional well-being, but also his full rights in the higher enjoyment of science and art."* [Peter Kropotkin, **Anarchism**, pp. 48–49] As Errico Malatesta argued:

> *"If [workers] succeed in getting what they demand, they will be better off: they will earn more, work fewer hours and will have more time and energy to reflect on things that matter to them, and will immediately make greater demands and have greater needs … [T]here exists no natural law (law of wages) which determines what part of a worker's labour should go to him [or her] … Wages, hours and other conditions of employment are the result of the struggle between bosses and workers. The former try and give the workers as little as possible; the latter try, or should try to work as little, and earn as much, as possible. Where workers accept any conditions, or even being discontented, do not know how to put up effective resistance to the bosses demands, they are soon reduced to bestial conditions of life. Where, instead, they have ideas of how human beings should live and know how to join forces, and through refusal to work or the latent and open threat of rebellion, to win bosses respect, in such cases, they are treated in a relatively decent way … Through struggle, by resistance against the bosses, therefore, workers can, up to a certain point, prevent a worsening of their conditions as well as obtaining real improvement."* [**Errico Malatesta: His Life and Ideas**, pp. 191–2]

It is this struggle that determines wages and indirect income such as welfare, education grants and so forth. This struggle also influences the concentration of capital, as capital attempts to use technology to get an advantage against their competitors by driving down prices by increasing the productivity of labour (i.e., to extract the maximum surplus value possible from employees). And, as will be discussed in section D.10, increased capital investment also reflects an attempt to increase the control of the worker by capital (or to replace them with machinery that cannot say "no") **plus** the transformation of the individual into "the mass worker" who can be fired and replaced with little or no hassle. For example, Proudhon quotes an *"English Manufacturer"* who states that he invested in machinery precisely to replace humans by machines because machines are easier to control:

> *"The insubordination of our workforce has given us the idea of dispensing with them. We have made and stimulated every imaginable effort of the mind to replace the service of men by tools more docile, and we have achieved our object. Machinery has delivered*

> *capital from the oppression of labour."* [quoted by Proudhon, **System of Economical Contradictions**, p. 189]

(To which Proudhon replied *"[w]hat a misfortunate that machinery cannot also deliver capital from the oppression of consumers!"* The over-production and reductions in demand caused by machinery replacing people soon destroys these illusions of automatic production by a slump — see section C.7.3).

Therefore, class struggle influences both wages and capital investment, and so the prices of commodities in the market. It also, more importantly, determines profit levels and it is the rise and fall of profit levels that are the ultimate cause of the business cycle. This is because, under capitalism, production's *"only aim is to increase the profits of the capitalist. And we have, therefore, — the continuous fluctuations of industry, the crisis coming periodically."* [Kropotkin, **Op. Cit.**, p. 55]

A common capitalist myth, derived from neo-classical (and related) ideology, is that free-market capitalism will result in a continuous boom. Since the cause of slumps is allegedly state interference in the market (particularly in credit and money), eliminating such meddling will obviously bring reality into line with the textbooks and, consequently, eliminate such negative features of "actually existing" capitalism as the business cycle. Let us assume, for a moment, that this is the case (as will be discussed in section C.8, this is **not** the case). In the "boom economy" of capitalist dreams there will be full employment yet while this helps *"increase total demand, its fatal characteristic from the business view is that it keeps the reserve army of the unemployed low, thereby protecting wage levels and strengthening labour's bargaining power."* [Edward S. Herman, **Beyond Hypocrisy**, p. 93] This leads to the undermining of full employment as profit margins are placed under pressure (which explains why bosses have lead the fight against government full employment policies).

The process should be obvious enough. Full employment results in a situation where workers are in a very strong position, a strength which can undermine the system. This is because capitalism always proceeds along a tightrope. If a boom is to continue smoothly, real wages must develop within a certain band. If their growth is too low then capitalists will find it difficult to sell the products their workers have produced and so, because of this, face what is often called a *"realisation crisis"* (i.e. the fact that capitalists cannot make a profit if they cannot sell their products). If real wage growth is too high then the conditions for producing profits are undermined as labour gets more of the value it produces. This means that in periods of boom, when unemployment is falling, the conditions for realisation improve as demand for consumer goods increase, thus expanding markets and encouraging capitalists to invest. However, such an increase in investment (and so employment) has an adverse effect on the conditions for **producing** surplus value as labour can assert itself at the point of production, increase its resistance to the demands of management and, far more importantly, make its own.

If an industry or country experiences high unemployment, workers will put up with longer hours, stagnating wages, worse conditions and new technology in order to remain in work. This allows capital to extract a higher level of profit from those workers, which in turn signals other capitalists to invest in that area. As investment increases, unemployment falls. As the pool of available labour runs dry, then wages will rise as employers bid for scare resources and workers feel their power. As workers are in a better position they can go from resisting capital's agenda to proposing their own (e.g. demands for higher wages, better working conditions and even for workers' control). As workers' power increases, the share of income going to capital falls, as do profit rates, and capital experiences a profits squeeze and so cuts down on investment and employment and/or wages. The cut in investment increases unemployment in the capital goods sector of the economy, which in turn reduces demand for consumption goods as jobless workers can no longer afford to buy as much as before. This process accelerates as bosses fire workers or cut their wages and the slump deepens and so unemployment increases, which begins the cycle again. This can be called "subjective" pressure on profit rates.

This interplay of profits and wages can be seen in most business cycles. As an example, let us consider the crisis which ended post-war Keynesianism in the early 1970's and paved the way for the neo-liberal reforms of Thatcher and Reagan. This crisis, which started in 1973, had its roots in the 1960s boom and the profits squeeze it produced. If we look at the USA we find that it experienced continuous growth between 1961 and 1969 (the longest in its history until then). From 1961 onwards, unemployment steadily fell, effectively creating full employment. From 1963, the number of strikes and total working time lost steadily increased (the number of strikes doubled from 1963 to 1970, with the number of wildcat strike rising from 22% of all strikes in 1960 to 36.5% in 1966). By 1965 both the business profit shares and business profit rates peaked. The fall in profit share and rate of profit continued until 1970 (when unemployment started to increase), where it rose slightly until the 1973 slump occurred. In addition, after 1965, inflation started to accelerate as capitalist firms tried to maintain their profit margins by passing cost increases to consumers (as we discuss section C.8.2, inflation has far more to do with capitalist profits than it has with money supply or wages). This helped to reduce real wage gains and maintain profitability over the 1968 to 1973 period above what it otherwise would have been, which helped postpone, but not stop, a slump.

Looking at the wider picture, we find that for the advanced capital countries as a whole, the product wage rose steadily between 1962 and 1971 while productivity fell. The growth of the product wage (the real cost to the employer of hiring workers) exceeded that of productivity growth in the late 1960s, slightly after the year in which profit share in national income and the rate of profit peaked. From then on, productivity continued to fall while the product wage continued to rise. This process, the result of falling unemployment and rising workers' power (expressed, in part, by an explosion in the number of strikes across Europe and elsewhere), helped to ensure that workers keep an increasing share of the value they produced. The actual post-tax real wages and productivity in the advanced capitalist countries increased at about the same rate from 1960 to 1968 but between 1968 and 1973 the former increased at a larger rate than the latter (hence the profits squeeze). Moreover, increased international competition meant that many domestic companies where limited in their responses to the profits squeeze as well as facing a global decrease in demand for their products. This resulted in profit shares and rates declining to around 80% of their previous peak levels across the advanced capitalist nations. [Philip Armstrong, Andrew Glyn and John Harrison, **Capitalism Since 1945**, pp. 178–80, pp. 182–4 and pp. 192–3]

It must be stressed that social struggle was not limited to the workplace. In the 1960s a *"series of strong liberation movements emerged among women, students and ethnic minorities. A crisis of social institutions was in progress, and large social groups were questioning the very foundations of the modern, hierarchical society: the patriarchal family, the authoritarian school and university, the hierarchical workplace or office, the bureaucratic trade union or party."* [Takis Fotopoulos, *"The Nation-state and the Market,"* pp. 37–80, **Society and Nature**, Vol. 2, No. 2, p. 58] In stark contrast to the predictions of the right, state intervention within capitalism to maintain full employment and provide social services like health care had **not** resulted in a *"Road to Serfdom."* The opposite occurred, with previously marginalised sectors of the population resisting their oppression and exploitation by questioning authority in more and more areas of life — including, it must be stressed, within our own organisations as well (for example, the rank and file of trade unions had to rebel just as much against their own officials as they had against the bureaucracy of the capitalist firm).

These social struggles resulted in an economic crisis as capital could no longer oppress and exploit working class people sufficiently in order to maintain a suitable profit rate. This crisis was then used to discipline the working class and restore capitalist authority within and outside the workplace (see section C.8.2). We should also note that this process of social revolt in spite, or perhaps because of, the increase of material wealth was predicted by Malatesta. In 1922 he argued that:

> *"The fundamental error of the reformists is that of dreaming of solidarity, a sincere collaboration, between masters and servants, between proprietors and workers …*
>
> *"Those who envisage a society of well stuffed pigs which waddle contentedly under the ferule of a small number of swineherd; who do not take into account the need for freedom and the sentiment of human dignity … can also imagine and aspire to a technical organisation of production which assures abundance for all and at the same time materially advantageous both to bosses and the workers. But in reality 'social peace' based on abundance for all will remain a dream, so long as society is divided into antagonistic classes, that is employers and employees. And there will be neither peace nor abundance.*
>
> *"The antagonism is spiritual rather than material. There will never be a sincere understanding between bosses and workers for the better exploitation [sic!] of the forces of nature in the interests of mankind, because the bosses above all want to remain bosses and secure always more power at the expense of the workers, as well as by competition with other bosses, whereas the workers have had their fill of bosses and don't want more!"* [**Op. Cit.**, pp. 78–79]

The experience of the post-war compromise and social democratic reform shows that, ultimately, the social question is not poverty but rather freedom. However, to return to the impact of class struggle on capitalism.

It is the awareness that full employment is bad for business which is the basis of the so-called *"Non-Accelerating Inflation Rate of Unemployment"* (NAIRU). As we will discuss in more detail in section C.9, the NAIRU is the rate of unemployment for an economy under which inflation, it is claimed, starts to accelerate. While the basis of this "theory" is slim (the NAIRU is an invisible, mobile rate and so the "theory" can explain every historical event simply because you can prove anything when your datum cannot be seen by mere mortals) it is very useful for justifying policies which aim at attacking working people, their organisations and their activities. The NAIRU is concerned with a *"wage-price"* spiral caused by falling unemployment and rising workers' rights and power. Of course, you never hear of an *"interest-price"* spiral or a *"rent-price"* spiral or a *"profits-price"* spiral even though these are also part of any price. It is always a *"wage-price"* spiral, simply because interest, rent and profits are income to capital and so, by definition, above reproach. By accepting the logic of NAIRU, the capitalist system implicitly acknowledges that it and full employment are incompatible and so with it any claim that it allocates resources efficiently or labour contracts benefit both parties equally.

For these reasons, anarchists argue that a continual "boom" economy is an impossibility simply because capitalism is driven by profit considerations, which, combined with the subjective pressure on profits due to the class struggle between workers and capitalists, **necessarily** produces a continuous boom-and-bust cycle. When it boils down to it, this is unsurprising, as *"industry is directed, and will have to be directed, not towards what is needed to satisfy the needs of all, but towards that which, at a given moment, brings in the greatest temporary profit to a few. Of necessity, the abundance of some will be based upon the poverty of others, and the straitened circumstances of the greater number will have to be maintained at all costs, that there may be hands to sell themselves for a part only of that which they are capable of producing, without which private accumulation of capital is impossible!"* [Kropotkin, **Op. Cit.**, p. 128]

Of course, when such "subjective" pressures are felt on the system, when private accumulation of capital is threatened by improved circumstances for the many, the ruling class denounces working class "greed" and "selfishness." When this occurs we should remember what Adam Smith had to say on this subject:

> *"In reality high profits tend much more to raise the price of work than high wages ... That part of the price of the commodity that resolved itself into wages would ... rise only in arithmetical proportion to the rise in wages. But if profits of all the different employers of those working people should be raised five per cent., that price of the commodity which resolved itself into profit would ... rise in geometrical proportion to this rise in profit ... Our merchants and master manufacturers complain of the bad effects of high wages in raising the price and thereby lessening the sale of their goods at home and abroad. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains. They complain only of those of other people."* [**The Wealth of Nations**, pp. 87–88]

As an aside, we must note that these days we would have to add economists to Smith's *"merchants and master manufacturers."* Not that this is surprising, given that economic theory has progressed (or degenerated) from Smith's disinterested analysis into apologetics for any action of the boss (a classic example, we must add, of supply and demand, with the marketplace of ideas responding to a demand for such work from *"our merchants and master manufacturers"*). Any "theory" which blames capitalism's problems on "greedy" workers will always be favoured over one that correctly places them in the contradictions created by wage slavery. Ultimately, capitalist economics blame every problem of capitalism on the working class refusing to kow-tow to the bosses (for example, unemployment is caused by wages being too high rather than bosses needing unemployment to maintain their power and profits — see section C.9.2 on empirical evidence that indicates that the first explanation is wrong).

Before concluding, one last point. While it may appear that our analysis of the "subjective" pressures on capitalism is similar to that of mainstream economics, this is not the case. This s because our analysis recognises that such pressures are inherent in the system, have contradictory effects (and so cannot be easily solved without making things worse before they get better) and hold the potential for creating a free society. Our analysis recognises that workers' power and resistance **is** bad for capitalism (as for any hierarchical system), but it also indicates that there is nothing capitalism can do about it without creating authoritarian regimes (such as Nazi Germany) or by generating massive amounts of unemployment (as was the case in the early 1980s in both the USA and the UK, when right-wing governments mismanaged the economy into deep recessions) and even this is no guarantee of eliminating working class struggle as can be seen, for example, from 1930s America.

This means that our analysis shows the limitations and contradictions of the system as well as its need for workers to be in a weak bargaining position in order for it to "work" (which explodes the myth that capitalism is a free society). Moreover, rather than portray working people as victims of the system (as is the case in many Marxist analyses of capitalism) our analysis recognises that we, both individually and collectively, have the power to influence and **change** that system by our activity. We should be proud of the fact that working people refuse to negate themselves or submit their interests to that of others or play the role of order-takers required by the system. Such expressions of the human spirit, of the struggle of freedom against authority, should not be ignored or down-played, rather they should be celebrated. That the struggle against authority causes the system so much trouble is not an argument against social struggle, it is an argument against a system based on hierarchy, oppression, exploitation and the denial of freedom.

To sum up, in many ways, social struggle is the inner dynamic of the system, and its most basic contradiction: while capitalism tries to turn the majority of people into commodities (namely, bearers of labour power), it also has to deal with the human responses to this process of objectification (namely, the class struggle). However, it does not follow that cutting wages will solve a crisis — far from it, for, as we argue in section C.9.1, cutting wages will deepen any crisis, making things worse before they get better. Nor does it follow that, if social struggle were eliminated, capitalism would work fine. After all, if we assume that labour power is a commodity like any other, its price will rise as demand increases relative to supply (which will either produce inflation or a profits squeeze, probably both). Therefore, even without the social struggle which accompanies the fact that labour power cannot be separated from the individuals who sell it, capitalism would still be faced with the fact that only surplus labour (unemployment) ensures the creation of adequate amounts of surplus value.

Moreover, even assuming that individuals can be totally happy in a capitalist economy, willing to sell their freedom and creativity for a little more money, putting up, unquestioningly, with every demand and whim of their bosses (and so negating their own personality and individuality in the process), capitalism does have "objective" pressures limiting its development. So while social struggle, as argued above, can have a decisive effect on the health of the capitalist economy, it is not the only problem the system faces. This is because there are objective pressures within the system beyond and above the authoritarian social relations it produces and the resistance to them. These pressures are discussed next, in sections C.7.2 and C.7.3.

C.7.2 What role does the market play in the business cycle?

A major problem with capitalism is the working of the capitalist market itself. For the supporters of "free market" capitalism, the market provides all the necessary information required to make investment and production decisions. This means that a rise or fall in the price of a commodity acts as a signal to everyone in the market, who then respond to that signal. These responses will be co-ordinated by the market, resulting in a healthy economy.

This perspective is expressed well by right-liberal, Frederick von Hayek in his *"The Uses of Knowledge in Society"* (reprinted in **Individualism and Economic Order**). Using the example of the tin market, he defends capitalism against central planning on its ability to handle the division of knowledge within society and its dynamic use of this dispersed knowledge when demand or supply changes. *"Assume,"* he argues, *"that somewhere in the world a new opportunity for the use of some raw material, say tin, has arisen, or that one of the sources of supply of tin has been eliminated. It does not matter for our purpose and it is very significant that it does not matter which of these two causes has made tin more scarce. All that the users of tin need to know is that some of the tin they used to consume is now more profitably employed elsewhere, and that in consequence they must economise tin. There is no need for the great majority of them even to know where the more urgent need has arisen, or in favour of what other uses they ought to husband the supply."* The subsequent rise in its price will result in reduced consumption as many users will economise on its use and so the information that tin has become (relatively) scarcer spreads throughout the economy and influences not only tin users, but also its substitutes and the substitutes of these substitutes and so on. This will move the economy towards equilibrium without the people informed knowing anything about the original causes for these changes. *"The whole acts as one market, not because any of its members survey the whole field, but because their limited individual fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all."* (*"The use of knowledge in society,"* pp. 519–30, **American Economic Review**, Vol. 35, No. 4, , p. 526)

While it can be granted that this account of the market is not without foundation, it is also clear that the price mechanism does not communicate all the relevant information needed by companies or individuals. This means that capitalism does not work in the way suggested in the economic textbooks. It is the workings of the price mechanism itself which leads to booms and slumps in economic activity and the resulting human and social costs they entail. This can be seen if we investigate the actual processes hidden behind the workings of the price mechanism.

The key problem with Hayek's account is that he does not discuss the **collective** results of the individual decisions he highlights. It is true that faced with a rise in the price of tin, individual firms will cut back on its use. Yet there is no reason to suppose that the net result of these actions will bring the demand and supply of tin back to equilibrium. In fact, it is just as likely that the reduction in demand for tin is such that its producers face falling sales and so cut back production even more. Similarly, a rising demand for tin could easily result in all tin producers increasing supply so much as to produce a glut on the market. Proudhon described this process well in the 1840s:

> *"A peasant who has harvested twenty sacks of wheat, which he with his family proposes to consume, deems himself twice as rich as if he had harvested only ten; likewise a housewife who has spun fifty yards of linen believes that she is twice as rich as if she had spun but twenty-five. Relatively to the household, both are right; looked at in their external relations, they may be utterly mistaken. If the crop of wheat is double throughout the whole country, twenty sacks will sell for less than ten would have sold for if it had been but half as great; so, under similar circumstances, fifty yards of linen will be worth less than twenty-five: so that value decreases as the production of utility*

> *increases, and a producer may arrive at poverty by continually enriching himself."* [**The System of Economical Contradictions**, pp. 77–78]

He argued that this occurred due to the *"contradiction"* of *"the double character of value"* (i.e. between value in use and value in exchange). [**Op. Cit.**, p. 78]

As John O'Neill argues (basing himself on Marx rather than Proudhon), when producers *"make plans concerning future production, they are planning not with respect of demand at the present moment … but with respect to expected demand at some future moment … when their products reach the market."* The price mechanism provides information that indicates the relationship between supply and demand **now** and while this information **is** relevant to producers plans, it is not **all** the information that is relevant or is required by those involved. It cannot provide information which will allow producers to predict demand later. *"A major component of the information required for such a prediction is that of the plans of other producers which respond to that demand. This is information that the market, as a competitive system, fails to distribute."* It is this *"informational restriction"* which is one of the sources of why there is a business cycle. This is because each producer *"responds to the same signal the change in price. However, each agent acts independently of the response of other producers and consumers."* The result is *"an overproduction of goods in relation to effective demand for them. Goods cannot be sold. There is a realisation crisis: producers cannot realise the value of their products. Given this overproduction, demand falls against supply. There is a slump. This eventually leads to a rise in demand against supply, production expends leading to another boom, and so on."* [**The Market**, pp. 134–5]

This information cannot be supplied due to competition. Simply put, if A and B are in competition, if A informs B of her activities and B does not reciprocate, then B is in a position to compete more effectively than A. Hence communication within the market is discouraged and each production unit is isolated from the rest. In other words, each person or company responds to the same signal (the change in price) but each acts independently of the response of other producers and consumers. The result is often a slump in the market, causing unemployment and economic disruption. Thus the market *"blocks the communication of information and fails to co-ordinate plans for economic action."* [**Op. Cit.**, p. 137]

This, it should be noted, is not a problem of people making a series of unrelated mistakes. *"Rather, it is that the market imparts the same information to affected agents, and this information is such that the rational strategy for all agents is to expand production or contract consumption, while it is not rational for all agents to act in this manner collectively."* In other words, the information the market provides is not sufficient for rational decision making and naturally results in disproportionalities in the market. Thus the price mechanism actively encourages *"the suppression of the mutual exchange of information concerning planned responses"* to current prices and this *"leads to over production."* So it is **not** a question of inaccurate prediction (although given that the future is unknowable and unpredictable this is a factor). Instead, it is *"one of individually rational responses to the same signal resulting in collectively irrational responses."* [**Op. Cit.**, p. 135 and p. 197]

This means that prices in themselves do not provide adequate knowledge for rational decision making as they are not at their long-run equilibrium levels. This causes a problem for Hayek's account of the market process as he stresses that actual prices never are at this (purely theoretical) price. As we discuss in section C.8, Hayek's own theory of the business cycle shows the negative impact which the 'misinformation' conveyed by disequilibrium prices can cause on the economy.

In that analysis, the disequilibrium price that leads to very substantial macroeconomic distortions is the rate of interest but, obviously, the same argument applies for commodity prices as well. This means that the market process, based on the reactions of profit-maximising firms to the same (unsustainable) prices for a commodity can generating mal-investment and subsequent market distributions on a wide level. Simply put, the price mechanism may carry information regarding the terms on which various commodities may currently be exchanged but it does not follow that a knowledge of these exchange ratios enable agents to calculate the future profitability of their production decisions (social usefulness is, of course, of no concern).

It is this irrationality and lack of information which feed into the business cycle. *"These local booms and slumps in production … are then amplified into general crises precisely through the inter-connections in the market that Hayek highlights in his example of the production and consumption of tin."* [O'Neill, **Op. Cit.**, p. 136] The negative effects of over-production in one market will be passed on to those which supply it with goods in the shape of decreased demand. These firms will now experience relative over-production which, in turn, will affect their suppliers. Whatever benefits may accrue to consumers of these goods in the shape of lower prices will be reduced as demand for their products drops as more and more workers are made unemployed or their wages are cut (which means that **real** wages remain constant as prices are falling alongside money wages — see section C.9.1 for details). Firms will also seek to hoard money, leading to yet more falling demand for goods and so unemployed labour is joined by under-utilisation of capacity.

Which brings us to the issue of money and its role in the business cycle. "Free market" capitalist economics is based on Say's Law. This is the notion that supply creates its own demand and so general gluts of goods and mass unemployment are impossible. As we noted in section C.1.5, this vision of economic activity is only suited to precapitalist economies or ones without money for money is considered as nothing more than an aid to barter, a medium of exchange only. It ignores the fact that money is a store of value and, as such, can be held onto precisely for that reason. This means that Say's Law is invalid as its unity between sale and purchase can be disturbed so causing the chain of contractual relationships to be broken. Simply put, someone who sells a product need not spend their income on another product at the same time. Unlike barter, the sale of one commodity is an act distinct from the purchase of another. Money, in other words, *"brings in time"* into the market process and *"the possibility of hoarding."* Time *"because a good is usually sold some time after it is made, running the risk that its sale price could fall below the cost of production, wiping out the capitalist's expected profit."* Hoarding *"because income need not be spent but may merely be kept idle."* [Doug Henwood, **Wall Street**, p. 232]

This means that over-production becomes possible and bankruptcies and unemployment can become widespread and so a slump can start. *"As any Marxian or Keynesian crisis theorist can tell you,"* Henwood summarises, *"the separation of purchase and sale is one of the great flashpoints of capitalism; an expected sale that goes unmade can drive a capitalist under, and can unravel a chain of financial commitments. Multiply that by a thousand or two and you have great potential mischief."* Thus *"the presence of money as a store of value, the possibility of keeping wealth in financial form rather than spending it promptly on commodities, always introduces the possibility of crisis."* That is, the possibility *"of an excess of capital lacking a profitable investment outlet, and an excess of goods that couldn't be sold profitably on the open market."* [**Op. Cit.**, pp. 93–4 and p. 94]

So when the market prices of goods fall far below their cost prices then production and investment stagnate. This is because profits can only be transformed into capital at a loss and so it lies idle in banks. Thus unemployed labour is associated with unemployed capital, i.e. excess money.

This desire for capitalists to increase their demand for storing their wealth in money rather than investing it is driven by the rate of profit in the economy. Bad times result in increased hoarding and so a general fall in aggregate demand. Lowering interest rates will not provoke a demand for such money hoards, as claimed in "free market" capitalist theory, as few capitalists will seek to invest in a recession as expected profits will be lower than the interest rate.

However, it should be stressed that disproportionalities of production between industries and the separation of production and sale do not **per se** result in a general crisis. If that were the case the capitalism would be in a constant state of crisis as markets are rarely in a state of equilibrium and sales do not instantly result in purchases. This means that market dislocations need not automatically produce a general crisis in the economy as the problems associated with localised slumps can be handled when the overall conditions within an economy are good. It simply provides the **potential** for crisis and a means of transmitting and generalising local slumps when the overall economic situation is weak. In other words, it is an accumulative process in which small changes can build up on each other until the pressures they exert become unstoppable. The key thing to remember is that capitalism is an inherently dynamic system which consists of different aspects which develop unevenly (i.e., disproportionately). Production, credit, finance markets, circulation of money and goods, investment, wages, profits as well as specific markets get out of step. An economic crisis occurs when this process gets too far out of line.

This process also applies to investment as well. So far, we have assumed that firms adjust to price changes without seeking new investment. This is, of course, unlikely to always be the case. As we discuss in section C.8, this analysis of the market providing incomplete information also applies to the market for credit and other forms of external financing. This results in a situation where the problems associated with over-production can be amplified by over-investment. This means that the problems associated with markets creating disproportionalities are combined with the problems resulting from increased productivity and capital investment which are discussed in the next section.

C.7.3 What role does investment play in the business cycle?

Other problems for capitalism arise due to the increases in productivity which occur as a result of capital investment or new working practices which aim to increase short term profits for the company. The need to maximise profits results in more and more investment in order to improve the productivity of the workforce (i.e. to increase the amount of surplus value produced). A rise in productivity, however, means that whatever profit is produced is spread over an increasing number of commodities. This profit still needs to be realised on the market but this may prove difficult as capitalists produce not for existing markets but for expected ones. As individual firms cannot predict what their competitors will do, it is rational for them to try to maximise their market share by increasing production (by increasing investment). As the market does not provide the necessary information to co-ordinate their actions, this leads to supply exceeding demand and difficulties realising sufficient profits. In other words, a period of over-production occurs due to the over-accumulation of capital.

Due to the increased investment in the means of production, variable capital (labour) uses a larger and larger constant capital (the means of production). As labour is the source of surplus value, this means that in the short term profits may be increased by the new investment, i.e.

workers must produce more, in relative terms, than before so reducing a firms production costs for the commodities or services it produces. This allows increased profits to be realised at the current market price (which reflects the old costs of production). Exploitation of labour must increase in order for the return on total (i.e. constant **and** variable) capital to increase or, at worse, remain constant. However, while this is rational for one company, it is not rational when all firms do it (which they must in order to remain in business). As investment increases, the surplus value workers have to produce must increase faster. As long as the rate of exploitation produced by the new investments is high enough to counteract the increase in constant capital and keep the profit rate from falling, then the boom will continue. If, however, the mass of possible profits in the economy is too small compared to the total capital invested (both in means of production, fixed, and labour, variable) then the possibility exists for a general fall in the rate of profit (the ratio of profit to investment in capital and labour). Unless exploitation increases sufficiently, already produced surplus value earmarked for the expansion of capital may not be realised on the market (i.e. goods may not be sold). If this happens, then the surplus value will remain in its money form, thus failing to act as capital. In other words, accumulation will grind to a halt and a slump will start.

When this happens, over-investment has occurred. No new investments are made, goods cannot be sold resulting in a general reduction of production and so increased unemployment as companies fire workers or go out of business. This removes more and more constant capital from the economy, increasing unemployment which forces those with jobs to work harder, for longer so allowing the mass of profits produced to be increased, resulting (eventually) in an increase in the rate of profit. Once profit rates are high enough, capitalists have the incentive to make new investments and slump turns to boom. As we discuss in section C.8, the notion that investment will be helped by lowing interest rates in a slump fails to understand that *"the rate of investment decisions is an increasing function of the difference between the prospective rate of profit and the rate of interest."* [Michal Kalecki, quoted by Malcolm Sawyer, **The Economics of Michal Kalecki**, p. 98] If profit rates are depressed due to over-investment then even the lowest interest rates will have little effect. In other words, expectations of capitalists and investors are a key issue and these are shaped by the general state of the economy.

It could be argued that such an analysis is flawed as no company would invest in machinery if it would reduce its rate of profit. But such an objection is flawed, simply because (as we noted) such investment is perfectly sensible (indeed, a necessity) for a specific firm. By investing they gain (potentially) an edge in the market and so increased profits for a period. This forces their competitors to act likewise and **they** invest in new technology. Unfortunately, while this is individually sensible, collectively it is not as the net result of these individual acts is over-investment in the economy as a whole. Moreover, unlike the model of perfect competition, in a real economy capitalists have no way of knowing the future, and so the results of their own actions never mind the actions of their competitors. Thus over-accumulation of capital is the natural result of competition simply because even if we assume that the bosses of the firms are individually rational they are driven to make decisions which are collectively irrational to remain in business. The future is unknowable and so the capitalist has no idea what the net result of their decisions will be nor the state of the economy when their investment decisions are finally active. Both of these factors ensure that firms act as they do, investing in machinery which, in the end, will result in a crisis of over-accumulation.

The logic is simple and is rooted in the concept of *"the fallacy of composition."* To use an analogy, if you attend a rock concert and take a box to stand on then you will get a better view. If others do the same, you will be in exactly the same position as before. Worse, even, as it may be easier to loose your balance and come crashing down in a heap (and, perhaps, bringing others with you). This analogy shows why introducing new machinery, which is profitable for an individual company, has such a potentially negative effect on the economy as a whole. While it is profitable for an individual company in the short term, its overall effect means that it is **not** profitable for all in the long run. As Kalecki put it, the *"tragedy of investment is that it causes crisis because it is useful. Doubtless many people will consider this theory paradoxical. But it is not the theory which is paradoxical, but its subject — the capitalist economy."* [quoted by Sawyer **Op. Cit.**, p. 156] This paradox applies to the issue of wages as well:

> *"What a system is that which leads a business man to think with delight that society will soon be able to dispense with men! **Machinery has delivered capital from the oppression of labour**! … Fool! though the workmen cost you something, they are your customers: what will you do with your products, when, driven away by you, they shall consume them no longer? Thus machinery, after crushing the workmen, is not slow in dealing employers a counter-blow; for, if production excludes consumption, it is soon obliged to stop itself.*
>
> *[…]*
>
> *"These failures were caused by over-production, — that is, by an inadequate market, or the distress of the people. What a pity that machinery cannot also deliver capital from the oppression of consumers! What a misfortune that machines do not buy the fabrics which they weave! The ideal society will be reached when commerce, agriculture, and manufactures can proceed without a man upon earth!"* [Proudhon, **System of Economical Contradictions**, pp. 189–90]

So, if the profit rate falls to a level that does not allow capital formation to continue, a slump sets in. This general slump means that the rate of profit over the whole economy falls due to excessive investment. When one industry over-invests and over-produces, it cuts back production, introduces cost-cutting measures, fires workers and so on in order to try and realise more profits. These may spread if the overall economic is fragile as the reduced demand for industries that supplied the affected industry impacts on the **general** demand (via a fall in inputs as well as rising unemployment). The related industries now face over-production themselves and the natural response to the information supplied by the market is for individual companies to reduce production, fire workers, etc., which again leads to declining demand. This makes it even harder to realise profit on the market and leads to more cost cutting, deepening the crisis. While individually this is rational, collectively it is not and so soon all industries face the same problem. A local slump is propagated through the economy.

Cycles of prosperity, followed by over-production and then depression are the natural result of capitalism. Over-production is the result of over-accumulation, and over-accumulation occurs because of the need to maximise short-term profits in order to stay in business. So while the crisis appears as a glut of commodities on the market, as there are more commodities in circulation that can be purchased by the aggregate demand (*"Property sells products to the labourer for more* *than it pays him for them,"* to use Proudhon's words), its roots are deeper. It lies in the nature of capitalist production itself.

"Over-production," we should point out, exists only from the viewpoint of capital, **not** of the working class:

> *"What economists call over-production is but a production that is above the purchasing power of the worker... this sort of over-production remains fatally characteristic of the present capitalist production, because workers cannot buy with their salaries what they have produced and at the same time copiously nourish the swarm of idlers who live upon their work."* [Kropotkin, **Op. Cit.**, pp. 127–128]

In other words, over-production and under-consumption reciprocally imply each other. There is no over production except in regard to a given level of solvent demand. There is no deficiency in demand except in relation to a given level of production. The goods "over-produced" may be required by consumers, but the market price is too low to generate a profit and so existing goods must be destroyed and production must be reduced in order to artificially increase it. So, for example, the sight of food and other products being destroyed while people are in need of them is a common one in depression years.

So, while the crisis appears on the market as a *"commodity glut"* (i.e. as a reduction in effective demand) and is propagated through the economy by the price mechanism, its roots lie in production. Until such time as profit levels stabilise at an acceptable level, thus allowing renewed capital expansion, the slump will continue. The social costs of the wage cutting this requires is yet another "externality," to be bothered with only if they threaten capitalist power and wealth.

There are means, of course, by which capitalism can postpone (but not stop) a general crisis developing. The extension of credit by banks to both investors and consumers is the traditional, and most common, way. Imperialism, by which markets are increased and profits are extracted from less developed countries and used to boost the imperialist countries profits, is another method (*"The workman being unable to purchase with their wages the riches they are producing, industry must search for markets elsewhere."* [Kropotkin, **Op. Cit.**, p. 55]). Another is state intervention in the economy (such as minimum wages, the incorporation of trades unions into the system, arms production, manipulating interest rates to maintain a *"natural"* rate of unemployment to keep workers on their toes, etc.). Another is state spending to increase aggregate demand, which can increase consumption and so lessen the dangers of over-production. However, these have (objective and subjective) limits and can never succeed in stopping depressions from occurring as they ultimately flow from capitalist production and the need to make profits.

A classic example of these "objective" pressures on capitalism is the "Roaring Twenties" that preceded the Great Depression of the 1930s. After the 1921 slump, there was a rapid rise in investment in the USA with investment nearly doubling between 1919 and 1927. Because of this investment in capital equipment, manufacturing production grew by 8.0% per annum between 1919 and 1929 and labour productivity grew by an annual rate of 5.6% (this is including the slump of 1921–22). With costs falling and prices comparatively stable, profits increased which in turn lead to high levels of capital investment (the production of capital goods increased at an average annual rate of 6.4%). [William Lazonick, **Competitive Advantage on the Shop Floor**, p. 241] The optimism felt by business as a result of higher profits was reflected in the wealthy sections of America. In the 1920s prosperity was concentrated at the top. One-tenth of the top 1% of families received as much income as the bottom 42% and only 2.3% of the population enjoyed incomes over $100,00 (60% of families made less than $2,000 a year, 42% less than $1,000). While the richest 1% owned 40% of the nation's wealth by 1929 (and the number of people claiming half-million dollar incomes rose from 156 in 1920 to 1,489 in 1929) the bottom 93% of the population experienced a 4% drop in real disposable per-capita income between 1923 and 1929. However, in spite (or, perhaps, because) of this, US capitalism was booming and belief in capitalism was at its peak.

But by 1929 all this had changed with the stock market crash — followed by a deep depression. What was its cause? Given our analysis presented in section C.7.1, it may have been expected to have been caused by the "boom" decreasing unemployment, so increased working class power and leading to a profits squeeze but this was not the case. This slump was **not** the result of working class resistance, indeed the 1920s were marked by a labour market which was continuously favourable to employers. This was for two reasons. Firstly, the "Palmer Raids" at the end of the 1910s saw the state root out radicals in the US labour movement and wider society. Secondly, the deep depression of 1920–21 (during which national unemployment rates averaged over 9%, the highest level over any two-year period since the 1890s) changed the labour market from a seller's to a buyer's market. This allowed the bosses to apply what became to be known as *"the American Plan,"* namely firing workers who belonged to a union and forcing them to sign *"yellow-dog"* contracts (promises not to join a union) to gain or keep their jobs. Reinforcing this was the use of legal injunctions by employers against work protests and the use of industrial spies to identify and sack union members. This class war from above made labour weak, which is reflected in the influence and size of unions falling across the country. As union membership declined, the number of strilkes reached their lowest level since the early 1880s, falling to just over 700 per year between 1927 to 1930 (compared to 3,500 per year between 1916 and 1921). [Lazonick, **Op. Cit.**, pp. 249–251] The key thing to remember is that the impact of unemployment is not limited to the current year's figures. High unemployment rates have a sustained impact on the organisations, morale, and bargaining power of workers even if unemployment rates fall afterwards. This was the situation in the 1920s, with workers remembering the two years of record unemployment rates of 1921 and 1922 (in fact, the unemployment rate for manufacturing workers was close to the overall rate in 1933).

During the post-1922 boom, this position did not change. The national 3.3% unemployment rate hid the fact that non-farm unemployment averaged 5.5% between 1923 and 1929. Across all industries, the growth of manufacturing output did not increase the demand for labour. Between 1919 and 1929, employment of production workers fell by 1% and non-production employment fell by about 6% (during the 1923 to 29 boom, production employment only increased by 2%, and non-production employment remained constant). This was due to the introduction of labour saving machinery and the rise in the capital stock. In addition, the numbers seeking work were boosted by new immigrants and the unwillingness of existing ones to return home due to difficulties returning to America. Lastly, the greatest source of industrial labour supply came from the American farm — there was a flood of rural workers into the urban labour market over the 1920s. [Lazonick, **Op. Cit.**, pp. 252–5] It is interesting to note that even **with** a labour market favourable to employers for over 5 years, unemployment was still high. This suggests that the neo-classical "argument" (assertion would be more correct) that unemployment within capitalism is caused by strong unions or high real wages is somewhat flawed to say the least (see section C.9).

Facing high unemployment, workers' quit rates fell due to fear of loosing jobs (particularly those workers with relatively higher wages). This, combined with the steady decline of the unions and the very low number of strikes, indicates that labour was weak. This is reflected in the share of total manufacturing income going to wages fell from 57.5% in 1923–24 to 52.6% in 1928/29 (between 1920 and 1929, it fell by 5.7%). Productivity increased from an annual rate of 1.2% between 1909 and 1919 to 5.6% between 1919 and 1929. This increase in productivity was reflected in the fact that over the post-1922 boom, the share of manufacturing income paid in salaries rose from 17% to 18.3% and the share to capital rose from 25.5% to 29.1%. Managerial salaries rose by 21.9% and firm surplus by 62.6% between 1920 and 1929. [Lazonick, **Op. Cit.**, pp. 241–2] Any notion that the 1929 crash was the result of a rebellious working class is not applicable.

The key to understanding what happened lies in the contradictory nature of capitalist production. The "boom" conditions were the result of capital investment, which increased productivity thereby reducing costs and increasing profits. The large and increasing investment in capital goods was the principal device by which profits were spent. In addition, those sectors of the economy marked by big business (i.e. oligopoly, a market dominated by a few firms) placed pressures upon the more competitive ones. As big business, as usual, received a higher share of profits due to their market position (see section C.5), this lead to many firms in the more competitive sectors of the economy facing a profitability crisis during the 1920s.

The increase in investment, while directly squeezing profits in the more competitive sectors of the economy, also eventually caused the rate of profit to stagnate, and then fall, over the economy as a whole. While the mass of available profits in the economy grew, it eventually became too small compared to the total capital invested. Moreover, with the fall in the share of income going to labour and the rise of inequality, aggregate demand for goods could not keep up with production leading to unsold goods (which is another way of expressing the process of over-investment leading to over-production, as over-production implies under-consumption and vice versa). As expected returns (profitability) on investments hesitated, a decline in investment demand occurred and so a slump began (rising predominantly from the capital stock rising faster than profits). Investment flattened out in 1928 and turned down in 1929. With the stagnation in investment, a great speculative orgy occurred in 1928 and 1929 in an attempt to enhance profitability. This unsurprisingly failed and in October 1929 the stock market crashed, paving the way for the Great Depression of the 1930s.

This process of over-investment relative to consumption is based on rising labour productivity combined with stagnant wages or relative slow wage growth. This implies inadequate workers' consumption but rising profit rates. This is possible as long as aggregate demand remains sufficient, which it can as long as high profit rates stimulate investment (i.e., money is not saved or sufficient credit is generated to ensure that investment spending does not lag consumption). Investment creates new capacity and that implies the need for further increases in investment, capitalist luxury consumption, and credit-based consumption to maintain aggregate demand. This profit-led growth is hard to sustain as high profits rates are difficult to maintain due to low working class income as both investment and capitalist luxury consumption are more unstable. Investment is more volatile than consumption, so the average degree of instability increases which, in turn, means that the probability of a slump rises. Further, this type of growth creates imbalances between sectors of the economy as firms rush to invest in profitable sections leading to relative over-production and over-investment in those areas (see last section). With the rise in unstable forms of demand, an economy becomes increasingly fragile and so increasingly vulnerable to "shocks." The stock market crash of 1929 was such a shock and the resulting panic and reduced demand for luxury goods and investment that it produced exposed the underlying weakness of the economy. After the Crash, restrictive fiscal and monetary policies and falling demand interacted to break this unstable prosperity and to accelerate the slump. This was reinforced by wage-cut induced under-consumption as well as debt deflation making over-investment worse in relation to over demand within the economy. So US prosperity was fragile long before late 1929, due to the process of over-investment relative to demand which lead the economy to be reliant on unstable forms of demand such as luxury consumption and investment.

The crash of 1929 indicates the "objective" limits of capitalism. Even with a very weak position of labour crisis still occurred and prosperity turned to "hard times." In contradiction to neo-classical economic theory, the events of the 1920s indicate that even if the capitalist assumption that labour is a commodity like all others **is** approximated in real life, capitalism is still subject to crisis (ironically, a militant union movement in the 1920s would have postponed crisis by shifting income from capital to labour, increasing aggregate demand, reducing investment and supporting the more competitive sectors of the economy!). Therefore, any neo-classical "blame labour" arguments for crisis (which were so popular in the 1930s and 1970s) only tells half the story (if that). Even if workers **do** act in a servile way to capitalist authority, capitalism will still be marked by boom and bust (as shown by the 1920s and 1980/90s).

To conclude, capitalism will suffer from a boom-and-bust cycle due to the above-mentioned objective pressures on profit production, even if we ignore the subjective revolt against authority by workers, explained earlier. In other words, even if the capitalist assumption that workers are not human beings but only "variable capital" **were** true, it would not mean that capitalism would be a crisis free system. However, for most anarchists, such a discussion is somewhat academic for human beings are not commodities, the labour "market" is not like the iron market, and the subjective revolt against capitalist domination will exist as long as capitalism does.

C.8 Is state control of money the cause of the business cycle?

As explained in the last section, capitalism will suffer from a boom-and-bust cycle due to objective pressures on profit production even if we ignore the subjective revolt against authority by working class people. It is this two-way pressure on profit rates, the subjective and objective, which causes the business cycle and such economic problems as *"stagflation."* However, for supporters of the free market, this conclusion is unacceptable and so they usually try to explain the business cycle in terms of **external** influences rather than those generated by the way capitalism works. Most pro-"free market" capitalists blame government intervention in the market, particularly state control over money, as the source of the business cycle. This analysis is defective, as will be shown below.

First it should be noted that many supporters of capitalism ignore the "subjective" pressures on capitalism that we discussed in section C.7.1. In addition, the problems associated with rising capital investment (as highlighted in section C.7.3) are also usually ignored, because they usually consider capital to be "productive" and so cannot see how its use could result in crises. This leaves them with the problems associated with the price mechanism, as discussed in section C.7.2. It is here, in the market for credit and money, that the role of the state comes into play, distorting the natural workings of the market and causing the ups and downs of business.

In pre-Keynesian bourgeois economics, the reason why Say's Law is applicable in a money economy is the interest rate. As we discussed in section C.2.6, this is claimed to reflect the *"time preference"* of individuals. While it is possible for sales not to be turned into purchases in the market, the money involved is not withdrawn from the economy. Rather, it is saved and made available to investors. The interest rate is the means by which savings and investment come into line. This means that Say's Law is maintained as savings are used to purchase capital goods and so demand and supply match. As long as interest rates are working as they should, the possibility of a general crisis is impossible. The problem is that the credit system does not work exactly as it claimed and this lies with the banks who introduce fractional reserve banking. This allows them to loan out more money than they have in savings in order to increase their profits. This lowers the rate of interest below its *"natural"* (or equilibrium) rate and thus firms get price signals which do not reflect the wishes of consumers for future goods rather than current ones. This causes over-investment and, ultimately, a crisis. This is because, eventually, interest rates must rise and projects which were profitable at the lower rate of interest will no longer be so. The moral of the theory is that if the actual rate of interest equalled the *"natural"* rate then a situation of *"neutral"* money would be achieved and so misdirections of production would be avoided, so ending the business cycle.

As far as capitalist economics had a theory of the business cycle, this was it and it was the dominant ideological position within the profession until publication of Keynes' **The General Theory of Employment, Interest and Money** in 1936. Politically, it was very useful as it recommended that the state should do nothing during the crisis and this was the preferred position of right-wing governments in America and Britain. It was forcefully argued by "Austrian" economist Frederick von Hayek during the early 1930s, who was repeating the earlier arguments of his mentor Ludwig von Mises and has been repeated by their followers ever since. Yet, for some strange reason, they almost always fail to mention that Hayek was roundly defeated in the theoretical battles of the time by Keynesians. In fact, his former students (including John Hicks and Nicholas Kaldor) showed how Hayek's theory was flawed and he gave up business cycle research in the early 1940s for other work. Kaldor's first critique (*"Capital Intensity and the Trade Cycle"*), for example, resulted in Hayek completed rewriting his theory while Kaldor's second article (*"Professor Hayek and the Concertina-effect"*) showed that Hayek's Ricardo Effect was only possible under some very special circumstances and so highly unlikely. [Kaldor, **Essays on Economic Stability and Growth**, pp. 120–147 and pp. 148–176]

Kaldor's critique was combined with an earlier critique by Piero Sraffa who noted that Hayek's desire for *"neutral"* money was simply impossible in any real capitalist economy for *"a state of things in which money is 'neutral' is identical with a state in which there is no money at all."* Hayek *"completely ignored"* the fact that *"money is not only the medium of exchange, but also a store of value"* which *"amounts to assuming away the very object of the inquiry."* Sraffa also noted that the starting point of Hayek's theory was flawed: *"An essential confusion … is the belief that the divergence of rates is a characteristic of a money economy … If money did not exist, and loans were made in terms of all sorts of commodities, there would be a single rate which satisfies the conditions of equilibrium, but there might be at any moment as many 'natural' rates of interest as there are commodities, though they would not be 'equilibrium' rates. The 'arbitrary' action of the banks is by no means a necessary condition for the divergence; if loans were made in wheat and farmers (or for that matter the weather) 'arbitrarily changed' the quantity of wheat produced, the actual rate of interes on loans in terms of wheat would diverge from the rate on other commodities and there would be no single equilibrium rate."* [*"Dr. Hayek on Money and Capital,"* pp. 42–53, **The Economic Journal**, vol. 42, no. 165, p. 42, pp. 43–4 and p. 49] Hayek admitted that this was a possibility, to which Sraffa replied:

> *"only under conditions of equilibrium would there be a single rate, and that when saving was in progress there would be at any one moment be many 'natural' rates, possibly as many as there are commodities; so that it would be not merely difficult in practice, but altogether inconceivable, that the money rate would be equal to 'the' natural rate … Dr. Hayek now acknowledges the multiplicity of the 'natural' rates, but he has nothing more to say on this specific point than that they 'all would be equilibrium rates.' The only meaning (if it be a meaning) I can attach to this is that his maxim of policy now requires that the money rate should be equal to all these divergent natural rates."* [*"A Rejoinder,"* pp. 249–251, **Op. Cit.** Vol. 42, No. 166, p. 251]

Then there was the practical suggestions that flowed from the analysis, namely do nothing. It also implied that the best thing to do in a recession or depression is not to spend, but rather to save as this will bring the savings and loans back into the equilibrium position. Economist R. F. Kahn recounted when Hayek presented his theory at a seminar in Cambridge University. His presentation was followed by silence. Then Kahn asked the obvious question: *"Is it your view that if I went out tomorrow and bought a new overcoat, that would increase unemployment?"* All that Hayek could offer in reply was the unconvincing claim that to show why would require a complicated mathematical argument. The notion that reducing consumption in a depression was the best thing to do convinced few people and the impact of such saving should be obvious, namely a collapse in demand for goods and services. Any savings would, in the circumstances of a recession, be unlikely to be used for investing. After all, which company would start increasing its capital stock facing a fall in demand and which capitalist would venture to create a new company during a depression? Unsurprisingly, few economists thought that advocating a deflationary policy in the midst of the most severe economic crisis in history made much sense. It may have been economic orthodoxy but making the depression worse in order to make things better would have ensured either the victory of fascism or some-sort of socialist revolution.

Given these practical considerations and the devastating critiques inflicted upon it, Keynesian theory became the dominant theme in economics (particularly once it had been lobotomised of any ideas which threatened neo-classical supremacy — see section C.8.1). This has not, as noted, stopped Hayek's followers repeating his theory to this day (nor has its roots in equilibrium theory bothered them — see section C.1.6). Bearing this in mind, it is useful to discuss this theory because it reflects the pre-Keynesian orthodoxy although we must stress that our discussion of "Austrian" economics here should not be taken as suggesting that they are a significant school of thought or that their influence is large. Far from it — they still remain on the sidelines of economics where they were pushed after von Hayek's defeat in the 1930s. We use them simply because they are the only school of thought which still subscribes fully to the pre-Keynesian position. Most modern neo-classical economists pay at least lip-service to Keynes.

Take, for example, "Austrian" economist W. Duncan Reekie's argument that the business cycle *"is generated by monetary expansion and contraction … When new money is printed it appears as if the supply of savings has increased. Interest rates fall and businessmen are misled into borrowing additional funds to finance extra investment activity."* This would be of *"no consequence"* if it had been the outcome of genuine saving *"but the change was government induced … Capital goods industries will find their expansion has been in error and malinvestments have been incurred"* and so there has been *"wasteful mis-investment due to government interference with the market."* [**Markets, Entrepreneurs and Liberty**, pp. 68–9]

Yet the government does **not** force banks to make excessive loans and this is the first, and most obvious, fallacy of argument. After all, what Reekie is actually complaining about when he argues that *"state action"* creates the business cycle by creating excess money is that the state **allows** bankers to meet the demand for credit by creating it. This makes sense, for how could the state force bankers to expand credit by loaning more money than they have savings? This is implicitly admitted when Reekie argues that *"[o]nce fractional reserve banking is introduced, however, the supply of money substitutes will include fiduciary media. The ingenuity of bankers, other financial intermediaries and the endorsement and* ***guaranteeing of their activities by governments and central banks*** *has ensured that the quantity of fiat money is immense."* [**Op. Cit.**, p. 73] As we will discuss in detail below what is termed *"credit money"* (created by banks) is an essential part of capitalism and would exist without a system of central banks. This is because money is created from within the system, in response to the needs of capitalists. In a word, the money supply is endogenous.

The second fallacy of this theory of the business cycle lies with the assumption that the information provided by the interest rate itself is sufficient in itself to ensure rational investment decisions, it that provides companies and individuals with accurate information about how price changes will affect future trends in production. Specifically, the claim is that changes in interest rates (i.e. changes in the demand and supply of credit) indirectly inform companies of the responses of their competitors. As John O'Neill argues, the argument assumes *"that information about the panned responses of producers in competition is indirectly distributed by changes in interest rates: the planned increase in production by separate producers is reflected in an increased demand for credit, and hence a rise in interest rates."* [**The Market**, p. 135]

For example, if the price of tin rises, this will lead to an expansion in investment in the tin industry to reap the higher profits this implies. This would lead to a rise in interest rates as more credit is demanded. This rise in interest rates lowers anticipated profits and dampens the expansion. The expansion of credit stops this process by distorting the interest rate and so stops it performing its economic function. This results in overproduction as interest rates do not reflect **real** savings and so capitalists over-invest in new capital, capital which appears profitable only because the interest rate is artificially low. When the rate inevitably adjusts upwards towards its "natural" value, the invested capital becomes unprofitable and so over-investment appears. Hence, according to the argument, by eliminating state control of money these negative effects of capitalism would disappear as the credit system, if working correctly, will communicate all the relevant information required by capitalists.

"However," argues O'Neil, *"this argument is flawed. It is not clear that the relevant information is communicated by changes in interest rates."* This is because interest rates reflect the general aggregate demand for credit in an economy. However, the information which a **specific** company requires *"if the over-expansion in the production of some good is to be avoided is not the general level of demand for credit, but the level of demand amongst competitors."* It does not provide the relative demands in different industries (the parallels with Sraffa's critique should be obvious). *"An increase in the planned production of some good by a group of competitors will be reflected in a proportional change in interest rates only if it is assumed that the change in demand for credit by that group is identical with that found in the economy as a whole, i.e. if rates of change in the demand for credit are even throughout an economy. However, there is no reason to suppose such an assumption is true, given the different production cycles of different industries."* This will produce differing needs for credit (in both terms of amount and of intensity). *"Assuming uneven changes in the demand for credit"* between industries reflecting uneven changes in their requirements it is quite possible for over-investment (and so over-production) to occur *"even if the credit system is working 'satisfactorily'"* (i.e., as it should in theory. The credit system, therefore, *"does not communicate the relevant information"* and for this reason *"it is not the case that we must look to a departure from an ideal credit system to explain the business cycle."* [**Op. Cit.**, pp. 135–6]

Another underlying assumption in this argument is that the economy is close to equilibrium (a concept which "Austrian" economists claim to reject). After all, rising interest rates will cause debt-servicing to become harder even if it reflects the *"natural"* rate. Equally, it also suggests that both banks and firms are capable of seeing into the future. For even **if** the credit market is working as postulated in the theory it does not mean that firms and banks do not make mistakes nor experience unexpected market situations. In such circumstances, firms may find it impossible to repay loans, credit chains may start to break as more and more firms find themselves in economic difficulties. Just because actual interest rates somehow equal the natural rate does not make the future any more certain nor does it ensure that credit is invested wisely. Crucially, it does not ensure that credit is not used to inflate a bubble or add to over-investment in a specific sector of the economy. To assume otherwise suggests the firms and banks rarely make mistakes and that the accumulative impact of all decisions move an economy always towards, and never away from, equilibrium. As Post-Keynesian Paul Davidson dryly noted, *"Austrian subjectivists cannot have it both ways — they cannot argue for the importance of time, uncertainty, and money, and simultaneously presume that plan or pattern co-ordination must exist and is waiting to be discovered."* [*"The economics of ignorance or the ignorance of economics?"*, pp. 467–87, **Critical Review**, vol. 3, no. 3–4, p. 468]

In other words, the notion that if the actual interest rate somehow equalled the *"natural"* one is not only rooted in equilibrium but also the neo-classical notion of perfect knowledge of current and future events — all of which "Austrian" economists are meant to reject. This can be seen when Murray Rothbard states that entrepreneurs *"are trained to forecast the market correctly; they only make mass errors when governmental or bank intervention distorts the 'signals' of the market."* He even attacks Joseph Schumpeter's crisis theory because, in effect, Schumpeter does not show how entrepreneurs cannot predict the future (*"There is no explanation offered on the lack of accurate forecasting … why were not the difficulties expected and discounted?"*). [**America's Great Depression**, p. 48 and p. 70] Rothbard does not ponder why bankers, who are surely entrepreneurs as well, make **their** errors nor why the foresight of business people in an uncertain and complex economy seems to fail them in the face of repeated actions of banks (which they could, surely, have *"expected and discounted"*). This means that the argument concerning distortions of the interest rate does not, as such, explain the occurrence of over-investment (and so the business cycle). Therefore, it cannot be claimed that removing state interference in the market for money will also remove the business-cycle.

However, these arguments do have an element of truth in them. Expansion of credit above the *"natural"* level which equates it with savings can and does allow capital to expand further than it otherwise would and so **encourages** over-investment (i.e. it builds upon trends already present rather than **creating** them). While we have ignored the role of credit expansion in our comments above to stress that credit is not fundamental to the business cycle, it is useful to discuss this as it is an essential factor in real capitalist economies. Indeed, without it capitalist economies would not have grown as fast as they have. Credit is fundamental to capitalism and this is the last fallacy in the pre-Keynesian argument. In a real economy, it is the most important. Even assuming that the actual rate of interest **could** always equal the equilibrium rate and that it reflected the natural rate of all commodities and all industries, it would not matter as banks would always seek to make profits by extending credit and so artificially lower the actual interest rate during booms. To understand why, we need to explain the flaws in the main laissez-faire approaches to money.

There are three main approaches to the question of eliminating state control of money in "free market" capitalist economics — Monetarism, the 100% gold reserve limit for banks and what is often called "free banking." All three are associated with the right and all three are wrong. The first two are easy to dismiss. Monetarism has been tried and has failed spectacularly in the early 1980s. As it was a key aspect of the neo-liberal war on working class people at this time we will discuss its limitations as part of our account of this period in section C.8.3.

The second option, namely imposing a 100% gold reserve limit for banks is highly interventionist and so not remotely laissez-faire (why should the banking industry be subject to state regulation unlike the rest?). Its logic is simple, namely to ensure that banks do not make loans unless they have sufficient savings to cover them all. In other words, it seeks to abolish the credit cycle by abolishing credit by making banks keep 100% gold reserves against notes. This, in effect, abolishes banking as an industry. Simply put (and it seems strange to have to point this out to supporters of capitalism) banks seek to make a profit and do so by providing credit. This means that any capitalist system will be, fundamentally, one with credit money as banks will always seek to make a profit on the spread between loan and deposit rates. It is a necessity for the banking system and so non-fractional banking is simply not possible. The requirement that banks have enough cash on hand to meet all depositors demand amounts to the assertion that banks do not lend any money. A 100% reserve system is not a reformed or true banking system. It is the abolition of the banking system. Without fractional reserves, banks cannot make any loans of any kind as they would not be in a position to give their clients their savings if they have made loans. Only someone completely ignorant of a real capitalist economy could make such a suggestion and, unsurprisingly, this position is held by members of the "Austrian" school (particularly its minimum state wing).

This leaves "free banking." This school of thought is, again, associated with the "Austrian" school of economics and right-wing "libertarians" in general. It is advocated by those who seek to eliminate fractional reserve banking but balk by the regulations required by a 100% gold standard (Rothbard gets round this by arguing this standard *"would be part and parcel of the general libertarian legal prohibition against fraud."* [**Op. Cit.**, p. 32]). It is based on totally privatising the banking system and creating a system in which banks and other private companies compete on the market to get their coins and notes accepted by the general population. This position, it must be stressed, is not the same as anarchist mutual banking as it is seen not as a way of reducing usury to zero but rather as a means of ensuring that interest rates work as they are claimed to do in capitalist theory.

The "free banking" school argues that under competitive pressures, banks would maintain a 100% ratio between the credit they provide and the money they issue with the reserves they actually have. They argue that under the present system, banks can create more credit than they have funds/reserves available as the state exists as lender of last resort and so banks will count on it to bail them out in bad times. Market forces would ensure the end of fractional reserve banking and stop them pushing the rate of interest below its "natural rate." So if banks were subject to market forces, it is argued, then they would not generate credit money, interest rates would reflect the real rate and so over-investment, and so crisis, would be a thing of the past. Knowing that the state would not step in to save them will also force banks to be prudent in their activities.

This analysis, however, is flawed. We have noted one flaw above, namely the problem that interest rates do not provide sufficient or correct information for investment decisions. Thus relative over-investment could still occur. Another problem is the endogenous nature of money and credit and the pressures this puts on banks. As Steve Keen notes, Austrian economists think that *"the current system of State money means that the money supply is entirely exogenous and under the control of the State authorities. They then attribute much of the cyclical behaviour of the economy to government meddling with the money supply and the rate of interest."* In contrast, Post-Keynesian economists argue that *"though it may appear that the State controls the money supply, the complex chain of causation in the finance sector actually works backwards"* with *"private banks and other credit-generating institutions largely forc[ing] the State's hand. Thus the money supply is largely endogenously determined by the market economy, rather than imposed upon it exogenously by the State."* He notes that the *"empirical record certainly supports Post-Keynesians rather than Austrians on this point. Statistical evidence about the leads and lags between the State-determined component of money supply and broad credit show that the latter 'leads' the former."* [**Debunking

Economics, p. 303] Moreover, as our discussion of the failure of Monetarism will show, central banks could **not** control the money supply when they tried.

To understand why, we need to turn to the ideas of the noted Post-Keynesian economist Hyman Minsky. He created an analysis of the finance and credit markets which gives an insight into why it is doubtful that even a "free banking" system would resist the temptation to create credit money (i.e. loaning more money than available savings). This model is usually called *"The Financial Instability Hypothesis."*

Let us assume that the economy is going into the recovery period after a crash. Initially firms would be conservative in their investment while banks would lend within their savings limit and to low-risk investments. In this way the banks do ensure that the interest rate reflects the "natural" rate. However, this combination of a growing economy and conservatively financed investment means that most projects succeed and this gradually becomes clear to managers/capitalists and bankers. As a result, both managers and bankers come to regard the present risk premium as excessive. New investment projects are evaluated using less conservative estimates of future cash flows. This is the foundation of the new boom and its eventual bust. In Minsky's words, *"stability is destabilising."*

As the economy starts to grow, companies increasingly turn to external finance and these funds are forthcoming because the banking sector shares the increased optimism of investors. Let us not forget that banks are private companies too and so seek profits as well. As Minsky argues, *"bankers live in the same expectational climate as businessmen"* and so *"profit-seeking bankers will find ways of accommodating their customers … Banks and bankers are not passive managers of money to lend or to invest; they are in business to maximise profits."* [quoted by L. Randall Wray, **Money and Credit in Capitalist Economies**, p. 85] Providing credit is the key way of doing this and so credit expansion occurs. If they did not, the boom would soon turn into slump as investors would have no funds available for them and interest rates would increase, thus forcing firms to pay more in debt repayment, an increase which many firms may not be able to do or find difficult. This in turn would suppress investment and so production, generating unemployment (as companies cannot "fire" investments as easily as they can fire workers), so reducing consumption demand along with investment demand, so deepening the slump.

To avoid this and to take advantage of the rising economy, bankers accommodate their customers and generate credit rather than rise interest rates. In this way they accept liability structures both for themselves and for their customers *"that, in a more sober expectational climate, they would have rejected."* [Minsky, **Inflation, Recession and Economic Policy**, p. 123] The banks innovate their financial products, in other words, in line with demand. Firms increase their indebtedness and banks are more than willing to allow this due to the few signs of financial strain in the economy. The individual firms and banks increase their financial liability, and so the whole economy moves up the liability structure. Like other businesses, banks operate in an uncertain environment and have no way of knowing whether their actions will increase the fragility within the economy or push it into crisis.

The central banks, meanwhile, accommodate the banks activity. They do not and cannot force them to create credit. Alan Holmes, a senior vice president at the New York Federal Reserve, put the process this way:

> *"In the real world, banks extend credit, creating deposits in the process, and look for the reserves later. The question then becomes one of whether and how the Federal Reserve*

will accommodate the demand for reserves. In the very short run, the Federal Reserve has little or no choice about accommodating that demand, over time, its influence can obviously be felt." [quoted by Doug Henwood, **Wall Street**, p. 220]

As long as profits exceed debt servicing requirements, the system will continue to work. Eventually, though, interest rates rise as the existing extension of credit appears too high to the banks or the central bank. This affects all firms, from the most conservatively financed to the most speculative, and "pushes" them up even higher up the liability structure. Refinancing existing debts is made at the higher rate of interest, increasing cash outflows and reducing demand for investment as the debt burden increases. Conservatively financed firms can no longer can repay their debts easily, less conservative ones fail to pay them and so on. The margin of error narrows and firms and banks become more vulnerable to unexpected developments, such a new competitors, strikes, investments which do not generate the expected rate of return, credit becoming hard to get, interest rates increase and so on. In the end, the boom turns to slump and firms and banks fail. The state then intervenes to try and stop the slump getting worse (with varying degrees of success and failure).

Thus the generation of credit is a spontaneous process rooted in the nature of capitalism and is fundamentally endogenous in nature. This means that the business cycle is an inherent part of capitalism even if we assume that it is caused purely by disequilibrium in the credit market. In other words, it is more than likely that the credit market will be in disequilibrium like every other market in any real capitalist economy — and for the same reasons. As such, the natural rate of interest relies on concepts of equilibrium that are not only inconsistent with reality but also with the broader principles of "Austrian" economic ideology.

The "free banking" school reject this claim and argue that private banks in competition would **not** do this as this would make them appear less competitive on the market and so customers would frequent other banks (this is the same process by which inflation would be solved). However, it is **because** the banks are competing that they innovate — if they do not, another bank or company would in order to get more profits. Keynesian economist Charles P. Kindleburger comments:

> *"As a historical generalisation, it can be said that every time the authorities stabilise or control some quantity of money… in moments of euphoria more will be produced. Or if the definition of money is fixed in terms of particular assets, and the euphoria happens to 'monetise' credit in new ways that are excluded from the definition, the amount of money defined in the old way will not grow, but its velocity will increase … fix any [definition of money] and the market will create new forms of money in periods of boom to get round the limit."* [**Manias, Panics and Crashes**, p. 48]

This can be seen from the fact that *"[b]ank notes … and bills of exchange … were initially developed because of an inelastic supply of coin."* Thus monetary expansion *"is systematic and endogenous rather than random and exogenous."* [Kindleburger, **Op. Cit.**, p. 51 and p. 150] This means that *"any shortage of commonly-used types [of money] is bound to lead to the emergence of new types; indeed, this is how, historically, first bank notes and the chequing account emerged."* If the state tries to regulate one form of money, *"lending and borrowing is diverted to other sources."* [Nicholas Kaldor, *"The New Monetarism"*, **The Essential Kaldor**, p. 481 and p. 482] This means that the notion that abolishing central banking will result in the use of gold and 100% reverses and so eliminate the business cycle is misplaced:

> *"This view overlooks the fact that the* ***emergence*** *of money-substitutes — whether in the form of bank notes, bank accounts, or credit cards — was a spontaneous process, not planned or regulated 'from above' by some central authority, and for that reason alone it is impossible to treat some arbitrary definition of money (which included specific forms of such money-substitutes in the definition of money) as an exogenous variable. The emergence of surrogate money was a spontaneous process resulting from the development of the banking system; this development brought a steady increase in the ratio of money substitutes of 'real' money."* [Nicholas Kaldor, **The Scourge of Monetarism**, p. 44f]

This process can be seen at work in Adam Smith's time. Then Scotland was based on a competitive banking system in which baking firms issued their own money and maintained their own reverse of gold. Yet, as Smith notes, they issued more money than was available in the banks coffers:

> *"Though some of those notes [the banks issued] are continually coming back for payment, part of them continue to circulate for months and years together. Though he [the banker] has generally in circulation, therefore, notes to the extent of a hundred thousand pounds, twenty thousand pounds in gold and silver may frequently be a sufficient provision for answering occasional demands."* [**The Wealth of Nations**, pp. 257–8]

In other words, the competitive banking system did not, in fact, eliminate fractional reserve banking. Ironically enough, Smith noted that *"the Bank of England paid very dearly, not only for its own imprudence, but for the much greater imprudence of almost all of the Scotch [sic!] banks."* Thus the central bank was more conservative in its money and credit generation than the banks under competitive pressures! Indeed, Smith argues that the banking companies did not, in fact, act in line with their interests as assumed by the "free banking" school for *"had every particular banking company always understood and attended to its own particular interest, the circulation never could have been overstocked with paper money. But every particular baking company has not always understood and attended to its own particular interest, and the circulation has frequently been overstocked with paper money."* Thus we have reserve banking plus bankers acting in ways opposed to their *"particular interest"* (i.e. what economists consider to be their actual self-interest rather than what the bankers actually thought was their self-interest!) in a system of competitive banking. Why could this be the case? Smith mentions, in passing, a possible reason. He notes that *"the high profits of trade afforded a great temptation to over-trading"* and that while a *"multiplication of banking companies ... increases the security of the public"* by forcing them *"to be more circumspect in their conduct"* it also *"obliges all bankers to be more liberal in their dealings with their customers, lest their rivals should carry them away."* [**Op. Cit.**, p. 269, p. 267, p. 274 and p. 294]

Thus the banks were pulled in two directions at once, to accommodate their loan customers and make more profits while being circumspect in their activities to maintain sufficient reserves for the demands of their savers. Which factor prevails would depend on the state of the economy, with up-swings provoking liberal lending (as described by Minsky). Moreover, given that credit generation is meant to produce the business cycle, it is clear from the case of Scotland that competitive banking would not, in fact, stop either. This also was the case with 19th century America, which did not have a central bank for most of that period and that *"left the volatile US financial system without any kind of lender of last resort, but in booms all kinds of funny money passed."* This lead to *"thousands of decentralised banks … hoarding reserves"* and so *"starving the system of liquidity precisely at the moment it was most badly needed"* while *"the up cycles were also extraordinary, powered by loose credit and kinky currencies (like privately issued banknotes)."* [Doug Henwood, **Op. Cit.**, p. 93 and p. 94]

As Nicholas Kaldor argued, *"the essential function of banks in the creation of 'finance' (or credit) was well understood by Adam Smith, who … regarded branch-banking as a most important invention for the enrichment of society. He described how, as a result of the finance banks were able to place at the disposal of producers, the real income of Scotland doubled or trebled in a remarkably short time. Expressed in Keynesian terms, the 'finance' provided by banks made it possible to increase investments ahead of income or savings, and to provide the savings counterpart of the investment out of the additional income generated through a multiplier process by the additional spending."* This process, however, was unstable which naturally lead to the rise of central banks. *"Since the notes issued by some banks were found more acceptable than those of others, giving rise to periodic payments crises and uncertainty, it was sooner or later everywhere found necessary to concentrate the right of issuing bank notes in the hands of a single institution."* [*"How Monetarism Failed,"* **Further Essays on Economic Theory and Policy**, p. 181] In addition, from an anarchist perspective, no ruling class wants economic instability to undermine its wealth and income generating ability (Doug Henwood provides a useful summary of this process, and the arguments used to justify it within the American ruling class, for the creation of the US Federal Reserve at the start of the 20th century. [**Wall Street**, pp. 92–5]). Nor would any ruling class want too easy credit undermining its power over the working class by holding down unemployment too long (or allowing working class people to create their own financial institutions).

Thus the over supply of credit, rather than being the **cause** of the crisis is actually a symptom. Competitive investment drives the business cycle expansion, which is allowed and encouraged by the competition among banks in supplying credit. Such expansion complements — and thus amplifies — other objective tendencies towards crisis, such as over-investment and disportionalities. In other words, a pure "free market" capitalism would still have a business cycle as this cycle is caused by the nature of capitalism, not by state intervention. In reality (i.e. in "actually existing" capitalism), state manipulation of money (via interest rates) is essential for the capitalist class as it allows indirect profit-generating activity, such as ensuring a "natural" level of unemployment to keep profits up, an acceptable level of inflation to ensure increased profits, and so forth, as well as providing a means of tempering the business cycle, organising bailouts and injecting money into the economy during panics. Ultimately, if state manipulation of money caused the problems of capitalism, we would not have seen the economic successes of the post-war Keynesian experiment or the business cycle in pre-Keynesian days and in countries which had a more free banking system (for example, nearly half of the late 19th century in the US was spent in periods of recession and depression, compared to a fifth since the end of World War II).

It is true that all crises have been preceded by a speculatively-enhanced expansion of production and credit. This does not mean, however, that crisis **results** from speculation and the expansion of credit. The connection is not causal in free market capitalism. The expansion and contraction of credit is a mere symptom of the periodic changes in the business cycle, as the decline of profitability contracts credit just as an increase enlarges it. So while there are some similarities in the pre-Keynesian/"Austrian" theory and the radical one outlined here, the key differences are two-fold. Firstly, the pro-capitalist theory argues that it is possible for capitalist banks **not** to act, well, like capitalists if subject to competition (or regulated enough). This seems highly unlikely and fits as badly into their general theories as the notion that disequilibrium in the credit market is the root of the business cycle. Secondly, the radical position stresses that the role of credit reflect deeper causes. Paul Mattick gives the correct analysis:

> *"[M]oney and credit policies can themselves change nothing with regard to profitability or insufficient profits. Profits come only from production, from the surplus value produced by workers … The expansion of credit has always been taken as a sign of a coming crisis, in the sense that it reflected the attempt of individual capital entities to expand despite sharpening competition, and hence survive the crisis… Although the expansion of credit has staved off crisis for a short time, it has never prevented it, since ultimately it is the real relationship between total profits and the needs of social capital to expand in value which is the decisive factor, and that cannot be altered by credit."* [**Economics, Politics and the Age of Inflation**, pp. 17–18]

In short, the apologists of capitalism confuse the symptoms for the disease.

The cyclical movements on the real side of the economy will be enhanced (both upwards and downwards) by events in its financial side and this may result in greater amplitudes in the cycle but the latter does not create the former. Where there *"is no profit to be had, credit will not be sought."* While extension of the credit system *"can be a factor deferring crisis, the actual outbreak of crisis makes it into an aggravating factor because of the larger amount of capital that must be devalued."* [Paul Mattick, **Economic Crisis and Crisis Theory**, p. 138] But this is also a problem facing competing private companies using the gold standard. The money supply reflects the economic activity within a country and if that supply cannot adjust, interest rates rise and provoke a crisis. Thus the need for a flexible money supply (as desired, for example, by Mutualists and the US Individualist Anarchists).

It must always be remembered that a loan is not like other commodities. Its exchange value is set by its use value. As its use value lies in investing and so generating a stream of income, the market rate of interest is governed by the average expectations of profits for the capitalist class. Thus credit is driven by its **perceived** use-value rather than its cost of production or the amount of money a bank has. Its possible use value reflects the prospective exchange-values (prices and profits) it can help produce. This means that uncertainty and expectations play a key role in the credit and financial markets and these impact on the real economy. This means that money can **never** be neutral and so capitalism will be subject to the business cycle and so unemployment will remain a constant threat over the heads of working class people. In such circumstances, the notion that capitalism results in a level playing field for classes is simply not possible and so, except in boom times, working class will be at a disadvantage on the labour market.

To sum up, *"[i]t is not credit but only the increase in production made possible by it that increases surplus value. It is then the rate of exploitation which determines credit expansion."* [Paul Mattick, **Economics, Politics and the Age of Inflation**, p. 18] Hence credit money would increase and decrease in line with capitalist profitability, as predicted in capitalist economic theory. But this could not affect the business cycle, which has its roots in production for capital (i.e. profit) and capitalist authority relations, to which the credit supply would obviously reflect, and not vice versa.

C.8.1 Does this mean that Keynesianism works?

If state interference in credit generation does not cause the business cycle, does that mean Keynesianism capitalism can work? Keynesian economics, as opposed to free market capitalism, maintains that the state can and should intervene in the economy in order to stop economic crises from occurring. Can it work? To begin to answer that question, we must first quickly define what is meant by Keynesianism as there are different kinds of Keynesianist policies and economics.

As far as economics goes, Keynes' co-worker Joan Robinson coined the phrase *"Bastard Keynesianism"* to describe the vulgarisation of his economics and its stripping of all aspects which were incompatible with the assumptions of neo-classical economics. Thus the key notion of uncertainty was eliminated and his analysis of the labour market reduced to the position he explicitly rejected, namely that unemployment was caused by price rigidities. This process was aided by the fact that Keynes retained significant parts of the neo-classical position in his analysis and argued that the role of the state was limited to creating the overall conditions necessary to allow the neo-classical system to come *"into its own again"* and allow capitalism *"to realise the full potentialities of production."* [**The General Theory**, pp. 378–9] Unlike many of his more radical followers, Keynes was blind to real nature of capitalism as a class based system and so failed to understand the functional role that unemployment plays within it (see section C.1.5).

However, the context in which Keynes worked explains much. Faced with the dire situation capitalism faced during the 1930s, he presented a new theoretical analysis of capitalism that both explained the crisis and suggested policies that would, without interfering with its general principles, end it. Keynes' work was aided both by the practical failure of traditional solutions and growing fear of revolution and so even the most died-in-the-wool neo-classical economists could not keep his theory from being tried. When it appeared to work that, on one level, ended the argument. However, at a deeper level, at the level of theory, the struggle was just beginning. As the neo-classical (and Austrian) tradition is axiom-led rather than empirically-led (otherwise their axioms would have been abandoned long ago), the mere fact that capitalism was in crisis and that Keynes had presented a theory more in line with the reality was not enough to change mainstream economics. From the start, neo-classical economists began their counter-attack. Led by Paul Samuelson in the US and John Hicks in the UK, they set about making Keynes' theories safe for neo-classical economics. They did this by using mathematics on a part of his theory, leaving out all those bits that were inconsistent with neo-classical axioms. This bowdlerised version of Keynes soon became the standard in undergraduate courses.

The fate of Keynes reinforces the comment of French revolutionary Louis de Saint-Just that *"those who make revolution half way only dig their own graves."* Keynes ideas were only a partial break with the neo-classical orthodoxy and, as such, allowed the basis for the neo-classical-Keynesian synthesis which dominated post-war economics until the mid-1970s as well as giving the Monetarist counter-revolution space to grow. Perhaps this partial break is understandable, given the dominance of neo-classical ideas in the economics profession it may have been too much to expect them to renounce all their dogmas yet it ensured that any developments towards an economics based on science rather than ideology would be resigned to the sidelines.

It is important to stress that Keynes was, first and foremost, a supporter of capitalism. He aimed to save it, not to end it. As he put it the *"**class war** will find me on the side of the educated bourgeoisie."* [quoted by Henwood, **Wall Street**, p. 212] That he presented a more accurate picture of capitalism and exposed some of the contradictions within neo-classical economics is part of the reason he was and is so hated by many on the right, although his argument that the state should limit some of the power of individual firms and capitalists and redistribute some income and wealth was a far more important source of that hatred. That he helped save capitalism from itself (and secure their fortunes) did not seem to concern his wealthy detractors. They failed to understand Keynes often sounded more radical than he actually was. Doug Henwood gives a good overview of Keynes' ideas (and limitations) in chapter 5 of his book **Wall Street**.

What of Keynesian policies? The *"Bastard Keynesianism"* of the post-war period (for all its limitations) did seem to have some impact on capitalism. This can be seen from comparing Keynesianism with what came before. The more laissez-faire period was nowhere near as stable as modern day supporters of free(r) market capitalists like to suggest. There were continual economic booms and slumps. The last third of the 19$^{\text{th}}$ century (often considered as the heyday of private enterprise) was a period of profound instability and anxiety as it *"was characterised by violent booms and busts, in nearly equal measure, since almost half the period was one of panic and depression."* American spent nearly half of the late 19$^{\text{th}}$ century in periods of recession and depression. By way of comparison, since the end of world war II, only about a fifth of the time has been. [Doug Henwood, **Wall Street**, p. 94 and p. 54] Between 1867 and 1900 there were 8 complete business cycles. Over these 396 months, the economy expanded during 199 months and contracted during 197. Hardly a sign of great stability. Overall, the economy went into a slump, panic or crisis in 1807, 1817, 1828, 1834, 1837, 1854, 1857, 1873, 1882, and 1893 (in addition, 1903 and 1907 were also crisis years).

Then there is what is often called the *"Golden Age of Capitalism,"* the boom years of (approximately) 1945 to 1975. This post-war boom presents compelling evidence that Keynesianism can effect the business cycle for the better by reducing its tendency to develop into a full depression. By intervening in the economy, the state would reduce uncertainty for capitalists by maintaining overall demand which will, in turn, ensure conditions where they will invest their money rather than holding onto it (what Keynes termed *"liquidity-preference"*). In other words, to create conditions where capitalists will desire to invest and ensure the willingness on the part of capitalists to act as capitalists.

This period of social Keynesianism after the war was marked by reduced inequality, increased rights for working class people, less unemployment, a welfare state you could actually use and so on. Compared to present-day capitalism, it had much going for it. However, Keynesian capitalism is still capitalism and so is still based upon oppression and exploitation. It was, in fact, a more refined form of capitalism, within which the state intervention was used to protect capitalism from itself while trying to ensure that working class struggle against it was directed, via productivity deals, into keeping the system going. For the population at large, the general idea was that the welfare state (especially in Europe) was a way for society to get a grip on capitalism by putting some humanity into it. In a confused way, the welfare state was promoted as an attempt to create a society in which the economy existed for people, not people for the economy.

While the state has always had a share in the total surplus value produced by the working class, only under Keynesianism is this share increased and used actively to manage the economy. Traditionally, placing checks on state appropriation of surplus value had been one of the aims of classical capitalist thought (simply put, cheap government means more surplus value available for capitalists to compete for). But as capital has accumulated, so has the state increased and its share in social surplus (for control over the domestic enemy has to be expanded and society protected from the destruction caused by free market capitalism). It must be stressed that state intervention was not **totally** new for *"[f]rom its origins, the United States had relied heavily on state intervention and protection for the development of industry and agriculture, from the textile industry in the early nineteenth century, through the steel industry at the end of the century, to computers, electronics, and biotechnology today. Furthermore, the same has been true of every other successful industrial society."* [Noam Chomsky, **World Orders, Old and New**, p. 101] The difference was that such state action was directed to social goals as well as bolstering capitalist profits (much to the hatred of the right).

The roots of the new policy of higher levels and different forms of state intervention lie in two related factors. The Great Depression of the 1930s had lead to the realisation that attempts to enforce widespread reductions in money wages and costs (the traditional means to overcome depression) simply did not work. As Keynes stressed, cutting wages reduced prices and so left real wages unaffected. Worse, it reduced aggregate demand and lead to a deepening of the slump (see section C.9.1 for details). This meant that leaving the market to solve its own problems would make things a lot worse before they became better. Such a policy would, moreover, be impossible because the social and economic costs would have been too expensive. Working class people simply would not tolerate more austerity imposed on them and increasingly took direct action to solve their problems. For example, America saw a militant strike wave involving a half million workers in 1934, with factory occupations and other forms of militant direct action commonplace. It was only a matter of time before capitalism was either ended by revolution or saved by fascism, with neither prospect appealing to large sections of the ruling class.

So instead of attempting the usual class war (which may have had revolutionary results), sections of the capitalist class thought a new approach was required. This involved using the state to manipulate demand in order to increase the funds available for capital. By means of demand bolstered by state borrowing and investment, aggregate demand could be increased and the slump ended. In effect, the state acts to encourage capitalists to act like capitalists by creating an environment when they think it is wise to invest again. As Paul Mattick points out, the *"additional production made possible by deficit financing does appear as additional demand, but as demand unaccompanied by a corresponding increase in total profits… [this] functions immediately as an increase in demand that stimulates the economy as a whole and can become the point for a new prosperity"* if objective conditions allow it. [**Economic Crisis and Crisis Theory**, p. 143]

State intervention can, in the short term, postpone crises by stimulating production. This can be seen from the in 1930s New Deal period under Roosevelt when the economy grew five years out of seven compared to it shrinking every year under the pro-laissez-faire Republican President Herbert Hoover (under Hoover, the GNP shrank an average of -8.4 percent a year, under Roosevelt it grew by 6.4 percent). The 1938 slump after 3 years of growth under Roosevelt was due to a decrease in state intervention:

> *"The forces of recovery operating within the depression, as well as the decrease in unemployment via public expenditures, increased production up to the output level of 1929. This was sufficient for the Roosevelt administration to drastically reduce public works … in a new effort to balance the budget in response to the demands of the business world…*

> *The recovery proved to be short-lived. At the end of 1937 the Business Index fell from 110 to 85, bringing the economy back to the state in which it had found itself in 1935 … Millions of workers lost their jobs once again."* [Paul Mattick, **Economics, Politics and the Age of Inflation**, p. 138]

The rush to war made Keynesian policies permanent. With the success of state intervention during the second world war, Keynesianism was seen as a way of ensuring capitalist survival. The resulting boom is well known, with state intervention being seen as the way of ensuring prosperity for all sections of society. It had not fully recovered from the Great Depression and the boom economy during the war had obviously contrasted deeply with the stagnation of the 1930s. Plus, of course, a militant working class, which had put up with years of denial in the struggle against fascist-capitalism would not have taken lightly to a return to mass unemployment and poverty. Capitalism had to turn to continued state intervention as it is not a viable system. So, politically and economically a change was required. This change was provided by the ideas of Keynes, a change which occurred under working class pressure but in the interests of the ruling class.

So there is no denying that for a considerable time, capitalism has been able to prevent the rise of depressions which so plagued the pre-war world and that this was accomplished by government interventions. This is because Keynesianism can serve to initiate a new prosperity and postpone crisis by state intervention to bolster demand and encourage profit investment. This can mitigate the conditions of crisis, since one of its short-term effects is that it offers private capital a wider range of action and an improved basis for its own efforts to escape the shortage of profits for accumulation. In addition, Keynesianism can fund Research and Development in new technologies and working methods (such as automation) which can increase profits, guarantee markets for goods as well as transferring wealth from the working class to capital via indirect taxation and inflation. In the long run, however, Keynesian *"management of the economy by means of monetary and credit policies and by means of state-induced production must eventually find its end in the contradictions of the accumulation process."* [Paul Mattick, **Op. Cit.**, p. 18] This is because it cannot stop the tendency to (relative) over-investment, disproportionalities and profits squeeze we outlined in section C.7. In fact, due to its maintenance of full employment it increases the possibility of a crisis arising due to increased workers' power at the point of production.

So, these interventions did not actually set aside the underlying causes of economic and social crisis. The modifications of the capitalist system could not totally countermand the subjective and objective limitations of a system based upon wage slavery and social hierarchy. This can be seen when the rosy picture of post-war prosperity changed drastically in the 1970s when economic crisis returned with a vengeance, with high unemployment occurring along with high inflation. This soon lead to a return to a more "free market" capitalism with, in Chomsky's words, *"state protection and public subsidy for the rich, market discipline for the poor."* This process and its aftermath are discussed in the next section.

C.8.2 What happened to Keynesianism in the 1970s?

Basically, the subjective and objective limitations to Keynesianism we highlighted in the last section were finally reached in the early 1970s. It, in effect, came into conflict with the reality of capitalism as a class and hierarchical system. It faced either revolution to increase popular participation in social, political and economic life (and so eliminate capitalist power), an increase in social democratic tendencies (and so become some kind of democratic state capitalist regime) or a return to free(r) market capitalist principles by increasing unemployment and so placing a rebellious people in its place. Under the name of fighting inflation, the ruling class unsurprisingly picked the latter option.

The 1970s are a key time in modern capitalism. In comparison to the two previous decades, it suffered from high unemployment and high inflation rates (the term stagflation is usually used to describe this). This crisis was reflected in mass strikes and protests across the world. Economic crisis returned, with the state interventions that for so long kept capitalism healthy either being ineffective or making the crisis worse. In other words, a combination of social struggle and a lack of surplus value available to capital resulted in the breakdown of the successful post-war consensus. Both subjected the *"Bastard Keynesianism"* of the post-war period to serious political and ideological challenges. This lead to a rise in neo-classical economic ideology and the advocating of free(r) market capitalism as the solution to capitalism's problems. This challenge took, in the main, the form of Milton Friedman's Monetarism.

The roots and legacy of this breakdown in Keynesianism are informative and worth analysing. The post-war period marked a distinct change for capitalism, with new, higher levels of state intervention. The mix of intervention obviously differed from country to country, based upon the needs and ideologies of the ruling parties and social elites as well as the impact of social movements and protests. In Europe, nationalisation was widespread as inefficient capital was taken over by the state and reinvigorated by state funding while social spending was more important as Social Democratic parties attempted to introduce reforms. Chomsky describes the process in the USA:

> *"Business leaders recognised that social spending could stimulate the economy, but much preferred the military Keynesian alternative — for reasons having to do with privilege and power, not 'economic rationality.' This approach was adopted at once, the Cold War serving as the justification... The Pentagon system was considered ideal for these purposes. It extends well beyond the military establishment, incorporating also the Department of Energy... and the space agency NASA, converted by the Kennedy administration to a significant component of the state-directed public subsidy to advanced industry. These arrangements impose on the public a large burden of the costs of industry (research and development, R&D) and provide a guaranteed market for excess production, a useful cushion for management decisions. Furthermore, this form of industrial policy does not have the undesirable side-effects of social spending directed to human needs. Apart from unwelcome redistributive effects, the latter policies tend to interfere with managerial prerogatives; useful production may undercut private gain, while state-subsidised waste production... is a gift to the owner and manager, to whom any marketable spin-offs will be promptly delivered. Social spending may also arouse public interest and participation, thus enhancing the threat of democracy... The defects of social spending do not taint the military Keynesian alternative. For such reasons,* ***Business Week*** *explained, 'there's a tremendous social and economic difference between welfare pump-priming and military pump-priming,' the latter being far preferable."* [**World Orders, Old and New**, pp. 100–1]

Over time, social Keynesianism took increasing hold even in the USA, partly in response to working class struggle, partly due to the need for popular support at elections and partly due to *"[p]opular opposition to the Vietnam war [which] prevented Washington from carrying out a national mobilisation … which might have made it possible to complete the conquest without harm to the domestic economy. Washington was forced to fight a 'guns-and-butter' war to placate the population, at considerable economic cost."* [Chomsky, **Op. Cit.**, pp. 157–8]

Social Keynesianism directs part of the total surplus value to workers and unemployed while military Keynesianism transfers surplus value from the general population to capital and from capital to capital. This allows R&D and capital to be publicly subsidised, as well as essential but unprofitable capital to survive. As long as real wages did not exceed a rise in productivity, Keynesianism would continue. However, both functions have objective limits as the transfer of profits from successful capital to essential, but less successful, or long term investment can cause a crisis is there is not enough profit available to the system as a whole. The surplus value producing capital, in this case, would be handicapped due to the transfers and cannot respond to economic problems as freely as before. This was compounded by the world becoming economically "tripolar," with a revitalised Europe and a Japan-based Asian region emerging as major economic forces. This placed the USA under increased pressure, as did the Vietnam War. Increased international competition meant the firms were limited in how they could adjust to the increased pressures they faced in the class struggle.

This factor, class struggle, cannot be underestimated. In fact, the main reason for the 1970s breakdown was social struggle by working people. The only limit to the rate of growth required by Keynesianism to function is the degree to which final output consists of consumption goods for the presently employed population instead of investment. As long as wages rise in line with productivity, capitalism does well and firms invest (indeed, investment is the most basic means by which work, i.e. capitalist domination, is imposed). However, faced with a workforce which is able to increase its wages and resist the introduction of new technologies then capitalism will face a crisis. The net effect of full employment was the increased rebellious of the working class (both inside and outside the workplace). This struggle was directed against hierarchy in general, with workers, students, women, ethnic groups, anti-war protesters and the unemployed all organising successful struggles against authority. This struggle attacked the hierarchical core of capitalism as well as increasing the amount of income going to labour, resulting in a profit squeeze (see section C.7). By the 1970s, capitalism and the state could no longer ensure that working class struggles could be contained within the system.

This profits squeeze reflected the rise in inflation. While it has become commonplace to argue that Keynesianism did not predict the possibility of exploding inflation, this is not entirely true. While Keynes and the mainstream Keynesians failed to take into account the impact of full employment on class relations and power, his left-wing followers did not. Influenced by Michal Kalecki, the argued that full employment would impact on power at the point of production and, consequently, prices. To quote Joan Robinson from 1943:

> *"The first function of unemployment (which has always existed in open or disguised forms) is that it maintains the authority of master over man. The master has normally been in a position to say: 'If you don't want the job, there are plenty of others who do.' When the man can say: 'If you don't want to employ me, there are plenty of others who will', the situation is radically altered. One effect of such a change might be to remove*

> *a number of abuses to which the workers have been compelled to submit in the past ... [Another is that] the absence of fear of unemployment might go further and have a disruptive effect upon factory discipline ... [He may] us[e] his newly-found freedom from fear to snatch every advantage that he can ...*
>
> *"The change in the workers' bargaining position which would follow from the abolition of unemployment would show itself in another and more subtle way. Unemployment ... has not only the function of preserving discipline in industry, but also indirectly the function of preserving the value of money ... there would be a constant upward pressure upon money wage-rates ... the vicious spiral of wages and prices might become chronic ... if it moved too fast, it might precipitate a violent inflation."* [**Collected Economic Papers**, vol. 1, pp. 84–5]

Thus left-wing Keynesians (who later founded the Post-Keynesian school of economics) recognised that capitalists *"could recoup themselves for rising costs by raising prices."* [**Op. Cit.**, p. 85] This perspective was reflected in a watered-down fashion in mainstream economics by means of the Philips Curve. When first suggested in the 1958, this was taken to indicate a stable relationship between unemployment and inflation. As unemployment fell, inflation rose. This relationship fell apart in the 1970s, as inflation rose as unemployment rose.

Neo-classical (and other pro-"free market" capitalist) economics usually argues that inflation is purely a monetary phenomenon, the result of there being more money in circulation than is needed for the sale of the various commodities on the market. This was the position of Milton Friedman and his Monetarist school during the 1960s and 1970s. However, this is not true. In general, there is no relationship between the money supply and inflation. The amount of money can increase while the rate of inflation falls, for example (as we will discuss in the next section, Monetarism itself ironically proved there is no relationship). Inflation has other roots, namely it is *"an expression of inadequate profits that must be offset by price and money policies ... Under any circumstances, inflation spells the need for higher profits."* [Paul Mattick, **Economics, Politics and the Age of Inflation**, p. 19] Inflation leads to higher profits by making labour cheaper. That is, it reduces *"the real wages of workers... [which] directly benefits employers... [as] prices rise faster than wages, income that would have gone to workers goes to business instead."* [J. Brecher and T. Costello, **Common Sense for Hard Times**, p. 120]

Inflation, in other words, is a symptom of an on-going struggle over income distribution between classes. It is caused when capitalist profit margins are reduced (for whatever reason, subjective or objective) and the bosses try to maintain them by increasing prices, i.e. by passing costs onto consumers. This means that it would be wrong to conclude that wage increases "cause" inflation as such. To do so ignores the fact that workers do not set prices, capitalists do. Any increase in costs could, after all, be absorbed by lowering profits. Instead working class people get denounced for being "greedy" and are subjected to calls for "restraint" — in order for their bosses to make sufficient profits! As Joan Robinson put it, while capitalist economies denies it (unlike, significantly, Adam Smith) there is an *"inflationary pressure that arises from an increase in the share of gross profits in gross income. How are workers to be asked to accept 'wage restraint' unless there is a restraint on profits? ... unemployment is the problem. If it could be relived by tax cuts, generating purchasing power, would not a general cut in profit margins be still more effective? These are the questions that all the rigmarole about marginal productivity is designed to prevent us from discussing."* [**Collected Economic Papers**, vol. 4, p. 134]

Inflation and the response by the capitalist class to it, in their own ways, shows the hypocrisy of capitalism. After all, wages are increasing due to "natural" market forces of supply and demand. It is the **capitalists** who are trying to buck the market by refusing to accept lower profits caused by conditions on it. Obviously, to use Benjamin Tucker's expression, under capitalism market forces are good for the goose (labour) but bad for the gander (capital). The so-called "wages explosion" of the late 1960s was a symptom of this shift in class power away from capital and to labour which full employment had created. The growing expectations and aspirations of working class people led them not only to demand more of the goods they produced, it had start many questioning why social hierarchies were needed in the first place. Rather than accept this as a natural outcome of the eternal laws of supply and demand, the boss class used the state to create a more favourable labour market environment (as, it should be stressed, it has always done).

This does not mean that inflation suits all capitalists equally (nor, obviously, does it suit those social layers who live on fixed incomes and who thus suffer when prices increase but such people are irrelevant in the eyes of capital). Far from it — during periods of inflation, lenders tend to lose and borrowers tend to gain. The opposition to high levels of inflation by many supporters of capitalism is based upon this fact and the division within the capitalist class it indicates. There are two main groups of capitalists, finance capitalists and industrial capitalists. The latter can and do benefit from inflation (as indicated above) but the former sees high inflation as a threat. When inflation is accelerating it can push the real interest rate into negative territory and this is a horrifying prospect to those for whom interest income is fundamental (i.e. finance capital). In addition, high levels of inflation can also fuel social struggle, as workers and other sections of society try to keep their income at a steady level. As social struggle has a politicising effect on those involved, a condition of high inflation could have serious impacts on the political stability of capitalism and so cause problems for the ruling class.

How inflation is viewed in the media and by governments is an expression of the relative strengths of the two sections of the capitalist class and of the level of class struggle within society. For example, in the 1970s, with the increased international mobility of capital, the balance of power came to rest with finance capital and inflation became the source of all evil. This shift of influence to finance capital can be seen from the rise of rentier income. The distribution of US manufacturing profits indicate this process — comparing the periods 1965–73 to 1990–96, we find that interest payments rose from 11% to 24%, dividend payments rose from 26% to 36% while retained earnings fell from 65% to 40%. Given that retained earnings are the most important source of investment funds, the rise of finance capital helps explain why, in contradiction to the claims of the right-wing, economic growth has become steadily worse as markets have been liberalised — funds that could have been resulted in real investment have ended up in the finance machine. In addition, the waves of strikes and protests that inflation produced had worrying implications for the ruling class as they showed a working class able and willing to contest their power and, perhaps, start questioning **why** economic and social decisions were being made by a few rather than by those affected by them. However, as the underlying reasons for inflation remained (namely to increase profits) inflation itself was only reduced to acceptable levels, levels that ensured a positive real interest rate and acceptable profits.

Thus, Keynesianism sowed the seeds of its own destruction. Full employment had altered the balance of power in the workplace and economy from capital to labour. The prediction of socialist economist Michal Kalecki that full employment would erode social discipline had become true (see section B.4.4). Faced with rising direct and indirect costs due to this, firms passed them on to consumers. Yet consumers are also, usually, working class and this provoked more direct action to increase real wages in the face of inflation. Within the capitalist class, finance capital was increasing in strength at the expense of industrial capital. Facing the erosion of their loan income, states were subject to economic pressures to place fighting inflation above maintaining full employment. While Keynes had hoped that *"the rentier aspect of capitalism [was] a transitional phase"* and his ideas would lead to *"the euthanasia of the rentier,"* finance capital was not so willing to see this happen. [**The General Theory**, p. 376] The 1970s saw the influence of an increasingly assertive finance capital rise at a time when significant numbers within ranks of industrial capitalists were sick of full employment and wanted compliant workers again. The resulting recessions may have harmed individual capitalists (particularly smaller ones) but the capitalist class as a whole did very well of them (and, as we noted in section B.2, one of the roles of the state is to manage the system in the interests of the capitalist class **as a whole** and this can lead it into conflict with **some** members of that class). Thus the maintenance of sufficiently high unemployment under the mantra of fighting inflation as the de facto state policy from the 1980s onwards (see section C.9). While industrial capital might want a slightly stronger economy and a slightly lower rate of unemployment than finance capital, the differences are not significant enough to inspire major conflict. After all, bosses in any industry *"like slack in the labour market"* as it *"makes for a pliant workforce"* and, of course, *"many non-financial corporations have heavy financial interests."* [Doug Henwood, **Wall Street**, pp. 123–4 and p. 135]

It was these processes and pressures which came to a head in the 1970s. In other words, post-war Keynesianism failed simply because it could not, in the long term, stop the subjective and objective pressures which capitalism always faces. In the 1970s, it was the subjective pressure which played the key role, namely social struggle was the fundamental factor in economic developments. The system could not handle the struggle of human beings against the oppression, exploitation, hierarchy and alienation they are subject to under capitalism.

C.8.3 How did capitalism adjust to the crisis in Keynesianism?

Basically by using, and then managing, the 1970s crisis to discipline the working class in order to reap increased profits and secure and extend the ruling classes' power. It did this using a combination of crisis, free(r) markets and adjusted Keynesianism as part of a ruling elite lead class war against labour.

In the face of crisis in the 1970s, Keynesianist redirection of profits between capitals and classes had become a burden to capital as a whole and had increased the expectations and militancy of working people to dangerous levels. The crisis of the 1970s and early 1980s helped control working class power and unemployment was utilised as a means of saving capitalism and imposing the costs of free(r) markets onto society as whole. The policies implemented were ostensibly to combat high inflation. However, as left-wing economist Nicholas Kaldor summarised, inflation may have dropped but this lay *"in their success in transforming the labour market from a twentieth-century sellers' market to a nineteenth-century buyers' market, with wholesome effects on factory discipline, wage claims, and proneness to strike."* [**The Scourge of Monetarism**, p. xxiii] Another British economist described this policy memorably as *"deliberately setting out to base the viability of the capitalist system on the maintenance of a large 'industrial reserve army' [of the unemployed] … [it is] the incomes policy of Karl Marx."* [Thomas Balogh, **The Irrelevance of Conventional**

Economics, pp. 177–8] The aim, in summary, was to swing the balance of social, economic and political power back to capital and ensure the road to (private) serfdom was followed. The rationale was fighting inflation.

Initially the crisis was used to justify attacks on working class people in the name of the free market. And, indeed, capitalism was made more market based, although with a "safety net" and "welfare state" for the wealthy. We have seen a partial return to *"what economists have called freedom of industry and commerce, but which really meant the relieving of industry from the harassing and repressive supervision of the State, and the giving to it full liberty to exploit the worker, whom was still to be deprived of his freedom."* The *"crisis of democracy"* which so haunted the ruling class in the 1960s and 1970s was overcome and replaced with, to use Kropotkin's words, the *"liberty to exploit human labour without any safeguard for the victims of such exploitation and the political power organised as to assure freedom of exploitation to the middle-class."* [Kropotkin, **The Great French Revolution**, vol.1, p. 28 and p. 30]

Fighting inflation, in other words, was simply code used by the ruling class for fighting the class war and putting the working class back in its place in the social hierarchy. *"Behind the economic concept of inflation was a fear among elites that they were losing control"* as the *"sting of unemployment was lessened and workers became progressively less docile."* [Doug Henwood, **After the New Economy**, p. 204] Milton Friedman's Monetarism was the means by which this was achieved. While (deservedly) mostly forgotten now, Monetarism was very popular in the 1970s and was the economic ideology of choice of both Reagan and Thatcher. This was the economic justification for the restructuring of capitalism and the end of social Keynesianism. Its legacy remains to some degree in the overriding concern over inflation which haunts the world's central banks and other financial institutions, but its specific policy recommendations have been dropped in practice after failing spectacularly when applied (a fact which, strangely, was not mentioned in the eulogies from the right that marked Friedman's death).

According to Monetarism, the problem with capitalism was money related, namely that the state and its central bank printed too much money and, therefore, its issue should be controlled. Friedman stressed, like most capitalist economists, that monetary factors are **the** most important feature in explaining such problems of capitalism as the business cycle, inflation and so on. This is unsurprising, as it has the useful ideological effect of acquitting the inner-workings of capitalism of any involvement in such developments. Slumps, for example, may occur, but they are the fault of the state interfering in the economy. Inflation was a purely monetary phenomenon caused by the state printing more money than required by the growth of economic activity (for example, if the economy grew by 2% but the money supply increased by 5%, inflation would rise by 3%). This analysis of inflation is deeply flawed, as we will see. This was how Friedman explained the Great Depression of the 1930s in the USA, for example (see, for example, his *"The Role of Monetary Policy"* [**American Economic Review**, Vol. 68, No. 1, pp. 1–17]).

Thus Monetarists argued for controlling the money supply, of placing the state under a *"monetary constitution"* which ensured that the central banks be required by law to increase the quantity of money at a constant rate of 3–5% a year. This would ensure that inflation would be banished, the economy would adjust to its natural equilibrium, the business cycle would become mild (if not disappear) and capitalism would finally work as predicted in the economics textbooks. With the *"monetary constitution"* money would become *"depoliticised"* and state influence and control over money would be eliminated. Money would go back to being what it is in neo-classical theory, essentially neutral, a link between production and consumption and capable of no mischief on its own. Hence the need for a *"legislated rule"* which would control *"the behaviour of the stock of money"* by *"instructing the monetary authority to achieve a specified rate of growth in the stock of money."* [**Capitalism and Freedom**, p. 54]

Unfortunately for Monetarism, its analysis was simply wrong. It cannot be stressed enough how deeply flawed and ideological Friedman's arguments were. As one critique noted, his assumptions have *"been shown to be fallacious and the empirical evidence questionable if not totally misinterpreted."* Moreover, *"none of the assumptions which Friedman made to reach his extraordinary conclusions bears any relation to reality. They were chosen precisely because they led to the desired conclusion, that inflation is a purely monetary phenomenon, originating solely in excess monetary demand."* [Thomas Balogh, **Op. Cit.**, p. 165 and p. 167] For Kaldor, Friedman's claims that empirical evidence supported his ideology were false. *"Friedman's assertions lack[ed] any factual foundation whatsoever."* He stressed, *"They ha[d] no basis in fact, and he seems to me have invented them on the spur of the moment."* [**Op. Cit.**, p. 26] There was no relationship between the money supply and inflation.

Even more unfortunately for both the theory and (far more importantly) vast numbers of working class people, it was proven wrong not only theoretically but also empirically. Monetarism was imposed on both the USA and the UK in the early 1980s, with disastrous results. As the Thatcher government in 1979 applied Monetarist dogma the most whole-heartedly we will concentrate on that regime (the same basic things occurred under Reagan as well but he embraced military Keynesianism sooner and so mitigated its worse effects. [Michael Stewart, **Keynes and After**, p. 181] This did not stop the right proclaiming the Reagan boom as validation of "free market" economics!).

Firstly, the attempt to control the money supply failed, as predicted by Nicholas Kaldor (see his 1970 essay *"The New Monetarism"*). This is because the money supply, rather than being set by the central bank or the state (as Friedman claimed), is a function of the demand for credit, which is itself a function of economic activity. To use economic terminology, Friedman had assumed that the money supply was "exogenous" and so determined outside the economy by the state when, in fact, it is "endogenous" in nature (i.e. comes from **within** the economy). [**The Essential Kaldor**, p. 483] This means that any attempt by the central bank to control the money supply, as desired by Friedman, will fail.

The experience of the Thatcher and Reagan regimes indicates this well. The Thatcher government could not meet the money controls it set. It took until 1986 before the Tory government stopped announcing monetary targets, persuaded no doubt by the embarrassment caused by its inability to hit them. In addition, the variations in the money supply showed that Friedman's argument on what caused inflation was also wrong. According to his theory, inflation was caused by the money supply increasing faster than the economy, yet inflation **fell** as the money supply increased. Between 1979 and 1981–2, its growth rose and was still higher in 1982–3 than it had been in 1978–9 yet inflation was down to 4.6% in 1983. As the moderate conservative MP Ian Gilmore pointed out, *"[h]ad Friedmanite monetarism… been right, inflation would have been about 16 per cent in 1982–3, 11 per cent in 1983–4, and 8 per cent in 1984–5. In fact … in the relevant years it never approached the levels infallibly predicted by monetarist doctrine."* [Ian Gilmore, **Dancing With Dogma**, p. 57 and pp. 62–3] So, as Henwood summarises, *"even the periods of recession and recovery disprove monetarist dogma."* [**Wall Street**, p. 202]

However, the failed attempt to control the money supply had other, more important effects, namely exploding interest and unemployment rates. Being unable to control the supply of money, the government did the next best thing: it tried to control the demand for money by rising interest rates. Unfortunately for the Tories their preferred measure for the money supply included interest-bearing bank deposits. This meant, as the government raised interest rates in its attempts to control the money supply, it was profitable for people to put more money on deposit. Thus the rise in interest rates promoted people to put money in the bank, so increasing the particular measure of the money supply the government sought to control which, in turn, lead them to increase interest rates. [Michael Stewart, **Keynes in the 1990s**, p. 50]

The exploding interest rates used in a vain attempt to control the money supply was the last thing Britain needed in the early 1980s. The economy was already sliding into recession and government attempts to control the money supply deepened it. While Milton Friedman predicted *"only a modest reduction in output and employment"* as a *"side effect of reducing inflation to single figures by 1982,"* in fact Britain experienced its deepest recession since the 1930s. [quoted by Michael Stewart, **Keynes and After**, p. 179] As Michael Stewart dryly notes, it *"would be difficult to find an economic prediction that that proved more comprehensively inaccurate."* Unemployment rose from around 5% in 1979 to 13% in the middle of 1985 (and would have been even higher but for a change in the method used for measuring it, a change implemented to knock numbers off of this disgraceful figure). In 1984 manufacturing output was still 10% lower than it had been in 1979. [**Op. Cit.**, p. 180] Little wonder Kaldor stated that Monetarism was *"a terrible curse, a visitation of evil spirits, with particularly unfortunate, one could almost say devastating, effects on"* Britain. [*"The Origins of the New Monetarism,"* pp. 160–177, **Further Essays on Economic Theory and Policy**, p. 160]

Eventually, inflation did fall. From an anarchist perspective, however, this fall in inflation was the result of the high unemployment of this period as it weakened labour, so allowing profits to be made in production rather than in circulation (see last section for this aspect of inflation). With no need for capitalists to maintain their profits via price increases, inflation would naturally decrease as labour's bargaining position was weakened by the fear mass unemployment produced in the workforce. Rather than being a purely monetary phenomena as Friedman claimed, inflation was a product of the profit needs of capital and the state of the class struggle. The net effect of the deep recession of the early 1980s and mass unemployment during the 1980s (and 1990s) was to control working class people by putting the fear of being fired back. The money supply had nothing to do with it and attempts to control it would, of necessity, fail and the only tool available to governments would be raising interest rates. This would reduce inflation only by depressing investment, generating unemployment, and so (eventually) slowing the growth in wages as workers bear the brunt of the recessions by lowering their real income (i.e., paying higher prices on the same wages). Which is what happened in the 1980s.

It is also of interest to note that even in Friedman's own test case of his basic contention, the Great Depression of 1929–33, he got it wrong. For Friedman, the *"fact is that the Great Depression, like most other periods of severe unemployment, was produced by government mismanagement rather than by any inherent instability of the private economy."* [**Op. Cit.**, p. 54] Kaldor pointed out that *"[a]ccording to Friedman's own figures, the amount of 'high-powered money'… in the US increased, not decreased, throughout the Great Contraction: in July 1932, it was more than 10 per cent higher than in July, 1929 … The Great Contraction of the money supply … occurred* ***despite*** *this increase in the monetary base."* [*"The New Monetarism"*, **The Essential Kaldor**, pp. 487–8] Other economists also investigated Friedman's claims, with similar result. Peter Temin, for example, critiqued them from a Keynesian point of view, asking whether the decline in spending resulted from a decline in the money supply or the other way round. He noted that while the Monetarist *"narrative is long and complex"* it *"offers far less support for [its] assertions than appears at first. In fact, it assumes the conclusion and describes the Depression in terms of it; it does not test or prove it at all."* He examined the changes in the real money balances and found that they increased between 1929 and 1931 from between 1 and 18% (depending on choice of money aggregate used and how it was deflated). Overall, the money supply not only did not decline but actually increased 5% between August 1929 and August 1931. Temin concluded that there is no evidence that money caused the depression after the stock market crash. [**Did Monetary Forces Cause the Great Depression?**, pp. 15–6 and p. 141]

There is, of course, a slight irony about Friedman's account of the Great Depression. Friedman suggested that the Federal Reserve actually caused the Great Depression, that it was in some sense a demonstration of the evils of government intervention. In his view, the US monetary authorities followed highly deflationary policies and so the money supply fell because they forced or permitted a sharp reduction in the monetary base. In other words, because they failed to exercise the responsibilities assigned to them. This is the core of his argument. Yet it is important to stress that by this he did not, in fact, mean that it happened because the government had intervened in the market. Ironically, Friedman argued it happened because the government did **not** intervene fast or far enough thus making a bad situation much worse. In other words, it was not interventionist enough!

This self-contradictory argument arises because Friedman was an ideologue for capitalism and so sought to show that it was a stable system, to exempt capitalism from any systemic responsibility for recessions. That he ended up arguing that the state caused the Great Depression by doing nothing (which, ironically, was what Friedman usually argued it should do) just shows the power of ideology over logic or facts. Its fleeting popularity was due to its utility in the class war for the ruling class at that time. Given the absolute failure of Monetarism, in both theory and practice, it is little talked about now. That in the 1970s it was the leading economic dogma of the right explains why this is the case. Given that the right usually likes to portray itself as being strong on the economy it is useful to indicate that this is **not** the case — unless you think causing the deepest recessions since the 1930s in order to create conditions where working class people are put in their place so the rich get richer is your definition of sound economic policy. As Doug Henwood summarises, there *"can be no doubt that monetarism … throughout the world from the Chilean coup onward, has been an important part of a conscious policy to crush labour and redistribute income and power toward capital."* [**Wall Street**, pp. 201–2]

For more on Monetarism, the work of its greatest critic, Nicholas Kaldor, is essential reading (see for example, *"Origins of the new Monetarism"* and *"How Monetarism Failed"* in **Further Essays on Economic Theory and Policy**, *"The New Monetarism"* in **The Essential Kaldor** and **The Scourge of Monetarism**).

So under the rhetoric of "free market" capitalism, Keynesianism was used to manage the crisis as it had previously managed the prosperity. "Supply Side" economics (combined with neoclassical dogma) was used to undercut working class power and consumption and so allow capital to reap more profits off working class people by a combination of reduced regulation for the capitalist class and state intervention to control the working class. Unemployment was used to discipline a militant workforce and as a means of getting workers to struggle **for** work instead of **against** wage labour. With the fear of job loss hanging over their heads, workers put up with speedups, longer hours, worse conditions and lower wages and this increased the profits that could be extracted directly from workers as well as reducing business costs by allowing employers to reduce on-job safety and protection and so on. The labour "market" was fragmented to a large degree into powerless, atomised units with unions fighting a losing battle in the face of a recession made much worse by government policy (and justified by economic ideology). In this way capitalism could successfully change the composition of demand from the working class to capital.

Needless to say, we still living under the legacy of this process. As we indicated in section C.3, there has been a significant shift in income from labour to capital in the USA. The same holds true in the UK, as does rising inequality and higher rates of poverty. While the economy is doing well for the few, the many are finding it harder to make ends meet and, as a result, are working harder for longer and getting into debt to maintain their income levels (in a sense, it could be argued that aggregate demand management has been partially privatised as so many working class people are in debt). Unsurprisingly 70% of the recent gain in per capita income in the Reagan-Bush years went to the top 1% of income earners (while the bottom lost absolutely). Income inequality increased, with the income of the bottom fifth of the US population falling by 18% while that of the richest fifth rose by 8%. [Noam Chomsky, **World Orders, Old and New**, p. 141] Combined with bubbles in stocks and housing, the illusion of a good economy is maintained while only those at the top are doing well (see section B.7 on rising inequality). This disciplining of the working class has been successful, resulting in the benefits of rising productivity and growth going to the elite. Unemployment and underemployment are still widespread, with most newly created jobs being part-time and insecure.

Indirect means of increasing capital's share in the social income were also used, such as reducing environment regulations, so externalising pollution costs onto current and future generations. In Britain, state owned monopolies were privatised at knock-down prices allowing private capital to increase its resources at a fraction of the real cost. Indeed, some nationalised industries were privatised **as monopolies** for a period allowing monopoly profits to be extracted from consumers before the state allowed competition in those markets. Indirect taxation also increased, reducing working class consumption by getting us to foot the bill for capitalist restructuring as well as military-style Keynesianism. Internationally, the exploitation of under-developed nations increased with $418 billion being transferred to the developed world between 1982 and 1990 [Chomsky, **Op. Cit.**, p. 130] Capital also became increasingly international in scope, as it used advances in technology to move capital to third world countries where state repression ensured a less militant working class. This transfer had the advantage of increasing unemployment in the developed world, so placing more pressures upon working class resistance.

This policy of capital-led class war, a response to the successful working class struggles of the 1960s and 1970s, obviously reaped the benefits it was intended to for capital. Income going to capital has increased and that going to labour has declined and the "labour market" has been disciplined to a large degree (but not totally we must add). Working people have been turned, to a large degree, from participants into spectators, as required for any hierarchical system. The human impact of these policies cannot be calculated. Little wonder, then, the utility of neo-classical dogma to the elite — it could be used by rich, powerful people to justify the fact that they are pursuing social policies that create poverty and force children to die. As Chomsky argues, *"one aspect of the internationalisation of the economy is the extension of the two-tiered Third World mode to the core countries. Market doctrine thus becomes an essential ideological weapon at home as well, its highly selective application safely obscured by the doctrinal system. Wealth and power are in-*

creasingly concentrated. Service for the general public — education, health, transportation, libraries, etc. — become as superfluous as those they serve, and can therefore be limited or dispensed with entirely." [**Year 501**, p. 109]

The state managed recession has had its successes. Company profits are up as the *"competitive cost"* of workers is reduced due to fear of job losses. The Wall Street Journal's review of economic performance for the last quarter of 1995 is headlined *"Companies' Profits Surged 61% on Higher Prices, Cost Cuts."* After-tax profits rose 62% from 1993, up from 34% for the third quarter. While working America faces stagnant wages, Corporate America posted record profits in 1994. **Business Week** estimated 1994 profits to be up *"an enormous 41% over [1993],"* despite a bare 9% increase in sales, a *"colossal success,"* resulting in large part from a *"sharp"* drop in the *"share going to labour,"* though *"economists say labour will benefit — eventually."* [quoted by Noam Chomsky, *"Rollback III"*, **Z Magazine**, April 1995] Labour was still waiting over a decade later.

Moreover, for capital, Keynesianism is still goes on as before, combined (as usual) with praises to market miracles. For example, Michael Borrus, co-director of the Berkeley Roundtable on the International Economy (a corporate-funded trade and technology research institute), cites a 1988 Department of Commerce study that states that *"five of the top six fastest growing U.S. industries from 1972 to 1988 were sponsored or sustained, directly or indirectly, by federal investment."* He goes on to state that the *"winners [in earlier years were] computers, biotechnology, jet engines, and airframes"* all *"the by-product of public spending."* [quoted by Chomsky, **World Orders, Old and New**, p. 109] As James Midgley points out, *"the aggregate size of the public sector did not decrease during the 1980s and instead, budgetary policy resulted in a significant shift in existing allocations from social to military and law enforcement."* [*"The radical right, politics and society"*, **The Radical Right and the Welfare State**, Howard Glennerster and James Midgley (eds.), p. 11] Indeed, the US state funds one third of all civil R&D projects, and the UK state provides a similar subsidy. [Chomsky, **Op. Cit.**, p. 107] And, of course, the state remains waiting to save the elite from their own market follies (for example, after the widespread collapse of Savings and Loans Associations in deregulated corruption and speculation, the 1980s pro-"free market" Republican administration happily bailed them out, showing that market forces were only for one class).

The corporate owned media attacks social Keynesianism, while remaining silent or justifying pro-business state intervention. Combined with extensive corporate funding of right-wing "think-tanks" which explain why (the wrong sort of) social programmes are counter-productive, the corporate state system tries to fool the population into thinking that there is no alternative to the rule by the market while the elite enrich themselves at the public's expense. This means that state intervention has not ended as such. We are still in the age of Keynes, but social Keynesianism has been replaced by military Keynesianism cloaked beneath the rhetoric of "free market" dogma. This is a mix of free(r) markets (for the many) and varying degrees of state intervention (for the select few), while the state has become stronger and more centralised (*"prisons also offer a Keynesian stimulus to the economy, both to the construction business and white collar employment; the fastest growing profession is reported to be security personnel."* [Chomsky, **Year 501**, p. 110]). In other words, pretty much the same situation that has existed since the dawn of capitalism (see section D.1) — free(r) markets supported by ready use of state power as and when required.

The continued role of the state means that it is unlikely that a repeat of the Great Depression is possible. The large size of state consumption means that it stabilises aggregate demand to a degree unknown in 1929 or in the 19th century period of free(r) market capitalism. This is **not** to suggest that deep recessions will not happen (they have and will). It is simply to suggest that they will **not** turn into a deep depression. Unless, of course, ideologues who believe the "just-so" stories of economic textbooks and the gurus of capitalism gain political office and start to dismantle too much of the modern state. As Thatcher showed in 1979, it is possible to deepen recessions considerably if you subscribe to flawed economic theory (ideology would be a better word) and do not care about the impact it is having on the general public — and, more importantly, if the general public cannot stop you).

However, as we discuss in section C.10 the net effect of this one-sided class war has not been as good as has been suggested by the ideologues of capitalism and the media. Faced with the re-imposition of hierarchy, the quality of life for the majority has fallen (consumption, i.e. the quantity of life, may not but that is due to a combination of debt, increased hours at work and more family members taking jobs to make ends meet). This, in turn, has lead to a fetish over economic growth. As Joan Robinson put it in the 1970s when this process started the *"economists have relapsed into the slogans of laisser faire — what is profitable promotes growth; what is most profitable is best. But people have began to notice that the growth of statistical GNP is not the same thing as an increase in welfare."* [**Collected Economic Papers**, vol. 4, p. 128] Yet even here, the post-1970s experience is not great. A quarter century of top heavy growth in which the vast majority of economic gains have gone to the richest 10% of the population has not produced the rate of GDP growth promised for it. In fact, the key stimulus for growth in the 1990s and 2000s was bubbles, first in the stock market and then in the housing market. Moreover, rising personal debt has bolstered the economy in a manner which are as unsustainable as the stock and housing bubbles which, in part, supported it. How long the system will stagger on depends, ultimately, on how long working class people will put up with it and having to pay the costs inflicted onto society and the environment in the pursuit of increasing the wealth of the few.

While working class resistance continues, it is largely defensive, but, as in the past, this can and will change. Even the darkest night ends with the dawn and the lights of working class resistance can be seen across the globe. For example, the anti-Poll Tax struggle in Britain against the Thatcher Government was successful as have been many anti-cuts struggles across the USA and Western Europe, the Zapatista uprising in Mexico was inspiring as was the Argentine revolt against neo-liberalism and its wave of popular assemblies and occupied workplaces. In France, the anti-CPE protests showed a new generation of working class people know not only how to protest but also nonsense when they hear it. In general, there has been continual strikes and protests across the world. Even in the face of state repression and managed economic recession, working class people are still fighting back. The job for anarchists to is encourage these sparks of liberty and help them win.

C.9 Would laissez-faire capitalism reduce unemployment?

In order to answer this question, we must first have to point out that "actually existing capitalism" tries to manage unemployment to ensure a compliant and servile working class. This is done under the name of fighting "inflation" but, in reality, it about controlling wages and maintaining high profit rates for the capitalist class. Market discipline for the working class, state protection for the ruling class, in other words. As Edward Herman points out:

> *"Conservative economists have even developed a concept of a 'natural rate of unemployment,' a metaphysical notion and throwback to an eighteenth century vision of a 'natural order,' but with a modern apologetic twist. The natural rate is defined as the minimum unemployment level consistent with price level stability, but, as it is based on a highly abstract model that is not directly testable, the natural rate can only be inferred from the price level itself. That is, if prices are going up, unemployment is below the 'natural rate' and too low, whether the actual rate is 4, 8, or 10 percent. In this world of conservative economics, anybody is 'voluntarily' unemployed. Unemployment is a matter of rational choice: some people prefer 'leisure' over the real wage available at going (or still lower) wage rates …*
>
> *"Apart from the grossness of this kind of metaphysical legerdemain, the very concept of a natural rate of unemployment has a huge built-in bias. It takes as granted all the other institutional factors that influence the price level-unemployment trade-off (market structures and independent pricing power, business investment policies at home and abroad, the distribution of income, the fiscal and monetary mix, etc.) and focuses solely on the tightness of the labour market as the controllable variable. Inflation is the main threat, the labour market (i.e. wage rates and unemployment levels) is the locus of the solution to the problem."* [**Beyond Hypocrisy**, p. 94]

Unsurprisingly, Herman defines this "natural" rate as *"the rate of unemployment preferred by the propertied classes."* [**Op. Cit.**, p. 156] The theory behind this is usually called the ***"Non-Accelerating Inflation Rate of Unemployment"*** (or NAIRU). Like many of the worse aspects of modern economics, the concept was raised Milton Friedman in the late 1960s. At around the same time, Edmund Phelps independently developed the theory (and gained the so-called "Nobel Prize" in economics for so doing in 2006). Both are similar and both simply repeat, in neo-classical jargon, the insight which critics of capitalism had argued for over a century: unemployment is a necessary aspect of capitalism for it is essential to maintaining the power of the boss over the worker. Ironically, therefore, modern neo-classical economics is based on a notion which it denied for over a century (this change may be, in part, because the ruling elite thinks it has won the class war and has, currently, no major political and social movements it has to refute by presenting a rosy picture of the system).

Friedman raised his notion of a *"Natural Rate of Unemployment"* in 1968. He rooted it in the neo-classical perspective of individual expectations rather than, say, the more realistic notion of class conflict. His argument was simple. There exists in the economy some *"natural"* rate associated with the real wage an ideal economy would produce (this is *"the level that would be ground out by the Walrasian system of general equilibrium equations,"* to quote him). Attempts by the government to reduce actual unemployment below this level would result in rising inflation. This is because there would be divergence between the actual rate of inflation and its expected rate. By lowering unemployment, bosses have to raise wages and this draws unemployed people into work (note the assumption that unemployment is voluntary). However, rising wages were passed on by bosses in rising prices and so the **real** wage remains the same. This eventually leads to people leaving the workforce as the real wage has fallen back to the previous, undesired, levels. However, while the unemployment level rises back to its *"natural"* level, inflation does not. This is because workers are interested in real wages and, so if inflation is at, say, 2% then they will demand wage increases that take this into account. If they expect inflation to increase again then workers will demand **more** wages to make up for it, which in turn will cause prices to rise (although Friedman downplayed that this was because **bosses** were increasing their prices to maintain profit levels). This will lead to rising inflation **and** rising unemployment. Thus the expectations of individuals are the key.

For many economists, this process predicted the rise of stagflation in the 1970s and gave Friedman's Monetarist dogmas credence. However, this was because the *"Bastard Keynesianism"* of the post-war period was rooted in the same neo-classical assumptions used by Friedman. Moreover, they had forgotten the warnings of left-wing Keynesians in the 1940s that full unemployment would cause inflation as bosses would pass on wage rises onto consumers. This class based analysis, obviously, did not fit in well with the panglossian assumptions of neo-classical economics. Yet basing an analysis on individual expectations does not answer the question whether these expectations are meet. With strong organisation and a willingness to act, workers can increase their wages to counteract inflation. This means that there are two main options within capitalism. The first option is to use price controls to stop capitalists increasing their prices. However, this contradicts the scared laws of supply and demand and violates private property. Which brings us to the second option, namely to break unions and raise unemployment to such levels that workers think twice about standing up for themselves. In this case, workers cannot increase their money wages and so their real wages drop.

Guess which option the capitalist state went for? As Friedman made clear when he introduced the concept there was really nothing *"natural"* about the natural rate theory as it was determined by state policy:

> *"I do not mean to suggest that it is immutable and unchangeable. On the contrary, many of the market characteristics that determine its level are man-made and policy-made. In the United States, for example, legal minimum wage rates … and the strength of labour unions all make the natural rate of unemployment higher than it would otherwise be."* [*"The Role of Monetary Policy,"* pp. 1–17, **American Economic Review**, Vol. 68, No. 1, p. 9]

Thus the "natural" rate is really a social and political phenomenon which, in effect, measures the bargaining strength of working people. This suggests that inflation will fall when working class people are in no position to recoup rising prices in the form of rising wages. The "Natural Rate" is, in other words, about class conflict.

This can be seen when the other (independent) inventor of the "natural" rate theory won the so-called Nobel prize in 2006. Unsurprisingly, the **Economist** magazine was cock-a-hoop. [*"A natural choice: Edmund Phelps earns the economics profession's highest accolade"*, Oct 12th 2006] The reasons why became clear. According to the magazine, *"Phelps won his laurels in part for kicking the feet from under his intellectual forerunners"* by presenting a (neo-classical) explanation for the breakdown of the so-called *"Phillips curve."* This presented a statistical trade-off between inflation and unemployment (*"unemployment was low in Britain when wage inflation was high, and high when inflation was low"*). The problem was that economists *"were quick — too quick — to conclude that policymakers therefore faced a grand, macroeconomic trade-off"* in which, due to *"such a tight labour market, companies appease workers by offering higher wages. They then pass on the cost in the form of dearer prices, cheating workers of a higher real wage. Thus policy makers can engineer lower unemployment only through deception."* Phelps innovation was to argue that *"[e]ventually workers will cotton on, demanding still higher wages to offset the rising cost of living. They can be duped for as long as inflation stays one step ahead of their rising expectations of what it will be."* The similarities with Friedman's idea are obvious. This meant that the *"stable trade-off depicted by the Phillips curve is thus a dangerous mirage"* which broke down in the 1970s with the rise of stagflation.

Phelps argued that there was a *"natural"* rate of unemployment, where *"workers' expectations are fulfilled, prices turn out as anticipated, and they no longer sell their labour under false pretences."* This *"equilibrium does not, sadly, imply full employment"* and so capitalism required *"leaving some workers mouldering on the shelf. Given economists' almost theological commitment to the notion that markets clear, the presence of unemployment in the world requires a theodicy to explain it."* The religious metaphor does seem appropriate as most economists (and **The Economist**) do treat the market like a god (a theodicy is a specific branch of theology and philosophy that attempts to reconcile the existence of evil in the world with the assumption of a benevolent God). And, as with all gods, sacrifices are required and Phelps' theory is the means by which this is achieved. As the magazine noted: *"in much of his work he contends that unemployment is necessary to cow workers, ensuring their loyalty to the company and their diligence on the job, at a wage the company can afford to pay"* (i.e., one which would ensure a profit).

It is this theory which has governed state policy since the 1980s. In other words, government's around the world have been trying to *"cow workers"* in order to ensure their obedience (*"loyalty to the company"*). Unsurprisingly, attempts to lower the *"natural rate"* have all involved using the state to break the economic power of working class people (attacking unions, increasing interest rates to increase unemployment in order to temporarily *"cow"* workers and so on). All so that profits can be keep high in the face of the rising wages caused by the natural actions of the market!

Yet it must be stressed that Friedman's and Phelps' conclusions are hardly new. Anarchists and other socialists had been arguing since the 1840s that capitalism had no tendency to full employment either in theory or in practice. They have also noted how periods of full employment bolstered working class power and harmed profits. It is, as we stressed in section C.1.5, the fundamental disciplinary mechanism of the system. Somewhat ironically, then, Phelps got bourgeois economics highest prize for restating, in neo-classical jargon, the model of the labour market expounded by, say, Marx:

"If [capital's] accumulation on the one hand increases the demand for labour, it increases on the other the supply of workers by 'setting them free', while at the same time the pressure of the unemployed compels those that are employed to furnish more labour, and therefore makes the supply of labour to a certain extent independent of the supply of labourers. The movement of the law of supply and demand of labour on this basis completes the despotism of capital. Thus as soon as the workers learn the secret of why it happens that the more they work, the more alien wealth they produce ... as soon as, by setting up trade unions, etc., they try to organise a planned co-operation between employed and unemployed in order to obviate or to weaken the ruinous effects of this natural law of capitalistic production on their class, so soon capital and its sycophant, political economy, cry out at the infringement of the 'eternal' and so to speak 'sacred' law of supply and demand. Every combination of employed and unemployed disturbs the 'pure' action of this law. But on the other hand, as soon as ... adverse circumstances prevent the creation of an industrial reserve army and, with it, the absolute dependence of the working-class upon the capitalist class, capital, along with its platitudinous Sancho Panza, rebels against the 'sacred' law of supply and demand, and tries to check its inadequacies by forcible means." [**Capital**, Vol. 1, pp. 793–4]

That the **Economist** and Phelps are simply echoing, and confirming, Marx is obvious. Modern economics, while disparaging Marx, has integrated this idea into its macro-economic policy recommendations by urging the state to manipulate the economy to ensure that "inflation" (i.e. wage rises) are under control. Economics has played its role of platitudinous sycophant well while Phelps' theory has informed state interference (*"forcible means"*) in the economy since the 1980s, with the expected result that wages have failed to keep up with rising productivity and so capital as enriched itself at the expense of labour (see section C.3 for details). The use of Phelps' theory by capital in the class war is equally obvious — as was so blatantly stated by **The Economist** and the head of the American Federal Reserve during this period:

"there's supporting testimony from Alan Greenspan. Several times during the late 1990s, Greenspan worried publicly that, as unemployment drifted steadily lower the 'pool of available workers' was running dry. The dryer it ran, the greater risk of 'wage inflation,' meaning anything more than minimal increases. Productivity gains took some of the edge of this potentially dire threat, said Greenspan, and so did 'residual fear of job skill obsolescence, which has induced a preference for job security over wage gains' ... Workers were nervous and acting as if the unemployment rate were higher than the 4% it reached in the boom. Still, Greenspan was a bit worried, because ... if the pool stayed dry, 'Significant increases in wages, in excess of productivity growth, [would] inevitably emerge, absent the unlikely repeal of the law of supply and demand.' Which is why Greenspan & Co. raised short-term interest rates by about two points during 1999 and the first half of 2000. There was no threat of inflation ... nor were there any signs of rising worker militancy. But wages were creeping higher, and the threat of the sack was losing some of its bite." [Doug Henwood, **After the New Economy**, pp. 206–7]

Which is quite ironic, given that Greenspan's role in the economy was, precisely, to *"repeal"* the *"law of supply and demand."* As one left-wing economist puts it (in a chapter correctly entitled

"The Workers Are Getting Uppity: Call In the Fed!"), the Federal Reverse (like all Central Banks since the 1980s) *"worries that if too many people have jobs, or if it is too easy for workers to find jobs, there will be upward pressure on wages. More rapid wage growth can get translated into more rapidly rising prices — in other words, inflation. So the Fed often decides to raise interest rates to slow the economy and keep people out of work in order to keep inflation from increasing and eventually getting out of control."* However, *"[m]ost people probably do not realise that the Federal Reserve Board, an agency of the government, intervenes in the economy to prevent it from creating too many jobs. But there is even more to the story. When the Fed hits the brakes to slow job growth, it is not doctors, lawyers, and CEOs who end up without jobs. The people who lose are those in the middle and the bottom — sales clerks, factory workers, custodians, and dishwashers. These are the workers who don't get hired or get laid off when the economy slows or goes into a recession."* [**The Conservative Nanny State**, p. 31] Thus the state pushes up unemployment rates to slow wage growth, and thereby relieve inflationary pressure. The reason should be obvious:

> *"In periods of low unemployment, workers don't only gain from higher wages. Employers must make efforts to accommodate workers' various needs, such as child care or flexible work schedules, because they know that workers have other employment options. The Fed is well aware of the difficulties that employers face in periods of low unemployment. It compiles a regular survey, called the 'Beige Book,' of attitudes from around the country about the state of the economy. Most of the people interviewed for the Beige Book are employers.*
>
> *"From 1997 to 2000, when the unemployment rate was at its lowest levels in 30 years, the Beige Book was filled with complaints that some companies were pulling workers from other companies with offers of higher wages and better benefits. Some Beige Books reported that firms had to offer such non-wage benefits as flexible work hours, child care, or training in order to retain workers. The Beige Books give accounts of firms having to send buses into inner cities to bring workers out to the suburbs to work in hotels and restaurants. It even reported that some employers were forced to hire workers with handicaps in order to meet their needs for labour.*
>
> *"From the standpoint of employers, life is much easier when the workers are lined up at the door clamouring for jobs than when workers have the option to shop around for better opportunities. Employers can count on a sympathetic ear from the Fed. When the Fed perceives too much upward wage pressure, it slams on the brakes and brings the party to an end. The Fed justifies limiting job growth and raising the unemployment rate because of its concern that inflation may get out of control, but this does not change the fact that it is preventing workers, and specifically less-skilled workers, from getting jobs, and clamping down on their wage growth."* [**Op. Cit.**, pp. 32–3]

This has not happened by accident. Lobbying by business, as another left-wing economist stresses, *"is directed toward increasing their economic power"* and business *"has been a supporter of macroeconomic policies that have operated the economy with higher rates of unemployment. The stated justification is that this lowers inflation, but it also weakens workers' bargaining power."* Unsurprisingly, *"the economic consequence of the shift in the balance of power in favour of business … has served to redistribute income towards profits at the expense of wages, thereby lowering demand and raising unemployment."* In effect, the Federal Reserve *"has been using monetary policy as a* *form of surrogate incomes policy, and this surrogate policy has been tilted against wages in favour of profits"* and so is regulating the economy *"in a manner favourable to business."* [Thomas I. Palley, **Plenty of Nothing**, p. 77, p. 111 and pp. 112–3] That this is done under the name of fighting inflation should not fool us:

> *"Mild inflation is often an indication that workers have some bargaining strength and may even have the upper hand. Yet, it is at exactly this stage that the Fed now intervenes owning to its anti-inflation commitment, and this intervention raises interest rates and unemployment. Thus, far from being neutral, the Fed's anti-inflation policy implies siding with business in the ever-present conflict between labour and capital over distribution of the fruits of economic activity … natural-rate theory serves as the perfect cloak for a pro-business policy stance."* [**Op. Cit.**, p. 110]

In a sense, it is understandable that the ruling class within capitalism desires to manipulate unemployment in this way and deflect questions about their profit, property and power onto the state of the labour market. High prices can, therefore, be blamed on high wages rather than high profits, rents and interest while, at the same time, workers will put up with lower hours and work harder and be too busy surviving to find the time or the energy to question the boss's authority either in theory or in practice. So managing the economy by manipulating interest rates to increase unemployment levels when required allows greater profits to be extracted from workers as management hierarchy is more secure. People will put up with a lot in the face of job insecurity. As left-wing economist Thomas Balogh put it, full employment *"generally removes the need for servility, and thus alters the way of life, the relationship between classes … weakening the dominance of men over men, dissolving the master-servant relation. It is the greatest engine for the attainment by all of human dignity and greater equality."* [**The Irrelevance of Conventional Economics**, p. 47]

Which explains, in part, why the 1960s and 1970s were marked by mass social protest against authority rather than von Hayek's *"Road to Serfdom."* It also explains why the NAIRU was so enthusiastically embraced and applied by the ruling class. When times are hard, workers with jobs think twice before standing up to their bosses and so work harder, for longer and in worse conditions. This ensures that surplus value is increased relative to wages (indeed, in the USA, real wages have stagnated since 1973 while profits have grown massively). In addition, such a policy ensures that political discussion about investment, profits, power and so on (*"the other institutional factors"*) are reduced and diverted because working class people are too busy trying to make ends meet. Thus the state intervenes in the economy to **stop** full employment developing to combat inflation and instability on behalf of the capitalist class.

That this state manipulation is considered consistent with the "free market" says a lot about the bankruptcy of the capitalist system and its defenders. But, then, for most defenders of the system state intervention on behalf of capital is part of the natural order, unlike state intervention (at least in rhetoric) on behalf of the working class (and shows that Kropotkin was right to stress that the state **never** practices "laissez-faire" with regard to the working class — see section D.1). Thus neo-liberal capitalism is based on monetary policy that explicitly tries to weaken working class resistance by means of unemployment. If "inflation" (i.e. labour income) starts to increase, interest rates are raised so causing unemployment and, it is hoped, putting the plebes back in their place. In other words, the road to private serfdom has been cleared of any barriers imposed on it by the rise of the working class movement and the policies of social democracy implemented after the Second World War to stop social revolution. This is the agenda pursued so strongly in America and Britain, imposed on the developing nations and urged upon Continental Europe.

Although the aims and results of the NAIRU should be enough to condemn it out of hand, it can be dismissed for other reasons. First and foremost, this "natural" rate is both invisible and can move. This means trying to find it is impossible (although it does not stop economists trying, and then trying again when rate inflation and unemployment rates refute the first attempt, and then trying again and again). In addition, it is a fundamentally a meaningless concept — you can prove anything with an invisible, mobile value — it is an non-refutable concept and so, fundamentally, non-scientific. Close inspection reveals natural rate theory to be akin to a religious doctrine. This is because it is not possible to conceive of a test that could possibly falsify the theory. When predictions of the natural rate turn out wrong (as they repeatedly have), proponents can simply assert that the natural rate has changed. That has led to the most recent incarnation of the theory in which the natural rate is basically the trend rate of unemployment. Whatever trend is observed is natural — case closed.

Since natural rate theory cannot be tested, a sensible thing would be to examine its assumptions for plausibility and reasonableness. However, Milton Friedman's early work on economic methodology blocks this route as he asserted that realism and plausibility of assumptions have no place in economics. With most economists blindly accepting this position, the result is a church in which entry is conditional on accepting particular assumptions about the working of markets. The net effect is to produce an ideology, an ideology which survives due to its utility to certain sections of society.

If this is the case, and it is, then any attempts to maintain the "natural" rate are also meaningless as the only way to discover it is to watch **actual** inflation levels and raising interest rates appropriately. Which means that people are being made unemployed on the off-chance that the unemployment level will drop below the (invisible and mobile) "natural" rate and harm the interests of the ruling class (high inflation rates harms interest incomes and full employment squeezes profits by increasing workers' power). This does not seem to bother most economists, for whom empirical evidence at the best of times is of little consequence. This is doubly true with the NAIRU, for with an invisible, mobile value, the theory is always true after the fact — if inflation rises as unemployment rises, then the natural rate has increased; if inflation falls as unemployment rises, it has fallen! As post-Keynesian economist James K. Galbraith noted in his useful critique of the NAIRU, *"as the real unemployment rate moves, the apparent NAIRU moves in its shadow"* and its *"estimates and re-estimates seem largely a response to predictive failure. We still have no theory, and no external evidence, governing the fall of the estimated NAIRU. The literature simply observes that inflation hasn't occurred and so the previous estimate must have been too high."* He stresses, economists have held *"to a concept in the face of twenty years of unexplained variation, predictive failure, and failure of the profession to coalesce on procedural issues."* [**Created Unequal**, p. 180] Given that most mainstream economists subscribe to this fallacy, it just shows how the "science" accommodates itself to the needs of the powerful and how the powerful will turn to any old nonsense if it suits their purpose. A better example of supply and demand for ideology could not be found.

So, supporters of "free market" capitalism do have a point, "actually existing capitalism" has created high levels of unemployment. What **is** significant is that most supporters of capitalism consider that this is a laissez-faire policy! Sadly, the ideological supporters of pure capitalism rarely mention this state intervention on behalf of the capitalist class, preferring to attack trade unions, minimum wages, welfare and numerous other "imperfections" of the labour market which, strangely, are designed (at least in rhetoric) to benefit working class people. Ignoring that issue, however, the question now arises, would a "purer" capitalism create full employment?

First, we should point out that some supporters of "free market" capitalism (most notably, the "Austrian" school) claim that real markets are not in equilibrium at all, i.e. that the nature state of the economy is one of disequilibrium. As we noted in section C.1.6, this means full employment is impossible as this is an equilibrium position but few explicitly state this obvious conclusion of their own theories and claim against logic that full employment can occur (full employment, it should be stressed, has never meant 100% employment as they will always be some people looking for a job and so by that term we mean close to 100% employment). Anarchists agree: full employment can occur in "free market" capitalism but not for ever nor even for long periods. As the Polish socialist economist Michal Kalecki pointed out in regards to pre-Keynesian capitalism, *"[n]ot only is there mass unemployment in the slump, but average employment throughout the cycle is considerably below the peak reached in the boom. The reserve of capital equipment and the reserve army of unemployed are typical features of capitalist economy at least throughout a considerable part of the [business] cycle."* [quoted by Malcolm C. Sawyer, **The Economics of Michal Kalecki**, pp. 115–6]

It is doubtful that "pure" capitalism will be any different. This is due to the nature of the system. What is missing from the orthodox analysis is an explicit discussion of class and class struggle (implicitly, they are there and almost always favour the bosses). Once this is included, the functional reason for unemployment becomes clear. It serves to discipline the workforce, who will tolerate being bossed about much more with the fear that unemployment brings. This holds down wages as the threat of unemployment decreases the bargaining power of workers. This means that unemployment is not only a natural product of capitalism, it is an essential part of it.

So cycles of short periods approaching full employment and followed by longer periods of high unemployment are actually a more likely outcome of pure capitalism than continued full employment. As we argued in sections C.1.5 and C.7.1 capitalism needs unemployment to function successfully and so "free market" capitalism will experience periods of boom and slump, with unemployment increasing and decreasing over time (as can be seen from 19th century capitalism). So as Juliet Schor, a labour economist, put it, usually *"employers have a structural advantage in the labour market, because there are typically more candidates ready and willing to endure this work marathon [of long hours] than jobs for them to fill."* Under conditions of full-employment *"employers are in danger of losing the upper hand"* and hiring new workers *"suddenly becomes much more difficult. They are harder to find, cost more, and are less experienced."* These considerations *"help explain why full employment has been rare."* Thus competition in the labour market is *"typically skewed in favour of employers: it is a buyers market. And in a buyer's market, it is the sellers who compromise."* In the end, workers adapt to this inequality of power and instead of getting what they want, they want what they get (to use Schor's expression). Under full employment this changes. In such a situation it is the bosses who have to start compromising. And they do not like it. As Schor notes, America *"has never experienced a sustained period of full employment. The closest we have gotten is the late 1960s, when the overall unemployment rate was under 4 percent for four years. But that experience does more to prove the point than any other example. The trauma caused to business by those years of a tight labour market was considerable. Since then, there has been a powerful consensus that the nation cannot withstand such a low rate of unemployment."* Hence the support for the NAIRU to ensure that *"forced idleness of some helps perpetuate the forced overwork of others."* [**The Overworked American**, p. 71, p. 75, p. 129, pp. 75–76 and p. 76]

So, full employment under capitalism is unlikely to last long (nor would full employment booms fill a major part of the business cycle). In addition, it should be stressed that the notion that capitalism naturally stays at equilibrium or that unemployment is temporary adjustments is false, even given the logic of capitalist economics. As Proudhon argued:

> *"The economists admit it [that machinery causes unemployment]: but here they repeat their eternal refrain that, after a lapse of time, the demand for the product having increased in proportion to the reduction in price [caused by the investment], labour in turn will come finally to be in greater demand than ever. Undoubtedly,* ***with time,*** *the equilibrium will be restored; but I must add again, the equilibrium will be no sooner restored at this point than it will be disturbed at another, because the spirit of invention never stops."* [**System of Economical Contradictions**, pp. 200–1]

That capitalism creates permanent unemployment and, indeed, needs it to function is a conclusion that few, if any, pro-"free market" capitalists subscribe to. Faced with the empirical evidence that full employment is rare in capitalism, they argue that reality is not close enough to their theories and must be changed (usually by weakening the power of labour by welfare "reform" and reducing "union power"). Thus reality is at fault, not the theory (to re-quote Proudhon, *"Political economy — that is, proprietary despotism — can never be in the wrong: it must be the proletariat."* [**Op. Cit**. p. 187]) So if unemployment exists, then its because real wages are too high, not because capitalists need unemployment to discipline labour (see section C.9.2 for evidence that this argument is false). Or if real wages are falling as unemployment is rising, it can only mean that the real wage is not falling fast enough — empirical evidence is never enough to falsify logical deductions from assumptions!

(As an aside, it is one of amazing aspects of the "science" of economics that empirical evidence is never enough to refute its claims. As the Post-Keynesian economist Nicholas Kaldor once pointed out, *"[b]ut unlike any scientific theory, where the basic assumptions are chosen on the basis of direct observation of the phenomena the behaviour of which forms the subject-matter of the theory, the basic assumptions of economic theory are either of a kind that are unverifiable… or of a kind which are directly contradicted by observation."* [**Further Essays on Applied Economics**, pp. 177–8])

Of course, reality often has the last laugh on any ideology. For example, since the late 1970s and early 1980s right-wing capitalist parties have taken power in many countries across the world. These regimes made many pro-free market reforms, arguing that a dose of market forces would lower unemployment, increase growth and so on. The reality proved somewhat different. For example, in the UK, by the time the Labour Party under Tony Blair come back to office in 1997, unemployment (while falling) was still higher than it had been when the last Labour government left office in 1979 (this in spite of repeated redefinitions of unemployment by the Tories in the 1980s to artifically reduce the figures). 18 years of labour market reform had **not** reduced unemployment even under the new definitions. This outcome was identical to New Zealand's neo-liberal experiment, were its overall effect was unimpressive, to say the least: lower growth, lower productivity and feeble real wage increases combined with rising inequality and unemployment. Like the UK, unemployment was still higher in 1997 than it had been in 1979. Over a decade of "flexible" labour markets had increased unemployment (more than doubling it, in fact, at one point as in the UK under Thatcher). It is no understatement to argue, in the words of two critics of neo-liberalism, that the *"performance of the world economy since capital was liberalised has been worse than when it was tightly controlled"* and that *"[t]hus far, [the] actual performance [of liberalised capitalism] has not lived up to the propaganda."* [Larry Elliot and Dan Atkinson, **The Age of Insecurity**, p. 274 and p. 223] In fact, as Palley notes, *"wage and income growth that would have been deemed totally unsatisfactory a decade ago are now embraced as outstanding economic performance."* [**Op. Cit.**, p. 202]

Lastly, it is apparent merely from a glance at the history of capitalism during its laissez-faire heyday in the 19th century that "free" competition among workers for jobs does not lead to full employment. Between 1870 and 1913, unemployment was at an average of 5.7% in the 16 more advanced capitalist countries. This compares to an average of 7.3% in 1913–50 and 3.1% in 1950–70. [Takis Fotopoulos, *"The Nation-State and the Market"*, pp. 37–80, **Society and Nature**, Vol. 2, No. 2, p. 61] If laissez-faire did lead to full employment, these figures would, surely, be reversed.

As discussed above, full employment **cannot** be a fixed feature of capitalism due to its authoritarian nature and the requirements of production for profit. To summarise, unemployment has more to do with private property than the wages of our fellow workers or any social safety nets working class movements have managed to pressure the ruling class to accept. However, it is worthwhile to discuss why the "free market" capitalist is wrong to claim that unemployment within their system will not exist for long periods of time. In addition, to do so will also indicate the poverty of their theory of, and "solution" to, unemployment and the human misery they would cause. We do this in the next section.

C.9.1 Would cutting wages reduce unemployment?

The "free market" capitalist (i.e., neo-classical, neo-liberal or "Austrian") argument is that unemployment is caused by the real wage of labour being higher than the market clearing level. The basic argument is that the market for labour is like any other market and as the price of a commodity increases, the demand for it falls. In terms of labour, high prices (wages) causes lower demand (unemployment). Workers, it is claimed, are more interested in money wages than real wages (which is the amount of goods they can buy with their money wages). This leads them to resist wage cuts even when prices are falling, leading to a rise in their real wages and so they price themselves out of work without realising it. From this analysis comes the argument that if workers were allowed to compete 'freely' among themselves for jobs, real wages would decrease and so unemployment would fall. State intervention (e.g. unemployment benefit, social welfare programmes, legal rights to organise, minimum wage laws, etc.) and labour union activity are, according to this theory, the cause of unemployment, as such intervention and activity forces wages above their market level and so force employers to "let people go." The key to ending unemployment is simple: cut wages.

This position was brazenly put by "Austrian" economist Murray Rothbard. He opposed any suggestion that wages should **not** be cut as the notion that *"the first shock of the depression must fall on profits and not on wages."* This was *"precisely the reverse of sound policy since profits provide the motive power for business activity."* [**America's Great Depression**, p. 188] Rothbard's analysis of the Great Depression is so extreme it almost reads like a satirical attack on the laissez-faire position as his hysterical anti-unionism makes him blame unions for the depression for, apparently, merely existing (even in an extremely weakened state) for their influence was such as to lead economists and the President to recommend to numerous leading corporate business men **not** to cut wages to end the depression (wages were cut, but not sufficiently as prices also dropped as we will discuss in the next section). It should be noted that Rothbard takes his position on wage cutting despite of an account of the business cycle rooted in bankers lowering interest rates and bosses over-investing as a result (see section C.8). So despite not setting interest rates nor making investment decisions, he expected working class people to pay for the actions of bankers and capitalists by accepting lower wages! Thus working class people must pay the price of the profit seeking activities of their economic masters who not only profited in good times, but can expect others to pay the price in bad ones. Clearly, Rothbard took the first rule of economics to heart: the boss is always right.

The chain of logic in this explanation for unemployment is rooted in many of the key assumptions of neo-classical and other marginalist economics. A firm's demand for labour (in this schema) is the marginal physical product of labour multiplied by the price of the output and so it is dependent on marginal productivity theory. It is assumed that there are diminishing returns and marginal productivity as only this produces a downward-sloping labour demand curve. For labour, it is assumed that its supply curve is upwards slopping. So it must be stressed that marginal productivity theory lies at the core of "free market" capitalist theories of output and distribution and so unemployment as the marginal product of labour is interpreted as the labour demand curve. This enforces the viewpoint that unemployment is caused by wages being too high as firms adjust production to bring the marginal cost of their products (the cost of producing one more item) into equality with the product's market-determined price. So a drop in labour costs theoretically leads to an expansion in production, producing jobs for the "temporarily" unemployed and moving the economy toward full-employment. So, in this theory, unemployment can only be reduced by lowering the real wages of workers currently employed. Thus the unfettered free market would ensure that all those who want to work at the equilibrium real wage will do so. By definition, any people who were idle in such a pure capitalism would be voluntarily enjoying leisure and **not** unemployed. At worse, mass unemployment would be a transitory disturbance which will quickly disappear if the market is flexible enough and there are no imperfections in it (such as trade unions, workers' rights, minimum wages, and so on).

Sadly for these arguments, the assumptions required to reach it are absurd as the conclusions (namely, that there is no involuntary unemployment as markets are fully efficient). More perniciously, when confronted with the reality of unemployment, most supporters of this view argue that it arises only because of government-imposed rigidities and trade unions. In their "ideal" world without either, there would, they claim, be no unemployment. Of course, it is much easier to demand that nothing should be done to alleviate unemployment and that workers' real wages be reduced when you are sitting in a tenured post in academia save from the labour market forces you wish others to be subjected to (in their own interests).

This perspective suffered during the Great Depression and the threat of revolution produced by persistent mass unemployment meant that dissident economists had space to question the orthodoxy. At the head of this re-evaluation was Keynes who presented an alternative analysis and solution to the problem of unemployment in his 1936 book **The General Theory of Employment, Interest and Money** (it should be noted that the Polish socialist economist Michal Kalecki independently developed a similar theory a few years before Keynes but without the neo-classical baggage Keynes brought into his work).

Somewhat ironically, given the abuse he has suffered at the hands of the right (and some of his self-proclaimed followers), Keynes took the assumptions of neo-classical economics on the labour market as the starting point of his analysis. As such, critics of Keynes's analysis generally misrepresent it. For example, right-liberal von Hayek asserted that Keynes *"started from the correct insight that the regular cause of extensive unemployment is real wages that are too high. The next step consisted in the proposition that a direct lowering of money wages could be brought about only by a struggle so painful and prolonged that it could not be contemplated. Hence he concluded that real wages must be lowered by the process of lowering the value of money,"* i.e. by inflation. Thus *"the supply of money must be so increased as to raise prices to a level where the real value of the prevailing money wage is no longer greater than the productivity of the workers seeking employment."* [**The Constitution of Liberty**, p. 280] This is echoed by libertarian Marxist Paul Mattick who presented an identical argument, stressing that for Keynes *"wages were less flexible than had been generally assumed"* and lowering real wages by inflation *"allowed for more subtle ways of wage-cutting than those traditionally employed."* [**Marx and Keynes**, p. 7]

Both are wrong. These arguments are a serious distortion of Keynes's argument. While he did start by assuming the neo-classical position that unemployment was caused by wages being too high, he was at pains to stress that even with ideally flexible labour markets cutting real wages would **not** reduce unemployment. As such, Keynes argued that unemployment was **not** caused by labour resisting wage cuts or by "sticky" wages. Indeed, any "Keynesian" economist who does argue that "sticky" wages are responsible for unemployment shows that he or she has not read Keynes — Chapter two of the **General Theory** critiques precisely this argument. Taking neo-classical economists at its word, Keynes analyses what would happen **if** the labour market were perfect and so he assumes the same model as his neo-classical opponents, namely that unemployment is caused by wages being too high and there is flexibility in both commodity and labour markets. As he stressed, his *"criticism of the accepted [neo-]classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world."* [**The General Theory**, p. 378]

What Keynes did was to consider the **overall** effect of cutting wages on the economy as a whole. Given that wages make up a significant part of the costs of a commodity, *"if money-wages change, one would have expected the [neo-]classical school to argue that prices would change in almost the same proportion, leaving the real wage and the level of unemployment practically the same as before."* However, this was not the case, causing Keynes to point out that they *"do not seem to have realised that … their supply curve for labour will shift bodily with every movement of prices."* This was because labour cannot determine its own real wage as prices are controlled by bosses. Once this is recognised, it becomes obvious that workers do not control the cost of living (i.e., the real wage). Therefore trade unions *"do not raise the obstacle to any increase in aggregate employment which is attributed to them by the [neo-]classical school."* So while workers could, in theory, control their wages by asking for less pay (or, more realistically, accepting any wage cuts imposed by their bosses as the alternative is unemployment) they do not have any control over the prices of the goods they produce. This means that they have **no** control over their real wages and so **cannot** reduce unemployment by pricing themselves into work by accepting lower wages. Given these obvious facts, Keynes concluded that there was *"no ground for the belief that* *a flexible wage policy is capable of continuous full employment ... The economic system cannot be made self-adjusting along these lines."* [**Op. Cit.**, p. 12, pp. 8–9, p. 15 and p. 267] As he summarised:

> *"the contention that the unemployment which characterises a depression is due to a refusal by labour to accept a reduction of money-wages is not clearly supported by the facts. It is not very plausible to assert that unemployment in the United States in 1932 was due either to labour obstinately refusing to accept a reduction of money-wages or to its demanding a real wage beyond what the productivity of the economic machine was capable of furnishing ... Labour is not more truculent in the depression than in the boom — far from it. Nor is its physical productivity less. These facts from experience are a* ***prima facie*** *ground for questioning the adequacy of the [neo-]classical analysis."* [**Op. Cit.**, p. 9]

This means that the standard neo-classical argument was flawed. While cutting wages may make sense for one firm, it would not have this effect throughout the economy as is required to reduce unemployment as a whole. This is another example of the fallacy of composition. What may work with an individual worker or firm will not have the same effect on the economy as a whole for cutting wages for all workers would have a massive effect on the aggregate demand for their firms products.

For Keynes and Kalecki, there were two possibilities if wages were cut. One possibility, which Keynes considered the most likely, would be that a cut in money wages across the whole economy would see a similar cut in prices. The net effect of this would be to leave real wages unchanged. The other assumes that as wages are cut, prices remain prices remained unchanged or only fell by a small amount (i.e. if wealth was redistributed from workers to their employers). This is the underlying assumption of "free market" argument that cutting wages would end the slump. In this theory, cutting real wages would increase profits and investment and this would make up for any decline in working class consumption and so its supporters reject the claim that cutting real wages would merely decrease the demand for consumer goods without automatically increasing investment sufficiently to compensate for this.

However, in order make this claim, the theory depends on three critical assumptions, namely that firms can expand production, that they will expand production, and that, if they do, they can sell their expanded production. This theory and its assumptions can be questioned. To do so we will draw upon David Schweickart's excellent summary. [**Against Capitalism**, pp. 105–7]

The first assumption states that it is always possible for a company to take on new workers. Yet increasing production requires more than just labour. Tools, raw materials and work space are all required in addition to new workers. If production goods and facilities are not available, employment will not be increased. Therefore the assumption that labour can always be added to the existing stock to increase output is plainly unrealistic, particularly if we assume with neo-classical economics that all resources are fully utilised (for an economy operating at less than full capacity, the assumption is somewhat less inappropriate).

Next, will firms expand production when labour costs decline? Hardly. Increasing production will increase supply and eat into the excess profits resulting from the fall in wages (assuming, of course, that demand holds up in the face of falling wages). If unemployment did result in a lowering of the general market wage, companies might use the opportunity to replace their current workers or force them to take a pay cut. If this happened, neither production nor employment would increase. However, it could be argued that the excess profits would increase capital investment in the economy (a key assumption of neo-liberalism). The reply is obvious: perhaps, perhaps not. A slumping economy might well induce financial caution and so capitalists could stall investment until they are convinced of the sustained higher profitability will last.

This feeds directly into the last assumption, namely that the produced goods will be sold. Assuming that money wages are cut, but prices remain the same then this would be a cut in real wages. But when wages decline, so does worker purchasing power, and if this is not offset by an increase in spending elsewhere, then total demand will decline. However, it can be argued that not everyone's real income would fall: incomes from profits would increase. But redistributing income from workers to capitalists, a group who tend to spend a smaller portion of their income on consumption than do workers, could reduce effective demand and increase unemployment. Moreover, business does not (cannot) instantaneously make use of the enlarged funds resulting from the shift of wages to profit for investment (either because of financial caution or lack of existing facilities). In addition, which sane company would increase investment in the face of falling demand for its products? So when wages decline, so does workers' purchasing power and this is unlikely to be offset by an increase in spending elsewhere. This will lead to a reduction in aggregate demand as profits are accumulated but unused, so leading to stocks of unsold goods and renewed price reductions. This means that the cut in real wages will be cancelled out by price cuts to sell unsold stock and unemployment remains. In other words, contrary to neo-classical economics, a fall in wages may result in the same or even more unemployment as aggregate demand drops and companies cannot find a market for their goods. And so, *"[i]f prices do not fall, it is still worse, for then real wages are reduced and unemployment is increased directly by the fall in the purchase of consumption goods."* [Joan Robinson, **Further Contributions to Economics**, p. 34]

The "Pigou" (or *"real balance"*) effect is another neo-classical argument that aims to prove that (in the end) capitalism will pass from slump to boom quickly. This theory argues that when unemployment is sufficiently high, it will lead to the price level falling which would lead to a rise in the real value of the money supply and so increase the real value of savings. People with such assets will have become richer and this increase in wealth will enable people to buy more goods and so investment will begin again. In this way, slump passes to boom naturally.

However, this argument is flawed in many ways. In reply, Michal Kalecki argued that, firstly, Pigou had *"assumed that the banking system would maintain the stock of money constant in the face of declining incomes, although there was no particular reason why they should."* If the money stock changes, the value of money will also change. Secondly, that *"the gain in money holders when prices fall is exactly offset by the loss to money providers. Thus, whilst the real value of a deposit in bank account rises for the depositor when prices fell, the liability represented by that deposit for the bank also rises in size."* And, thirdly, *"that falling prices and wages would mean that the real value of outstanding debts would be increased, which borrowers would find it increasingly difficult to repay as their real income fails to keep pace with the rising real value of debt. Indeed, when the falling prices and wages are generated by low levels of demand, the aggregate real income will be low. Bankruptcies follow, debts cannot be repaid, and a confidence crisis was likely to follow."* In other words, debtors may cut back on spending more than creditors would increase it and so the depression would continue as demand did not rise. [Malcolm C. Sawyer, **The Economics of Michal Kalecki**, p. 90]

So, the traditional neo-classical reply that investment spending will increase because lower costs will mean greater profits, leading to greater savings, and ultimately, to greater investment is weak. Lower costs will mean greater profits only if the products are sold, which they might not be if demand is adversely affected. In other words, a higher profit margins do not result in higher profits due to fall in consumption caused by the reduction of workers purchasing power. And, as Michal Kalecki argued, wage cuts in combating a slump may be ineffective because gains in profits are not applied immediately to increase investment and the reduced purchasing power caused by the wage cuts causes a fall in sales, meaning that higher profit margins do not result in higher profits. Moreover, as Keynes pointed out long ago, the forces and motivations governing saving are quite distinct from those governing investment. Hence there is no necessity for the two quantities always to coincide. So firms that have reduced wages may not be able to sell as much as before, let alone more. In that case they will cut production, add to unemployment and further reduce demand. This can set off a vicious downward spiral of falling demand and plummeting production leading to depression, a process described by Kropotkin (nearly 40 years before Keynes made the same point in **The General Theory**):

> *"Profits being the basis of capitalist industry, low profits explain all ulterior consequences.*
>
> *"Low profits induce the employers to reduce the wages, or the number of workers, or the number of days of employment during the week… As Adam Smith said, low profits ultimately mean a reduction of wages, and low wages mean a reduced consumption by the worker. Low profits mean also a somewhat reduced consumption by the employer; and both together mean lower profits and reduced consumption with that immense class of middlemen which has grown up in manufacturing countries, and that, again, means a further reduction of profits for the employers."* [**Fields, Factories and Workshops Tomorrow**, p. 33]

So, as is often the case, Keynes was simply including into mainstream economics perspectives which had long been held by critics of capitalism and dismissed by the orthodoxy. Keynes' critique of Say's Law essentially repeated Marx's while Proudhon pointed out in 1846 that *"if the producer earns less, he will buy less"* and this will *"engender … over-production and destitution."* This was because *"though the workmen cost [the capitalist] something, they are [his] customers: what will you do with your products, when driven away by [him], they shall consume no longer?"* This means that cutting wages and employment would not work for they are *"not slow in dealing employers a counter-blow; for if production excludes consumption, it is soon obliged to stop itself."* [**System of Economical Contradictions**, p. 204 and p. 190] Significantly, Keynes praised Proudhon's follower Silvio Gesell for getting part of the answer and for producing *"an anti-Marxian socialism"* which the *"future will learn more from"* than Marx. [**Op. Cit.**, p. 355]

So far our critique of the "free market" position has, like Keynes's, been within the assumptions of that theory itself. More has to be said, though, as its assumptions are deeply flawed and unrealistic. It should be stressed that while Keynes's acceptance of much of the orthodoxy ensured that at least some of his ideas become part of the mainstream, Post-Keynesians like Joan Robinson would latter bemoan the fact that he sought a compromise rather than clean break with the orthodoxy. This lead to the rise of the post-war neo-classical synthesis, the so-called "Keynesian" argument that unemployment was caused by wages being "sticky" and the means by which the right could undermine social Keynesianism and ensure a return to neo-classical orthodoxy.

Given the absurd assumptions underlying the "free market" argument, a wider critique is possible as it reflects reality no more than any other part of the pro-capitalist ideology which passes for mainstream economics.

As noted above, the argument that unemployment is caused by wages being too high is part of the wider marginalist perspective. Flaws in that will mean that its explanation of unemployment is equally flawed. So it must be stressed that the marginalist theory of distribution lies at the core of its theories of both output and unemployment. In that theory, the marginal product of labour is interpreted as the labour demand curve as the firm's demand for labour is the marginal physical product of labour multiplied by the price of the output and this produces the viewpoint that unemployment is caused by wages being too high. So given the central role which marginal productivity theory plays in the mainstream argument, it is useful to start our deeper critique by re-iterating that, as indicated in section C.2, Joan Robinson and Piero Sraffa had successfully debunked this theory in the 1950s. *"Yet for psychological and political reasons,"* notes James K. Galbraith, *"rather than for logical and mathematical ones, the capital critique has not penetrated mainstream economics. It likely never will. Today only a handful of economists seem aware of it."* [*"The distribution of income"*, pp. 32–41, Richard P. F. Holt and Steven Pressman (eds.), **A New Guide to Post Keynesian Economics**, p. 34] Given that this underlies the argument that high wages cause high unemployment, it means that the mainstream argument for cutting wages has no firm theoretical basis.

It should also be noted that the assumption that adding more labour to capital is always possible flows from the assumption of marginal productivity theory which treats "capital" like an ectoplasm and can be moulded into whatever form is required by the labour available (see section C.2.5 for more discussion). Hence Joan Robinson's dismissal of this assumption, for *"the difference between the future and the past is eliminated by making capital 'malleable' so that mistakes can always be undone and equilibrium is always guaranteed… with 'malleable' capital the demand for labour depends on the level of wages."* [**Contributions to Modern Economics**, p. 6] Moreover, *"labour and capital are not often as smoothly substitutable for each other as the [neo-classical] model requires … You can't use one without the other. You can't measure the marginal productivity of one without the other."* Demand for capital and labour is, sometimes, a **joint** demand and so it is often to adjust wages to a worker's marginal productivity independent of the cost of capital. [Hugh Stretton, **Economics: A New Introduction**, p. 401]

Then there is the role of diminishing returns. The assumption that the demand curve for labour is always downward sloping with respect to aggregate employment is rooted in the notion that industry operates, at least in the short run, under conditions of diminishing returns. However, diminishing returns are **not** a feature of industries in the real world. Thus the assumption that the downward slopping marginal product of labour curve is identical to the aggregate demand curve for labour is not true as it is inconsistent with empirical evidence. *"In a system at increasing returns,"* noted one economist, *"the direct relation between real wages and employment tends to render the ordinary mechanism of wage adjustment ineffective and unstable."* [Ferdinando Targetti, **Nicholas Kaldor**, p. 344] In fact, as discussed in section C.1.2, without this assumption mainstream economics cannot show that unemployment is, in fact, caused by real wages being too high (along with many other things).

Thus, if we accept reality, we must end up *"denying the inevitability of a negative relationship between real wages and employment."* Post-Keynesian economists have not found any empirical links between the growth of unemployment since the early in 1970s and changes in the relationship between productivity and wages and so there is *"no theoretical reason to expect a negative relationship between employment and the real wage, even at the level of the individual firm."* Even the beloved marginal analysis cannot be used in the labour market, as *"[m]ost jobs are offered on a take-it-or-leave-it basis. Workers have little or no scope to vary hours of work, thereby making marginal trade-offs between income and leisure. There is thus no worker sovereignty corresponding to the (very controversial) notion of consumer sovereignty."* Over all, *"if a relationship exists between aggregate employment and the real wage, it is employment that determines wages. Employment and unemployment are product market variables, not labour market variables. Thus attempts to restore full employment by cutting wages are fundamentally misguided."* [John E. King, *"Labor and Unemployment,"* pp. 65–78, Holt and Pressman (eds.), **Op. Cit.**, p. 68, pp. 67–8, p. 72, p. 68 and p. 72] In addition:

> *"Neo-classical theorists themselves have conceded that a negative relationship between the real wage and the level of employment can be established only in a one-commodity model; in a multi-commodity framework no such generalisation is possible. This confines neo-classical theory to an economy without money and makes it inapplicable to a capitalist or entrepreneurial economy."* [**Op. Cit.**, p. 71]

And, of course, the whole analysis is rooted in the notion of perfect competition. As Nicholas Kaldor mildly put it:

> *"If economics had been a 'science' in the strict sense of the word, the empirical observation that most firms operate in imperfect markets would have forced economists to scrap their existing theories and to start thinking on entirely new lines … unfortunately economists do not feel under the same compulsion to maintain a close correspondence between theoretical hypotheses and the facts of experience."* [**Further Essays on Economic Theory ad Policy**, p. 19]

Any real economy is significantly different from the impossible notion of perfect competition and *"if there exists even one monopoly anywhere in the system … it follows that others must be averaging less than the marginal value of their output. So to concede the existence of monopoly requires that one either drop the competitive model entirely or construct an elaborate new theory … that divides the world into monopolistic, competitive, and subcompetitive ('exploited') sectors."* [James K. Galbraith, **Created Unequal**, p. 52] As noted in section C.4.3, mainstream economists have admitted that monopolistic competition (i.e., oligopoly) is the dominant market form but they cannot model it due to the limitations of the individualistic assumptions of bourgeois economics. Meanwhile, while thundering against unions the mainstream economics profession remains strangely silent on the impact of big business and pro-capitalist monopolies like patents and copyrights on distribution and so the impact of real wages on unemployment.

All this means that *"neither the demand for labour nor the supply of labour depends on the real wage. It follows from this that the labour market is not a true market, for the price associated with it, the wage rate, is incapable of performing any market-clearing function, and thus variations in the wage rate cannot eliminate unemployment."* [King, **Op. Cit.**, p. 65] As such, the *"conventional* *economic analysis of markets ... is unlikely to apply"* to the labour market and as a result *"wages are highly unlikely to reflect workers' contributions to production."* This is because economists treat labour as no different from other commodities yet *"economic theory supports no such conclusion."* At its most basic, labour is **not** produced for profit and the *"supply curve for labour can 'slope backward' — so that a fall in wages can cause an increase in the supply of workers."* In fact, the idea of a backward sloping supply curve for labour is just as easy to derive from the assumptions used by economists to derive their standard one. This is because workers may prefer to work less as the wage rate rises as they will be better off even if they do not work more. Conversely, very low wage rates are likely to produce a very high supply of labour as workers need to work more to meet their basic needs. In addition, as noted at the end of section C.1.4, economic theory itself shows that workers will not get a fair wage when they face very powerful employers unless they organise unions. [Steve Keen, **Debunking Economics**, pp. 111–2 and pp. 119–23]

Strong evidence that this model of the labour market can be found from the history of capitalism. Continually we see capitalists turn to the state to ensure low wages in order to ensure a steady supply of labour (this was a key aim of state intervention during the rise of capitalism, incidentally). For example, in central and southern Africa mining companies tried to get locals to labour. They had little need for money, so they worked a day or two then disappeared for the rest of the week. To avoid simply introducing slavery, some colonial administrators introduced and enforced a poll-tax. To earn enough to pay it, workers had to work a full week. [Hugh Stretton, **Op. Cit.**, p. 403] Much the same was imposed on British workers at the dawn of capitalism. As Stephen Marglin points out, the *"indiscipline of the labouring classes, or more bluntly, their laziness, was widely noted by eighteenth century observers."* By laziness or indiscipline, these members of the ruling class meant the situation where *"as wages rose, workers chose to work less."* In economic terms, *"a backward bending labour supply curve is a most natural phenomenon as long as the individual worker controls the supply of labour."* However, *"the fact that higher wages led workers to choose more leisure ... was disastrous"* for the capitalists. Unsurprisingly, the bosses did not meekly accept the workings of the invisible hand. Their *"first recourse was to the law"* and they *"utilised the legislative, police and judicial powers of the state"* to ensure that working class people had to supply as many hours as the bosses demanded. [*"What do Bosses do?"*, pp. 60–112, **Review of Radical Political Economy**, Vol. 6, No. 2, pp. 91–4]

This means that the market supply curve *"could have any shape at all"* and so economic theory *"fails to prove that employment is determined by supply and demand, and reinforces the real world observation that involuntary unemployment can exist"* as reducing the wage need not bring the demand and supply of labour into alignment. While the possibility of backward-bending labour supply curves is sometimes pointed out in textbooks, the assumption of an upward sloping supply curve is taken as the normal situation but *"there is no theoretical — or empirical — justification for this."* Sadly for the world, this assumption is used to draw very strong conclusions by economists. The standard arguments against minimum wage legislation, trade unions and demand management by government are all based on it. Yet, as Keen notes, such important policy positions *"should be based upon robust intellectual or empirical foundations, rather than the flimsy substrate of mere fancy. Economists are quite prone to dismiss alternative perspectives on labour market policy on this very basis — that they lack any theoretical or empirical foundations. Yet their own policy positions are based as much on wishful thinking as on wisdom."* [**Op. Cit.**, pp. 121–2 and p. 123]

Within a capitalist economy the opposite assumption to that taken by economics is far more likely, namely that there **is** a backward sloping labour supply curve. This is because the decision to work is **not** one based on the choice between wages and leisure made by the individual worker. Most workers do **not** choose whether they work or not, and the hours spent working, by comparing their (given) preferences and the level of real wages. They do **not** practice voluntary leisure waiting for the real wage to exceed their so-called *"reservation"* wage (i.e. the wage which will tempt them to forsake a life of leisure for the disutility of work). Rather, most workers have to take a job because they do not have a choice as the alternative is poverty (at best) or starvation and homelessness (at worse). The real wage influences the decision on how much labour to supply rather than the decision to work or not. This is because as workers and their families have a certain basic living standard to maintain and essential bills which need to be paid. As earnings increase, basic costs are covered and so people are more able to work less and so the supply of labour tends to fall. Conversely, if real earnings fall because the real wage is less then the supply of labour may **increase** as people work more hours and/or more family members start working to make enough to cover the bills (this is because, once in work, most people are obliged to accept the hours set by their bosses). This is the opposite of what happens in "normal" markets, where lower prices are meant to produce a **decrease** in the amount of the commodity supplied. In other words, the labour market is not a market, i.e. it reacts in different ways than other markets (Stretton provides a good summary of this argument [**Op. Cit.**, pp. 403–4 and p. 491]).

So, as radical economists have correctly observe, such considerations undercut the "free market" capitalist contention that labour unions and state intervention are responsible for unemployment (or that depressions will easily or naturally end by the workings of the market). To the contrary, insofar as labour unions and various welfare provisions prevent demand from falling as low as it might otherwise go during a slump, they apply a brake to the downward spiral. Far from being responsible for unemployment, they actually mitigate it. For example, unions, by putting purchasing power in the hands of workers, stimulates demand and keeps employment higher than the level it would have been. Moreover, wages are generally spent immediately and completely whilst profits are not. A shift from profits to wages may stimulate the economy since more money is spent but there will be a delayed cut in consumption out of profits. [Malcolm Sawyer, **The Economics of Michal Kalecki**, p. 118] All this should be obvious, as wages (and benefits) may be costs for some firms but they are revenue for even more and labour is not like other commodities and reacts in changes in price in different ways.

Given the dynamics of the labour "market" (if such a term makes much sense given its atypical nature), any policies based on applying "economics 101" to it will be doomed to failure. As such, any book entitled **Economics in One Lesson** must be viewed with suspicion unless it admits that what it expounds has little or no bearing to reality and urges the reader to take at least the second lesson. Of course, a few people actually do accept the simplistic arguments that reside in such basic economics texts and think that they explain the world (these people usually become right-"libertarians" and spend the rest of their lives ignoring their own experience and reality in favour of a few simple axioms). The wage-cutting argument (like most of economics) asserts that any problems are due to people not listening to economists and that there is no economic power, there are no "special interests" — it is just that people are stupid. Of course, it is irrelevant that it is much easier to demand that workers' real wages be reduced when you are sitting in a tenured post in academia. True to their ideals and "science", it is refreshing to see how many of these "free market" economists renounce tenure so that their wages can adjust automatically as the market demand for their ideologically charged comments changes.

So when economic theories extol suffering for future benefits, it is always worth asking who suffers, and who benefits. Needless to say, the labour market flexibility agenda is anti-union, anti-minimum wage, and anti-worker protection. This agenda emerges from theoretical claims that price flexibility can restore full employment, and it rests dubious logic, absurd assumptions and on a false analogy comparing the labour market with the market for peanuts. Which, ironically, is appropriate as the logic of the model is that workers will end up working for peanuts! As such, the "labour market" model has a certain utility as it removes the problem of institutions and, above all, power from the perspective of the economist. In fact, institutions such as unions can only be considered as a problem in this model rather than a natural response to the unique nature of the labour "market" which, despite the obvious differences, most economists treat like any other.

To conclude, a cut in wages may deepen any slump, making it deeper and longer than it otherwise would be. Rather than being the solution to unemployment, cutting wages will make it worse (we will address the question of whether wages being too high actually causes unemployment in the first place, in the next section). Given that, as we argued in section C.8.2, inflation is caused by insufficient profits for capitalists (they try to maintain their profit margins by price increases) this spiralling effect of cutting wages helps to explain what economists term *"stagflation"* — rising unemployment combined with rising inflation (as seen in the 1970s). As workers are made unemployed, aggregate demand falls, cutting profit margins even more and in response capitalists raise prices in an attempt to recoup their losses. Only a very deep recession can break this cycle (along with labour militancy and more than a few workers and their families).

Thus the capitalist solution to crisis is based on working class people paying for capitalism's contradictions. For, according to the mainstream theory, when the production capacity of a good exceeds any reasonable demand for it, the workers must be laid off and/or have their wages cut to make the company profitable again. Meanwhile the company executives — the people responsible for the bad decisions to build lots of factories — continue to collect their fat salaries, bonuses and pensions, and get to stay on to help manage the company through its problems. For, after all, who better, to return a company to profitability than those who in their wisdom ran it into bankruptcy? Strange, though, no matter how high their salaries and bonuses get, managers and executives **never** price **themselves** out of work.

All this means that working class people have two options in a slump — accept a deeper depression in order to start the boom-bust cycle again or get rid of capitalism and with it the contradictory nature of capitalist production which produces the business cycle in the first place (not to mention other blights such as hierarchy and inequality). In the end, the only solution to unemployment is to get rid of the system which created it by workers seizing their means of production and abolishing the state. When this happens, then production for the profit of the few will be ended and so, too, the contradictions this generates.

C.9.2 Is unemployment caused by wages being too high?

As we noted in the last section, most capitalist economic theories argue that unemployment is caused by wages being too high. Any economics student will tell you that labour is like any other commodity and so if its price is too high then there will be less demand for it, so producing an excess supply of it on the market. Thus high wages will reduce the quantity of labour demanded and so create unemployment — a simple case of "supply and demand."

From this theory we would expect that areas and periods with high wages will also have high levels of unemployment. Unfortunately for the theory, this does not seem to be the case. Even worse for it, high wages are generally associated with booms rather than slumps and this has been known to mainstream economics since at least 1939 when in March of that year **The Economic Journal** printed an article by Keynes about the movement of real wages during a boom in which he evaluated the empirical analysis of two labour economists (entitled *"Relative Movements of Real Wages and Output"* this is contained as an Appendix of most modern editions of **The General Theory**).

These studies showed that *"when money wages are rising, real wages have usually risen too; whilst, when money wages are falling, real wages are no more likely to rise than to fall."* Keynes admitted that in **The General Theory** he was *"accepting, without taking care to check the facts"*, a *"widely held"* belief. He discussed where this belief came from, namely leading 19th century British economist Alfred Marshall who had produced a *"generalisation"* from a six year period between 1880–86 which was not true for the subsequent business cycles of 1886 to 1914. He also quotes another leading economist, Arthur Pigou, from 1927 on how *"the upper halves of trade cycles have, on the whole, been associated with higher rates of real wages than the lower halves"* and indicates that he provided evidence on this from 1850 to 1910 (although this did not stop Pigou reverting to the *"Marshallian tradition"* during the Great Depression and blaming high unemployment on high wages). [**The General Theory**, p. 394, p. 398 and p. 399] Keynes conceded the point, arguing that he had tried to minimise differences between his analysis and the standard perspective. He stressed that while he assumed countercyclical real wages his argument did not depend on it and given the empirical evidence provided by labour economists he accepted that real wages were pro-cyclical in nature.

The reason why this is the case is obvious given the analysis in the last section. Labour does not control prices and so cannot control its own real wage. Looking at the Great Depression, it seems difficult to blame it on workers refusing to take pay cuts when by 1933 *"wages and salaries in U.S. manufacturing were less than half their 1929 levels and, in automobiles and steel, were under 40 percent of the 1929 levels."* In Detroit, there had been 475,000 auto-workers. By 1931 *"almost half has been laid off."* [William Lazonick, **Competitive Advantage on the Shop Floor**, p. 271] The notion of all powerful unions or workers' resistance to wage cuts causing high unemployment hardly fits these facts. Peter Temin provides information on real wages in manufacturing during the depression years. Using 1929 as the base year, weekly average real wages (i.e., earnings divided by the consumer price index) fell each year to reach a low of 85.5% by 1932. Hourly real wages remained approximately constant (rising to 100.1% in 1930 and then 102.6% in 1931 before falling to 99% in 1932). The larger fall in weekly wages was due to workers having a shorter working week. The *"effect of shorter hours and lower wages was to decrease the income of employed workers."* Thus the notion that lowering wages will increase employment seems as hard to support as the notion that wages being too high caused the depression in the first place. Temin argues, *"no part of the [neo-]classical story is accurate."* [**Did Monetary Forces Cause the Great Depression?**, pp. 139–40] It should be noted that the consensus of economists is that during this period the evidence seems to suggest that real wages **did** rise overall. This was because the prices of commodities fell faster than did the wages paid to workers. Which confirms Keynes, as he had argued that workers cannot price themselves into work as they have no control over prices. However, there is no reason to think that high real wages caused the high unemployment as the slump itself forced producers to cut prices (not to mention wages). Rather, the slump caused the increase in real wages.

Since then, economists have generally confirmed that real wage are procyclical. In fact, *"a great deal of empirical research has been conducted in this area — research which mostly contradicts the neo-classical assumption of an inverse relation between real wages and employment."* [Ferdinando Targetti, **Nicholas Kaldor**, p. 50] Nicholas Kaldor, one of the first Keynesians, also stressed that the notion that there is an inverse relationship between real wages and employment is *"contradicted by numerous empirical studies which show that, in the short period, changes in real wages are positively correlated with changes in employment and not negatively."* [**Further Essays on Economic Theory and Policy**, p. 114fn] As Hugh Stretton summarises in his excellent introductory text on economics:

> *"In defiance of market theory, the demand for labour tends strongly to vary **with** its price, not inversely to it. Wages are high when there is full employment. Wages — especially for the least-skilled and lowest paid — are lowest when there is least employment. The causes chiefly run from the employment to the wages, rather than the other way. Unemployment weakens the bargaining power, worsens the job security and working conditions, and lowers the pay of those still in jobs.*
>
> *"The lower wages do not induce employers to create more jobs … most business firms have no reason to take on more hands if wages decline. Only empty warehouses, or the prospect of more sales can get them to do that, and these conditions rarely coincide with falling employment and wages. The causes tend to work the other way: unemployment lowers wages, and the lower wages do not restore the lost employment."* [**Economics: A New Introduction**, pp. 401–2]

Will Hutton, the British neo-Keynesian economist, summarises research by two other economists that suggests high wages do not cause unemployment:

> *"the British economists David Blanchflower and Andrew Oswald [examined] … the data in twelve countries about the actual relation between wages and unemployment — and what they have discovered is another major challenge to the free market account of the labour market. Free market theory would predict that low wages would be correlated with low local unemployment; and high wages with high local unemployment.*
>
> *"Blanchflower and Oswald have found precisely the opposite relationship. The higher the wages, the lower the local unemployment — and the lower the wages, the higher the local unemployment. As they say, this is not a conclusion that can be squared with free market text-book theories of how a competitive labour market should work."* [**The State We're In**, p. 102]

Unemployment was highest where real wages were lowest and nowhere had falling wages being followed by rising employment or falling unemployment. Blanchflower and Oswald stated that their conclusion is that employees *"who work in areas of high unemployment earn less, other things constant, than those who are surrounded by low unemployment."* [**The Wage Curve**, p. 360]

This relationship, the exact opposite of that predicted by "free market" capitalist economics, was found in many different countries and time periods, with the curve being similar for different countries. Thus, the evidence suggests that high unemployment is associated with low earnings, not high, and vice versa.

Looking at less extensive evidence, if minimum wages and unions cause unemployment, why did the South-eastern states of the USA (with a **lower** minimum wage and weaker unions) have a **higher** unemployment rate than North-western states during the 1960s and 1970s? Or why, when the (relative) minimum wage declined under Reagan and Bush in the 1980s, did chronic unemployment accompany it? [Allan Engler, **The Apostles of Greed**, p. 107] Or the **Low Pay Network** report *"Priced Into Poverty"* which discovered that in the 18 months before they were abolished, the British Wages Councils (which set minimum wages for various industries) saw a rise of 18,200 in full-time equivalent jobs compared to a net loss of 39,300 full-time equivalent jobs in the 18 months afterwards. Given that nearly half the vacancies in former Wages Council sectors paid less than the rate which it is estimated Wages Councils would now pay, and nearly 15% paid less than the rate at abolition, there should (by the "free market" argument) have been rises in employment in these sectors as pay fell. The opposite happened. This research shows that the falls in pay associated with Wages Council abolition had not created more employment. Indeed, employment growth was more buoyant prior to abolition than subsequently. So whilst Wages Council abolition did not result in more employment, the erosion of pay rates caused by their abolition resulted in more families having to endure poverty pay. Significantly, the introduction of a national minimum wage by the first New Labour government did not have the dire impact "free market" capitalist economists and politicians predicted.

It should also be noted that an extensive analysis of the impact of minimum wage increases at the state level in America by economists David Card and Alan Kreuger found the facts contradicted the standard theory, with rises in the minimum wage having a small positive impact on both employment and wages for all workers. [**Myth and Measurement: The New Economics of the Minimum Wage**] While their work was attacked by business leaders and economists from think-tanks funded by them, Card and Kreuger's findings that raising the lowest wages had no effect on unemployment or decreased it proved to be robust. In particular, when replying to criticism of their work by other economists who based their work, in part, on data supplied by a business funded think-tank Card and Krueger discovered that not only was that work consistent with their original findings but that the *"only data set that indicates a significant decline in employment"* was by some amazing coincidence *"the small set of restaurants collected by"* the think tank. [*"Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply"*, pp. 1397–1420, **The American Economic Review**, Vol. 90, No. 5, p. 1419] For a good overview of *"how the fast food industry and its conservative allies sought to discredit two distinguished economists, and how the attack backfired"* when *"the two experts used by the fast food industry to impeach Card and Krueger, effectively ratified them"* see John Schmitt's *"Behind the Numbers: Cooked to Order."* [**The American Prospect**, May-June 1996, pp. 82–85]

(This does not mean that anarchists support the imposition of a legal minimum wage. Most anarchists do not because it takes the responsibility for wages from unions and other working class organisations, where it belongs, and places it in the hands of the state. We mention these examples in order to highlight that the "free market" capitalist argument has serious flaws with it.)

Empirical evidence does not support the argument the "free market" capitalist argument that unemployment is caused by real wages being too high. The phenomenon that real wages tend to increase during the upward swing of the business cycle (as unemployment falls) and fall during recessions (when unemployment increases) renders the standard interpretation that real wages govern employment difficult to maintain (real wages are *"pro-cyclical,"* to use economic terminology). This evidence makes it harder for economists to justify policies based on a direct attack on real wages as the means to cure unemployment.

While this evidence may come as a shock to those who subscribe to the arguments put forward by those who think capitalist economics reflect the reality of that system, it fits well with the anarchist and other socialist analysis. For anarchists, unemployment is a means of disciplining labour and maintaining a suitable rate of profit (i.e. unemployment is a key means of ensuring that workers are exploited). As full employment is approached, labour's power increases, so reducing the rate of exploitation and so increasing labour's share of the value it produces (and so higher wages). Thus, from an anarchist point of view, the fact that wages are higher in areas of low unemployment is not a surprise, nor is the phenomenon of pro-cyclical real wages. After all, as we noted in section C.3, the ratio between wages and profits are, to a large degree, a product of bargaining power and so we would expect real wages to grow in the upswing of the business cycle, fall in the slump and be high in areas of low unemployment.

The evidence therefore suggests that the "free market" capitalist claim that unemployment is caused by unions, "too high" wages, and so on, is false. Indeed, by stopping capitalists appropriating more of the income created by workers, high wages maintain aggregate demand and contribute to higher employment (although, of course, high employment cannot be maintained indefinitely under wage slavery due to the rise in workers' power this implies). Rather, unemployment is a key aspect of the capitalist system and cannot be got rid off within it. The "free market" capitalist "blame the workers" approach fails to understand the nature and dynamic of the system (given its ideological role, this is unsurprising). So high real wages for workers increases aggregate demand and reduces unemployment from the level it would be if the wage rate was cut. This is supported by most of the research into wage dynamics during the business cycle and by the *"wage curve"* of numerous countries. This suggests that the demand for labour is independent of the real wages and so the price of labour (wages) is incapable of performing any market clearing function. The supply and demand for labour are determined by two different sets of factors. The relationship between wages and unemployment flows from the latter to the former rather than the reverse: the wage is influenced by the level of unemployment. Thus wages are not the product of a labour market which does not really exist but rather is the product of *"institutions, customs, privilege, social relations, history, law, and above all power, with an admixture of ingenuity and luck. But of course power, and particularly market or monopoly power, changes with the general of demand, the rate of growth, and the rate of unemployment. In periods of high employment, the weak gain on the strong; in periods of high unemployment, the strong gain on the weak."* [Galbraith, **Created Unequal**, p. 266]

This should be obvious enough. It is difficult for workers to resist wage cuts and speeds-up when faced with the fear of mass unemployment. As such, higher rates of unemployment *"reduce labour's bargaining power vis-a-vis business, and this helps explain why wages have declined and workers have not received their share of productivity growth"* (between 1970 and 1993, only the top 20% of the US population increased its share of national income). [Thomas I. Palley, **Plenty of Nothing**, p. 55 and p. 58] Strangely, though, this obvious fact seems lost on most economists.

In fact, if you took their arguments seriously then you would have to conclude that depressions and recessions are the periods during which working class people do the best! This is on two levels. First, in neo-classical economics work is considered a disutility and workers decide not to work at the market-clearing real wage because they prefer leisure to working. Leisure is assumed to be intrinsically good and the wage the means by which workers are encouraged to sacrifice it. Thus high unemployment must be a good thing as it gives many more people leisure time. Second, for those in work their real wages are higher than before, so their income has risen. Alfred Marshall, for example, argued that in depressions money wages fell but not as fast as prices. A *"powerful friction"* stopped this, which *"establish[ed] a higher standard of living among the working classes"* and a *"diminish[ing of] the inequalities of wealth."* When asked whether during a period of depression the employed working classes got more than they did before, he replied *"[m]ore than they did before, on the average."* [quoted by Keynes, **Op. Cit.**, p. 396]

Thus, apparently, working class people do worse in booms than in slumps and, moreover, they can resist wage cuts more in the face of mass unemployment than in periods approaching full employment. That the theory which produced these conclusions could be taken remotely seriously shows the dangers of deducing an economic ideology from a few simple axioms rather than trusting in empirical evidence and common sense derived from experience. Nor should it come as too great a surprise, as "free market" capitalist economics tends to ignore (or dismiss) the importance of economic power and the social context within which individuals make their choices. As Bob Black acidly put it with regards to the 1980s, it *"wasn't the **workers** who took these gains [of increased productivity], not in higher wages, not in safer working conditions, and not in shorter hours — hours of work have **increased** … It must be, then, that in the 80s and after workers have 'chosen' lower wages, longer hours **and** greater danger on the job. Yeah, sure."* [*"Smokestack Lightning,"* pp. 43–62, **Friendly Fire**, p. 61]

In the real world, workers have little choice but to accept a job as they have no independent means to exist in a pure capitalist system and so no wages means no money for buying such trivialities as food and shelter. The decision to take a job is, for most workers, a non-decision — paid work is undertaken out of economic necessity and so we are not in a position to refuse work because real wages are too low to be worth the effort (the welfare state reduces this pressure, which is why the right and bosses are trying to destroy it). With high unemployment, pay and conditions will worsen while hours and intensity of labour will increase as the fear of the sack will result in increased job insecurity and so workers will be more willing to placate their bosses by obeying and not complaining. Needless to say, empirical evidence shows that *"when unemployment is high, inequality rises. And when unemployment is low, inequality tends to fall."* [James K. Galbraith, **Op. Cit.**, p. 148] This is unsurprising as the *"wage curve"* suggests that it is unemployment which drives wage levels, not the other way round. This is important as higher unemployment would therefore create higher inequality as workers are in no position to claim back productivity increases and so wealth would flood upwards.

Then there is the issue of the backward-bending supply curve of labour we discussed at the end of the last section. As the "labour market" is not really a market, cutting real wages will have the opposite effect on the supply of labour than its supporters claim. It is commonly found that as real wages fall, hours at work become longer and the number of workers in a family increases. This is because the labour supply curve is negatively slopped as families need to work more (i.e., provide more labour) to make ends meet. This means that a fall in real wages may **increase** the supply of labour as workers are forced to work longer hours or take second jobs simply to survive. The net effect of increasing supply would be to **decrease** real wages even more and so, potentially, start a vicious circle and make the recession deeper. Looking at the US, we find evidence that supports this analysis. As the wages for the bottom 80% of the population fell in real terms under Reagan and Bush in the 1980s, the number of people with multiple jobs increased as did the number of mothers who entered the labour market. In fact, *"the only reason that family income was maintained is the massive increase in labour force participation of married women … Put simply, jobs paying family wages have been disappearing, and sustaining a family now requires that both adults work … The result has been a squeeze on the amount of time that people have for themselves … there is a loss of life quality associated with the decline in time for family … they have also been forced to work longer … Americans are working longer just to maintain their current position, and the quality of family life is likely declining. A time squeeze has therefore accompanied the wage squeeze."* [Palley, **Op. Cit.**, pp. 63–4] That is, the supply of labour **increased** as its price fell (Reagan's turn to military Keynesianism and incomplete nature of the "reforms" ensured that a deep spiral was avoided).

To understand why this is the case, it is necessary to think about how the impact of eliminating the minimum wage and trade unions would actually have. First, of course, there would be a drop in the wages of the poorest workers as the assertion is that the minimum wage increases unemployment by forcing wages up. The assertion is that the bosses would then employ more workers as a result. However, this assumes that extra workers could easily be added to the existing capital stock which may not be the case. Assuming this is the case (and it **is** a big assumption), what happens to the workers who have had their pay cut? Obviously, they still need to pay their bills which means they either cut back on consumption and/or seek more work (assuming that prices have not fallen, as this would leave the real wage unchanged). If the former happens, then firms may find that they face reduced demand for their products and, consequently, have no need for the extra employees predicted by the theory. If the latter happens, then the ranks of those seeking work will increase as people look for extra jobs or people outside the labour market (like mothers and children) are forced into the job market. As the supply of workers increase, wages **must** drop according to the logic of the "free market" position. This does not mean that a recovery is impossible, just that in the short and medium terms cutting wages will make a recession worse and be unlikely to **reduce** unemployment for some time.

This suggests that a "free market" capitalism, marked by a fully competitive labour market, no welfare programmes nor unemployment benefits, and extensive business power to break unions and strikes would see aggregate demand constantly rise and fall, in line with the business cycle, and unemployment and inequality would follow suit. Moreover, unemployment would be higher over most of the business cycle (and particularly at the bottom of the slump) than under a capitalism with social programmes, militant unions and legal rights to organise because the real wage would not be able to stay at levels that could support aggregate demand nor could the unemployed use their benefits to stimulate the production of consumer goods. This suggests that a fully competitive labour market, as in the 19th century, would increase the instability of the system — an analysis which was confirmed in during the 1980s (*"the relationship between measured inequality and economic stability … was weak but if anything it suggests that the more egalitarian countries showed a more stable pattern of growth after 1979."* [Dan Corry and Andrew Glyn, *"The Macroeconomics of equality, stability and growth"*, **Paying for Inequality**, Andrew Glyn and David Miliband (eds.) pp. 212–213]).

So, in summary, the available evidence suggests that **high** wages are associated with **low** levels of unemployment. While this should be the expected result from any realistic analysis of the economic power which marks capitalist economies, it does not provide much support for claims that only by cutting real wages can unemployment be reduced. The "free market" capitalist position and one based on reality have radically different conclusions as well as political implications. Ultimately, most laissez-faire economic analysis is unpersuasive both in terms of the facts and their logic. While economics may be marked by axiomatic reasoning which renders everything the markets does as optimal, the problem is precisely that it is pure axiomatic reasoning with little or no regard for the real world. Moreover, by some strange coincidence, they usually involve policy implications which generally make the rich richer by weakening the working class. Unsurprisingly, decades of empirical evidence have not shifted the faith of those who think that the simple axioms of economics take precedence over the real world nor has this faith lost its utility to the economically powerful.

C.9.3 Are "flexible" labour markets the answer to unemployment?

The usual "free market" capitalist (or neo-liberal) argument is that labour markets must become more "flexible" to solve the problem of unemployment. This is done by weakening unions, reducing (or abolishing) the welfare state, and so on. In defence of these policies, their proponents point to the low unemployment rates of the USA and UK and contrast them to the claimed economic woes of Europe (particularly France and Germany). As we will indicate in this section, this stance has more to do a touching faith that deregulating the labour market brings the economy as a whole closer to the ideal of "perfect competition" than a balanced analysis and assessment of the available evidence. Moreover, it is always important to remember, as tenured economists (talking of protective labour market institutions!) seem to forget, that deregulation can and does have high economic (and not to mention individual and social) costs too.

The underlying argument for flexible labour markets is the notion that unemployment is cased by wages being too high and due to market imperfections wages are sticky downwards. While both claims, as we have seen above, are dubious both factually and logically this has not stopped this position becoming the reigning orthodoxy in elite circles. By market imperfections it is meant trade unions, laws which protect labour, unemployment benefit and other forms of social welfare provision (and definitely **not** big business, patent and copyright laws, or any other pro-business state interventions). All these ensure that wages for those employed are inflexible downwards and the living standards of those unemployed are too high to induce them to seek work. This means that orthodox economics is based on (to use John Kenneth Galbraith's justly famous quip) the assumption that the rich do not work because they are paid too little, while the poor do not work because they are paid too much.

We should first point out that attacks on social welfare have a long pedigree and have been conducted with much the same rationale — it made people lazy and gave them flexibility when seeking work. For example, the British **Poor Law Report** of the 1830s *"built its case against relief on the damage done by poor relief to personal morality and labour discipline (much the same thing in the eyes of the commissioners)."* [David McNally, **Against the Market**, p. 101] The report itself stated that *"the greatest evil"* of the system was *"the spirit of laziness and insubordination that it creates."* [quoted by McNally, **Op. Cit.**, p. 101]

While the rhetoric used to justify attacks on welfare has changed somewhat since then, the logic and rationale have not. They have as their root the need to eliminate anything which provided working class people any means for independence from the labour market. It has always aimed to ensure that the fear of the sack remains a powerful tool in the bosses arsenal and to ensure that their authority is not undermined. Ironically, therefore, its underlying aims are to **decrease** the options available to working class people, i.e. to reduce **our** flexibility within the labour market by limiting our options to finding a job fast or face dire poverty (or worse).

Secondly, there is a unspoken paradox to this whole process. If we look at the stated, public, rationale behind "flexibility" we find a strange fact. While the labour market is to be made more "flexible" and in line with ideal of "perfect competition", on the capitalist side no attempt is being made to bring **it** into line with that model. Let us not forget that perfect competition (the theoretical condition in which all resources, including labour, will be efficiently utilised) states that there must be a large number of buyers and sellers. This is the case on the sellers side of the "flexible" labour market, but this is **not** the case on the buyers (where, as indicated in section C.4, oligopoly reigns). Most who favour labour market "flexibility" are also those most against the breaking up of big business and oligopolistic markets or are against attempts to stop mergers between dominant companies in and across markets. Yet the model requires **both** sides to be made up of numerous small firms without market influence or power. So why expect making one side more "flexible" will have a positive effect on the whole?

There is no logical reason for this to be the case and as we noted in section C.1.4, neo-classical economics agrees — in an economy with both unions and big business, removing the former while retaining the latter will **not** bring it closer to the ideal of perfect competition. With the resulting shift in power on the labour market things will get worse as income is distributed from labour to capital. Which is, we must stress, precisely what **has** happened since the 1980s and the much lauded "reforms" of the labour market. It is a bit like expecting peace to occur between two warring factions by disarming one side and arguing that because the number of guns have been halved peacefulness has doubled! Of course, the only "peace" that would result would be the peace of the graveyard or a conquered people — subservience can pass for peace, if you do not look too close. In the end, calls for the "flexibility" of labour indicate the truism that, under capitalism, labour exists to meet the requirements of capital (or living labour exists to meet the needs of dead labour, a truly insane way to organise a society).

Then there is the key question of comparing reality with the rhetoric. As economist Andrew Glyn points out, the neo-liberal orthodoxy on this issue *"has been strenuously promoted despite weak evidence for the magnitude of its benefits and in almost total neglect of its costs."* In fact, *"there is no evidence that the countries which carried out more reforms secured significant falls in unemployment."* This is perhaps unsurprising as *"there is plenty of support for such deregulation from business even without strong evidence that unemployment would be reduced."* As far as welfare goes, the relationship between unemployment and benefits is, if anything, in the 'wrong' direction (higher benefits do along with lower unemployment). Of course there are a host of other influences on unemployment but *"if benefits were very important we might expect **some** degree of correlation in the 'right' (positive) direction ... such a lack of simple relation with unemployment applies to other likely suspects such as employment protection and union membership."* [**Capitalism Unleashed**, p. 48, p. 121, p. 48 and p. 47]

Nor is it mentioned that the history of labour market flexibility is somewhat at odds with the theory. It is useful to remember that American unemployment was far worse than Europe's during the 1950s, 60s and 70s. In fact, it did not get better than the European average until the second half of the 1980s. [David R. Howell, *"Introduction"*, pp. 3–34, **Fighting Unemployment**, David R. Howell (ed.), pp. 10–11] To summarise:

> *"it appears to be only relatively recently that the maintained greater flexibility of US labour markets has apparently led to a superior performance in terms of lower unemployment, despite the fact this flexibility is no new phenomenon. Comparing, for example, the United States with the United Kingdom, in the 1960s the United States averaged 4.8 per cent, with the United Kingdom at 1.9 per cent; in the 1970s the United States rate rose to 6.1 per cent, with the United Kingdom rising to 4.3 per cent, and it was only in the 1980s that the ranking was reversed with the United States at 7.2 per cent and the United Kingdom at 10 per cent... Notice that this reversal of rankings in the 1980s took place despite all the best efforts of Mrs Thatcher to create labour market flexibility... [I]f labour market flexibility is important in explaining the level of unemployment... why does the level of unemployment remain so persistently high in a country, Britain, where active measures have been taken to create flexibility?"* [Keith Cowling and Roger Sugden, **Beyond Capitalism**, p. 9]

If we look at the fraction of the labour force without a job in America, we find that in 1969 it was 3.4% (7.3% including the underemployed) and **rose** to 6.1% in 1987 (16.8% including the underemployed). Using more recent data, we find that, on average, the unemployment rate was 6.2% in 1990–97 compared to 5.0% in the period 1950–65. In other words, labour market "flexibility" has not reduced unemployment levels, in fact "flexible" labour markets have been associated with higher levels of unemployment. Of course, we are comparing different time periods. A lot changed between the 1960s and the 1990s and so comparing these periods cannot be the whole answer. However, it does seem strange that the period with stronger unions, higher minimum wages and more generous welfare state should be associated with **lower** unemployment than the subsequent "flexible" period. It is possible that the rise in flexibility and the increase in unemployment may be unrelated. If we look at different countries over the same time period we can see if "flexibility" actually reduces unemployment. As one British economist notes, this may not be the case:

> *"Open unemployment is, of course, lower in the US. But once we allow for all forms of non-employment [such as underemployment, jobless workers who are not officially registered as such and so on], there is little difference between Europe and the US: between 1988 and 1994, 11 per cent of men aged 25–55 were not in work in France, compared with 13 per cent in the UK, 14 per cent in the US and 15 per cent in Germany."* [Richard Layard, quoted by John Gray, **False Dawn**, p. 113]

Also when evaluating the unemployment records of a country, other factors than the "official" rate given by the government must taken into account. Firstly, different governments have different definitions of what counts as unemployment. As an example, the USA has a more restrictive definition of who is unemployed than Germany. For example, in 2005 Germany's unemployment rate was officially 11.2%. However, using the US definition it was only around 9% (7% in what was formerly West Germany). The offical figure was higher as it included people, such as those involuntarily working part-time, as being unemployed who are counted as being employed in the USA. America, in the same year, had an unemployment rate of around 5%. So comparing unadjusted unemployment figures will give a radically different picture of the problem than using standardised ones. Sadly far too often business reporting in newspapers fail to do this.

In addition, all estimates of America's unemployment record must take into account its incarceration rates. The prison population is not counted as part of the labour force and so is excluded when calculating unemployment figures. This is particularly significant as those in prison are disproportionately from demographic groups with very high unemployment rates and so it is likely that a substantial portion of these people would be unemployed if they were not in jail. If America and the UK did not have the huge surge in prison population since the 1980s neo-liberal reforms, the unemployment rate in both countries would be significantly higher. In the late 1990s, for example, more than a million extra people would be seeking work if the US penal policies resembled those of any other Western nation. [John Gray, **Op. Cit.**, p. 113] England and Wales, unsurprisingly, tops the prison league table for Western Europe. In 2005, 145 per 100,000 of their population was incarcerated. In comparison, France had a rate of 88 while Germany had one of 97. This would, obviously, reduce the numbers of those seeking work on the labour market and, consequently, reduce the unemployment statistics.

While the UK is praised for its "flexible" labour market in the 2000s, many forget the price which was paid to achieve it and even more fail to realise that the figures hide a somewhat different reality. It is therefore essential to remember Britain's actual economic performance during Thatcher's rule rather than the "economically correct" narrative we have inherited from the media and economic "experts." When Thatcher came to office in 1979 she did so promising to end the mass unemployment experienced under Labour (which had doubled between 1974 and 1979). Unemployment then tripled in her first term, rising to over 3 million in 1982 (for the first time since the 1930s, representing 1 in 8 people). This was due in large part to the application of Monetarist dogma making the recession far worse than it had to be. Unemployment remained at record levels throughout the 1980s, only dropping to below its 1979 level in 1997 when New Labour took office. It gets worse. Faced with unemployment rising to well over 10%, Thatcher's regime did what any respectable government would — it cooked the books. It changed how unemployment was recorded in order to artificially lower the official unemployment records. It also should be stressed that the UK unemployment figures do not take into account the Thatcherite policy of shunting as many people as possible off the unemployment roles and onto sickness and incapacity benefits during the 1980s and 1990s (*"In some countries, like the UK and the Netherlands, many [of the unemployed] found their way onto sickness benefit … Across the UK, for example, there was a strong positive correlation between numbers on sickness benefits and the local unemployment rate."* [Glyn, **Op. Cit.**, p. 107]). Once these "hidden" people are included the unemployment figures of Britain are similar to those countries, such as France and Germany, who are more honest in recording who is and is not unemployed.

Eighteen years of high unemployment and a massive explosion in those on incapacity benefits is hardly an advert for the benefits of "flexible" labour market. However, a very deep recession, double-figure unemployment for most of the decade, defeats for key strikes and unions plus continued high unemployment for nearly two decades had an impact on the labour movement. It made people willing to put up with anything in order to remain in work. Hence Thatcher's "economic miracle" — the working class finally knew its place in the social hierarchy.

Thus, if a politician is elected who is hailed by the right as a "new Thatcher", i.e., seeking to "reform" the economy (which is "economically correct" speak for using the state to break working class militancy) then there are some preconditions required before they force their populations down the road to (private) serfdom. They will have to triple unemployment in under three years and have such record levels last over a decade, provoke the deepest recession since the 1930s, oversee the destruction of the manufacturing sector and use the powers of the state to break the mass protests and strikes their policies will provoke. Whether they are successful depends on the willingness of working class people to stand up for their liberties and rights and so impose, from the streets, the changes that really needed — changes that politicians will not, indeed cannot, achieve.

Nor should it be forgotten that here are many European countries with around the same, or lower, official unemployment rates as the UK with much less "flexible" labour markets. Taking the period 1983 to 1995, we find that around 30 per cent of the population of OECD Europe lived in countries with average unemployment rates lower than the USA and around 70 per cent in countries with lower unemployment than Canada (whose wages are only slightly less flexible than the USA). Furthermore, the European countries with the lowest unemployment rates were not noted for their labour market flexibility (Austria 3.7%, Norway 4.1%, Portugal 6.4%, Sweden 3.9% and Switzerland 1.7%). Britain, which probably had the most flexible labour market had an average unemployment rate higher than half of Europe. And the unemployment rate of Germany is heavily influenced by areas which were formally in East Germany. Looking at the former West German regions only, unemployment between 1983 and 1995 was 6.3%, compared to 6.6% in the USA (and 9.8% in the UK). This did not change subsequently. There are many regulated European countries with lower unemployment than the USA (in 2002, 10 of 18 European countries had lower unemployment rates). Thus:

> *"Often overlooked in the 1990s in the rush to embrace market fundamentalism and to applaud the American model was the fact that several European countries with strong welfare states consistently reported unemployment rates well below that of the United States … At the same time, other European welfare sates, characterised by some of the lowest levels of wage inequality and the highest levels of social protection in the developed world, experienced substantial declines in unemployment over the 1990s, reaching levels that are now below that of the United States."* [David R. Howell, *"Conclusion"*, pp. 310–43, **Op. Cit.**, p. 310]

As such, it is important to remember that *"the empirical basis"* of the neo-liberal OECD-IMF orthodoxy is *"limited."* [Howell, **Op. Cit.**, p. 337] In fact, the whole "Europe is in a state of decline" narrative which is used to justify the imposition of neo-liberal reforms there is better understood as the corporate media's clever ploy to push Europe into the hands of the self-destructing neo-liberalism that is slowly taking its toll on Britain and America rather than a serious analysis of the real situation there.

Take, for example, the issue of high youth unemployment in many European countries which reached international awareness during the French anti-CPE protests in 2006. In fact, the percentage of prime-age workers (25–54) in employment is pretty similar in "regulated" France, Germany and Sweden as in "flexible" America and Britain (it is much higher for women in Sweden). However, there are significant differences in youth employment rates and this suggests where the apparent unemployment problem lies in Europe. This problem is due to the statistical method used to determine the unemployment figures. The standard measure of unemployment divides the number unemployed by the numbers unemployed plus employed. The flaw in this should be obvious. For example, assume that 90% of French youths are in education and of the remaining 10%, 5% are in work and 5% are unemployed. This last 10% are the "labour force" and so we would get a massive 50% unemployment rate but this is due to the low (5%) employment rate. Looking at the youth population as a whole, only 5% are actually unemployed. [David R. Howell, *"Introduction"*, pp. 3–34, **Op. Cit**., pp. 13–14] By the standard measure, French males age 15–24 had an unemployment rate of 20.8% in 2007, as compared to 11.8% in America. Yet this difference is mainly because, in France (as in the rest of Europe), there are many more young males not in the labour force (more are in school and fewer work part time while studying). As those who are not in the labour market are not counted in the standard measure, this gives an inflated value for youth unemployment. A far better comparison would be to compare the number of unemployed divided by the population of those in the same age group. This results in the USA having a rate of 8.3% and France 8.6%.

Another source of the "decline" of Europe is usually linked to lower GDP growth over the past few years compared to countries like Britain and the USA. Yet this perspective fails to take into account internal income distribution. Both the USA and UK are marked by large (and increasing) inequality and that GDP growth is just as unequally distributed. In America, for example, most of GDP growth since the 1980s has been captured by the top 5% of the population while median wages have been (at best) flat. Ignoring the enrichment of the elite in the USA and UK would mean that GDP growth would be, at least for the bulk of the population, better in Europe. This means that while Europe may have grown more slowly, it benefits more than just the ruling class. Then there are such factors as poverty and social mobility. Rates of poverty are much worse in the neo-liberal countries, while social mobility has fallen in the US and UK since the 1980s. There are less poor people in Europe and they stay in poverty for shorter periods of time compared to America and Britain.

Moreover, comparing Europe's income or GDP per person to the U.S. fails to take into account the fact that Europeans work far less than Americans or British people. So while France may have lagged America in per capita income in 2007 ($30,693 to $43,144), it cannot be said that working class people are automatically worse off as French workers have a significantly shorter working week and substantially more holidays. Less hours at work and longer holidays may impact negatively on GDP but only an idiot would say that this means the economy is worse, never mind the quality of life. Economists, it should be remembered, cannot say that one person is worse off than another if she has less income due to working fewer hours. So GDP per capita may be higher in the US, but only because American workers work more hours and **not** because they are more productive. Like other Europeans, the French have decided to work less and enjoy it more. So it is important to remember that GDP is not synonymous with well-being and that inequality can produce misleading per capita income comparisons.

A far better indicator of economic welfare is productivity. It is understandable that this is not used as a measure when comparing America to Europe as it is as high, or higher, in France and other Western European countries as it is in the US (and much higher than in the UK where low wages and long hours boost the figure). And it should be remembered that rising productivity in the US has not been reflecting in rising wages since 1980. The gains of productivity, in other words, have been accumulated by the boss class and not by the hard working American people (whose working week has steadily increased during that period). Moreover, France created more private sector jobs (+10% between 1996 and 2002, according to the OECD) than the UK (+6%) or the US (+5%). Ironically, given the praise it receives for being a neo-liberal model, the UK economy barely created any net employment in the private sector between 2002 and 2007 (unemployment **had** dropped, but that was due to increased state spending which led to a large rise in public sector jobs).

Then there is the fact that some European countries **have** listened to the neo-liberal orthodoxy and reformed their markets but to little success. So it should be noted that *"there has in fact already been a very considerable liberalisation and reform in Europe,"* both in product and labour markets. In fact, during the 1990s Germany and Italy reformed their labour markets *"roughly ten times"* as much as the USA. The *"point is that reforms should have boosted productivity growth in Europe,"* but they did not. If regulation *"was the fundamental problem, some positive impact on labour productivity growth should have come already from the very substantial deregulation already undertaken. Deregulation should have contributed to an acceleration in productivity growth in Europe whereas actually productivity growth declines. It is hard to see how regulation, which was declining, could be the source of Europe's slowdown."* [Glyn, **Op. Cit.**, p. 144]

So, perhaps, "flexibility" is not the solution to unemployment some claim it is (after all, the lack of a welfare state in the 19th century did not stop mass unemployment nor long depressions occurring). Indeed, a strong case can be made (and has been by left-wing economists) that the higher open unemployment in Europe has a lot less to do with "rigid" structures and "pampered" citizens than it does with the fiscal and monetary austerity produced by the excessively tight monetary policies of the European Central Bank plus the requirements of the Maastricht Treaty and the *"Growth and Stability pact"* which aims to reduce demand expansion (i.e. wage rises) under the name of price stability (i.e., the usual mantra of fighting inflation by lowering wage increases). So, *"[i]n the face of tight monetary policy imposed first by the [German] Bundesbank and then by the European Central Bank … it has been essential to keep wages moderate and budget deficits limited. With domestic demand severely constrained, many European countries experiences particularly poor employment growth in the mid-1990s."* [David R. Howell, *"Conclusion"*, **Op. Cit.**, p. 337] This has been essentially imposed by the EU bureaucrats onto the European population and as these policies, like the EU itself, has the support of most of Europe's ruling class such an explanation is off the political agenda.

So if "flexibility" does not result in lower unemployment, just what is it good for? The net results of American labour market "flexibility" were summarised by head the US Federal Reserve Alan Greenspan in 1997. He was discussing the late 1990s boom (which was, in fact, the product of the dot.com bubble rather than the dawn of a new era so many claimed at the time). He explained why unemployment managed to fall below the standard NAIRU rate without inflation increasing. In his words:

> *"Increases in hourly compensation … have continued to fall far short of what they would have been had historical relationships between compensation gains and the degree of labour market tightness held … As I see it, heightened job insecurity explains a significant part of the restraint on compensation and the consequent muted price inflation … The continued reluctance of workers to leave their jobs to seek other employment as the labour market has tightened provides further evidence of such concern, as does the tendency toward longer labour union contracts … The low level of work stoppages of recent years also attests to concern about job security … The continued decline in the share of the private workforce in labour unions has likely made wages more responsive*

to market forces … Owing in part to the subdued behaviour of wages, profits and rates of return on capital have risen to high levels." [quoted by Jim Stanford, *"Testing the Flexibility Paradigm: Canadian Labor Market Performance in International Context,"* pp. 119–155, **Fighting Unemployment**, David R. Howell (ed.), pp. 139–40]

Under such circumstances, it is obvious why unemployment could drop and inflation remain steady. Yet there is a massive contradiction in Greenspan's account. As well as showing how keen the Federal Reserve investigates the state of the class struggle, ready to intervene when the workers may be winning, it also suggests that flexibility works just one way:

> *"Some of the features highlighted by Greenspan reflect precisely a **lack** of flexibility in the labour market: a lack of response of compensation to tight labour markets, a reluctance of workers to leave their jobs, and the prevalence of long-term contracts that lock employment arrangements for six or more years at a time. And so Greenspan's portrayal of the unique features of the US model suggests that something more than flexibility is the key ingredient at work — or at least that 'flexibility' is being interpreted once again from an unbalanced and one-sided perspective. It is, rather, a high degree of labour market **discipline** that seems to be the operative force. US workers remain insecure despite a relatively low unemployment rate, and hence compensation gains … were muted. This implies a consequent redistribution of income from labour to capital … Greenspan's story is more about **fear** than it is about flexibility — and hence this famous testimony has come to be known as Greenspan's 'fear factor' hypothesis, in which he concisely described the importance of labour market discipline for his conduct of monetary policy."* [Jim Stanford, **Op. Cit.**, p. 140]

So while this attack on the wages, working conditions and social welfare is conducted under the pre-Keynesian notion of wages being *"sticky"* downwards, the underlying desire is to impose a "flexibility" which ensures that wages are *"sticky"* **upwards**. This suggests a certain one-sidedness to the "flexibility" of modern labour markets: employers enjoy the ability to practice flexpoilation but the flexibility of workers to resist is reduced.

Rather than lack of "flexibility," the key factor in explaining high unemployment in Europe is the anti-inflationary policies of its central banks, which pursue high interest rates in order to "control" inflation (i.e. wages). In contrast, America has more flexibility simply due to the state of the working class there. With labour so effectively crushed in America, with so many workers feeling they cannot change things or buying into the individualistic premises of capitalism thanks to constant propaganda by business funded think-tanks, the US central bank can rely on job insecurity and ideology to keep workers in their place in spite of relatively lower official unemployment. Meanwhile, as the rich get richer many working class people spend their time making ends meet and blaming everyone and everything but their ruling class for their situation (*"US families must work even more hours to achieve the standard of living their predecessors achieved 30 years ago."* [David R. Howell, *"Conclusion"*, **Op. Cit.**, p. 338]).

All this is unsurprising for anarchists as we recognise that "flexibility" just means weakening the bargaining power of labour in order to increase the power and profits of the rich (hence the expression ***"flexploitation"***!). Increased "flexibility" has been associated with **higher**, not lower unemployment. This, again, is unsurprising, as a "flexible" labour market basically means one in which workers are glad to have any job and face increased insecurity at work (actually, ***"insecurity"*** would be a more honest word to use to describe the ideal of a competitive labour market rather than *"flexibility"* but such honesty would let the cat out of the bag). In such an environment, workers' power is reduced meaning that capital gets a larger share of the national income than labour and workers are less inclined to stand up for their rights. This contributes to a fall in aggregate demand, so increasing unemployment. In addition, we should note that "flexibility" may have little effect on unemployment (although not on profits) as a reduction of labour's bargaining power may result in **more** rather than less unemployment. This is because firms can fire "excess" workers at will, increase the hours of those who remain and stagnating or falling wages reduces aggregate demand. Thus the paradox of increased "flexibility" resulting in higher unemployment is only a paradox in the neo-classical framework. From an anarchist perspective, it is just the way the system works as is the paradox of overwork and unemployment occurring at the same time.

So while "free market" economics protrays unions as a form of market failure, an interference with the natural workings of the market system and recommend that the state should eliminate them or ensure that they are basically powerless to act, this simply does not reflect the real world. Any real economy is marked by the economic power of big business (in itself, according to neo-classical economics, a distortion of the market). Unless workers organise then they are in a weak position and will be even more exploited by their economic masters. Left-wing economist Thomas I. Palley presents the correct analysis of working class organisation when he wrote:

> *"The reality is that unions are a correction of market failure, namely the massive imbalance of power that exists between individual workers and corporate capital. The importance of labour market bargaining power for the distribution of income, means that unions are a fundamental prop for widespread prosperity. Weakening unions does not create a 'natural' market: it just creates a market in which business has the power to dominate labour.*
>
> *"The notion of perfect natural markets is built on the assumption that market participants have no power. In reality, the process of labour exchange is characterised not only by the presence of power, but also by gross inequality of power. An individual worker is at a great disadvantage in dealing with large corporations that have access to massive pools of capital and can organise in a fashion that renders every individual dispensible … Unions help rectify the imbalance of power in labour markets, and they therefore correct market failure rather than causing it."* [**Op. Cit.**, pp. 36–7]

The welfare state also increases the bargaining power of workers against their firms and limits the ability of firms to replace striking workers with scabs. Given this, it is understandable why bosses hate unions and any state aid which undermines their economic power. Thus the *"hallmark"* of the neo-liberal age *"is an economic environment that pits citizen against citizen for the benefit of those who own and manage"* a country. [**Op. Cit**, p. 203]

And we must add that whenever governments have attempted to make the labour market *"fully competitive"* it has either been the product of dictatorship (e.g. Chile under Pinochet) or occurred at the same time as increased centralisation of state power and increased powers for the police and employers (e.g. Britain under Thatcher, Reagan in the USA). This is the agenda which is proscribed for Western Europe. In 2006, when successful street protests stopped a proposed labour market reform in France (the CPE), one American journalist, Elaine Sciolino, complained that *"the government seems to fear its people; the people seem to fear change."* [**New York Times**, March 17 2006] Such are the contradictions of neo-liberalism. While proclaiming the need to reduce state intervention, it requires increased state power to impose its agenda. It needs to make people fear their government and fear for their jobs. Once that has been achieved, then people who accept "change" (i.e. the decisions of their economic, social and political bosses) without question. That the French people do not want a British or American style labour market, full of low-wage toilers who serve at the boss's pleasure should not come as a surprise. Nor should the notion that elected officials in a supposed democracy are meant to reflect the feelings of the sovereign people be considered as unusual or irrational.

The anti-democratic nature of capitalist "flexiblity" applies across the world. Latin American Presidents trying to introduce neo-liberalism into their countries have had to follow suit and *"ride roughshod over democratic institutions, using the tradition Latin American technique of governing by decree in order to bypass congressional opposition… Civil rights have also taken a battering. In Bolivia, the government attempted to defuse union opposition … by declaring a state of siege and imprisoning 143 strike leaders… In Colombia, the government used anti-terrorist legislation in 1993 to try 15 trade union leaders opposing the privatisation of the state telecommunications company. In the most extreme example, Peru's Alberto Fujimori dealt with a troublesome Congress by simply dissolving it … and seizing emergency powers."* [Duncan Green, **The Silent Revolution**, p. 157]

This is unsurprising. People, when left alone, will create communities, organise together to collectively pursue their own happiness, protect their communities and environment. In other words, they will form groups, associations and unions to control and influence the decisions that affect them. In order to create a "fully competitive" labour market, individuals must be atomised and unions, communities and associations weakened, if not destroyed, in order to fully privatise life. State power must be used to disempower the mass of the population, restrict their liberty, control popular organisations and social protest and so ensure that the free market can function without opposition to the human suffering, misery and pain it would cause. People, to use Rousseau's evil term, *"must be forced to be free."* And, unfortunately for neo-liberalism, the countries that tried to reform their labour market still suffered from high unemployment, plus increased social inequality and poverty and where still subject to the booms and slumps of the business cycle.

Of course, bosses and the elite are hardly going to present their desire for higher profits and more power in those terms. Hence the need to appear concerned about the fate of the unemployed. As such, it is significant, of course, that right-wing economists only seem to become concerned over unemployment when trade unions are organising or politicians are thinking of introducing or raising the minimum wage. Then they will talk about how these will raise unemployment and harm workers, particularly those from ethnic minorities. Given that bosses always oppose such policies, we must conclude that they are, in fact, seeking a situation where there is full employment and finding willing workers is hard to do. This seems, to say the least, an unlikely situation. If bosses were convinced that, for example, raising the minimum wage would increase unemployment rather than their wages bill they would be supporting it wholeheartedly as it would allow them to pressurise their workers into labouring longer and harder to remain in employment. Suffice to say, bosses are in no hurry to see their pool of wage slaves drained and so their opposition to trade unions and minimum wages are the product of need for profits rather than some concern for the unemployed.

This applies to family issues as well. In its support for "free markets" you can get a taste of the schizophrenic nature of the conservative right's approach to family values. On the one hand, they complain that families do not spend enough time together as they are under financial pressure and this results both parents going out to work and working longer hours. Families will also suffer because businesses do not have to offer paid maternity leave, paid time off, flexitime, paid holidays, or other things that benefit them. However, the right cannot bring themselves to advocate unions and strike action by workers (or state intervention) to achieve this. Ironically, their support for "free market" capitalism and "individualism" undermines their support for "family values." Ultimately, that is because profits will always come before parents.

All this is unsurprising as, ultimately, the only real solution to unemployment and overwork is to end wage labour and the liberation of humanity from the needs of capital. Anarchists argue that an economy should exist to serve people rather than people existing to serve the economy as under capitalism. This explains why capitalism has always been marked by a focus on "what the economy wants" or "what is best for the economy" as having a capitalist economy always results in profit being placed over people. Thus we have the paradoxical situation, as under neo-liberalism, where an economy is doing well while the bulk of the population are not.

Finally, we must clarify the anarchist position on state welfare (we support working class organisations, although we are critical of unions with bureaucratic and top-down structures). As far as state welfare goes, anarchists do not place it high on the list of things we are struggling against (once the welfare state for the rich has been abolished, then, perhaps, we will reconsider that). As we will discuss in section D.1.5, anarchists are well aware that the current neo-liberal rhetoric of "minimising" the state is self-serving and hides an attack on the living standards of working class people. As such, we do not join in such attacks regardless of how critical we may be of aspects of the welfare state for we seek genuine reform from below by those who use it rather than "reform" from above by politicians and bureaucrats in the interests of state and capital. We also seek to promote alternative social institutions which, unlike the welfare state, are under working class control and so cannot be cut by decree from above. For further discussion, see sections J.5.15 and J.5.16.

C.9.4 Is unemployment voluntary?

Here we point out another aspect of the free market capitalist "blame the workers" argument, of which the diatribes against unions and workers' rights highlighted above is only a part. This is the assumption that unemployment is not involuntary but is freely chosen by workers. As Nicholas Kaldor put it, for "free market" economists involuntary employment *"cannot exist because it is excluded by the assumptions."* [**Further Essays on Applied Economics**, p. x] Many neo-classical economists claim that unemployed workers calculate that their time is better spent searching for more highly paid employment (or living on welfare than working) and so desire to be jobless. That this argument is taken seriously says a lot about the state of modern capitalist economic theory, but as it is popular in many right-wing circles, we should discuss it.

David Schweickart notes, these kinds of arguments ignore *"two well-established facts: First, when unemployment rises, it is layoffs, not [voluntary] quits, that are rising. Second, unemployed workers normally accept their first job offer. Neither of these facts fits well with the hypothesis that most unemployment is a free choice of leisure."* [**Against Capitalism**, p. 108] When a company fires a number of its workers, it can hardly be said that the sacked workers have calculated that their time is better spent looking for a new job. They have no option. Of course, there are numerous jobs advertised in the media. Does this not prove that capitalism always provides jobs for those who want them? Hardly, as the number of jobs advertised must have some correspondence to the number of unemployed and the required skills and those available. If 100 jobs are advertised in an areas reporting 1,000 unemployed, it can scarcely be claimed that capitalism tends to full employment. This hardly gives much support to the right-wing claim that unemployment is "voluntary" and gives an obvious answer to right-wing economist Robert Lucas's quest *"to explain why people allocate time to … unemployment, we need to know why they prefer it to all other activities."* [quoted by Schweickart, **Op. Cit**., p. 108] A puzzle indeed! Perhaps this unworldly perspective explains why there has been no real effort to verify the assertion that unemployment is "voluntary leisure."

Somewhat ironically, given the desire for many on the right to deny the possibility of involuntary unemployment this perspective became increasingly influential at precisely the same time as the various theories of the so-called "natural rate" of unemployment did (see section C.9). Thus, at the same time as unemployment was proclaimed as being a "voluntary" choice economics was also implicitly arguing that this was nonsense, that unemployment **is** an essential disciplinary tool within capitalism to keep workers in their place (sorry, to fight inflation).

In addition, it is worthwhile to note that the right-wing assumption that higher unemployment benefits and a healthy welfare state promote unemployment is not supported by the evidence. As a moderate member of the British Conservative Party notes, the *"OECD studied seventeen industrial countries and found no connect between a country's unemployment rate and the level of its social-security payments."* [**Dancing with Dogma**, p. 118] Moreover, the economists David Blanchflower and Andrew Oswald *"Wage Curve"* for many different countries is approximately the same for each of the fifteen countries they looked at. This also suggests that labour market unemployment is independent of social-security conditions as their "wage curve" can be considered as a measure of wage flexibility. Both of these facts suggest that unemployment is involuntary in nature and cutting social-security will **not** affect unemployment.

Another factor in considering the nature of unemployment is the effect of decades of "reform" of the welfare state conducted in both the USA and UK since 1980. During the 1960s the welfare state was far more generous than it was in the 1990s and unemployment was lower. If unemployment was "voluntary" and due to social-security being high, we would expect a decrease in unemployment as welfare was cut (this was, after all, the rationale for cutting it in the first place). In fact, the reverse occurred, with unemployment rising as the welfare state was cut. Lower social-security payments did not lead to lower unemployment, quite the reverse in fact.

Faced with these facts, some may conclude that as unemployment is independent of social security payments then the welfare state can be cut. However, this is not the case as the size of the welfare state does affect the poverty rates and how long people remain in poverty. In the USA, the poverty rate was 11.7% in 1979 and rose to 13% in 1988, and continued to rise to 15.1% in 1993. The net effect of cutting the welfare state was to help **increase** poverty. Similarly, in the UK during the same period, to quote the ex-Thatcherite John Gray, there *"was the growth of an underclass. The percentage of British (non-pensioner) households that are wholly workless — that is, none of whose members is active in the productive economy — increased from 6.5 per cent in 1975 to 16.4 per cent in 1985 and 19.1 per cent in 1994… Between 1992 and 1997 there was a 15 per cent increase in unemployed lone parents… This dramatic growth of an underclass occurred as a direct* *consequence of neo-liberal welfare reforms, particularly as they affected housing."* [**False Dawn**, p. 30] This is the opposite of the predictions of right-wing theories and rhetoric.

As Gray correctly argues, the *"message of the American [and other] New Right has always been that poverty and the under class are products of the disincentive effects of welfare, not the free market."* He goes on to note that it *"has never squared with the experience of the countries of continental Europe where levels of welfare provision are far more comprehensive than those of the United States have long co-existed with the absence of anything resembling an American-style underclass. It does not touch at virtually any point the experience of other Anglo-Saxon countries."* He points to the example of New Zealand where *"the theories of the American New Right achieved a rare and curious feat — self-refutation by their practical application. Contrary to the New Right's claims, the abolition of nearly all universal social services and the stratification of income groups for the purpose of targeting welfare benefits selectively created a neo-liberal poverty trap."* [**Op. Cit.**, p. 42]

So while the level of unemployment benefits and the welfare state may have little impact on the level of unemployment (which is to be expected if the nature of unemployment is essentially involuntary), it **does** have an effect on the nature, length and persistency of poverty. Cutting the welfare state increases poverty and the time spent in poverty (and by cutting redistribution, it also increases inequality).

If we look at the relative size of a nation's social security transfers as a percentage of Gross Domestic Product and its relative poverty rate we find a correlation. Those nations with a high level of spending have lower rates of poverty. In addition, there is a correlation between the spending level and the number of persistent poor. Those nations with high spending levels have more of their citizens escape poverty. For example, Sweden has a single-year poverty rate of 3% and a poverty escape rate of 45% and Germany has figures of 8% and 24% (and a persistent poverty rate of 2%). In contrast, the USA has figures of 20% and 15% (and a persistent poverty rate of 42%).

Given that a strong welfare state acts as a kind of floor under the wage and working conditions of labour, it is easy to see why capitalists and the supporters of "free market" capitalism seek to undermine it. By undermining the welfare state, by making labour "flexible," profits and power can be protected from working people standing up for their rights and interests. Little wonder the claimed benefits of "flexibility" have proved to be so elusive for the vast majority while inequality has exploded. The welfare state, in other words, reduces the attempts of the capitalist system to commodify labour and increases the options available to working class people. While it did not reduce the need to get a job, the welfare state did undermine dependence on any particular employee and so increased workers' independence and power. It is no coincidence that the attacks on unions and the welfare state was and is framed in the rhetoric of protecting the *"right of management to manage"* and of driving people back into wage slavery. In other words, an attempt to increase the commodification of labour by making work so insecure that workers will not stand up for their rights.

Unemployment has tremendous social costs, with the unemployed facing financial insecurity and the possibility of indebtedness and poverty. Many studies have found that unemployment results in family distribution, ill health (both physical and mental), suicide, drug addition, homelessness, malnutrition, racial tensions and a host of other, negative, impacts. Given all this, given the dire impact of joblessness, it strains belief that people would **choose** to put themselves through it. The human costs of unemployment are well documented. There is a stable correlation between rates of unemployment and the rates of mental-hospital admissions. There is a connection between unemployment and juvenile and young-adult crime. The effects on an individual's self-respect and the wider implications for their community and society are massive. As David Schweickart concludes the *"costs of unemployment, whether measured in terms of the cold cash of lost production and lost taxes or in the hotter units of alienation, violence, and despair, are likely to be large under Laissez Faire."* [**Op. Cit.**, p. 109]

Of course, it could be argued that the unemployed should look for work and leave their families, home towns, and communities in order to find it. However, this argument merely states that people should change their whole lives as required by "market forces" (and the wishes — *"animal spirits,"* to use Keynes' term — of those who own capital). In other words, it just acknowledges that capitalism results in people losing their ability to plan ahead and organise their lives (and that, in addition, it can deprive them of their sense of identity, dignity and self-respect as well), portraying this as somehow a requirement of life (or even, in some cases, noble).

It seems that capitalism is logically committed to viciously contravening the very values upon which it claims it be built, namely the respect for the innate worth and separateness of individuals. This is hardly surprising, as capitalism is based on reducing individuals to the level of another commodity (called "labour"). To requote Karl Polanyi:

> *"In human terms such a postulate [of a labour market] implied for the worker extreme instability of earnings, utter absence of professional standards, abject readiness to be shoved and pushed about indiscriminately, complete dependence on the whims of the market. [Ludwig Von] Mises justly argued that if workers 'did not act as trade unionists, but reduced their demands and changed their locations and occupations according to the labour market, they would eventually find work.' This sums up the position under a system based on the postulate of the commodity character of labour. It is not for the commodity to decide where it should be offered for sale, to what purpose it should be used, at what price it should be allowed to change hands, and in what manner it should be consumed or destroyed."* [**The Great Transformation**, p. 176]

However, people are **not** commodities but living, thinking, feeling individuals. The "labour market" is more a social institution than an economic one and people and work more than mere commodities. If we reject the neo-liberals' assumptions for the nonsense they are, their case fails. Capitalism, ultimately, cannot provide full employment simply because labour is **not** a commodity (and as we discussed in section C.7, this revolt against commodification is a key part of understanding the business cycle and so unemployment).

C.10 Is "free market" capitalism the best way to reduce poverty?

It is far to say that supporters of "free-market" capitalism make the claim that their system not only benefits everyone, but especially working class people (indeed, the very poorest sectors of society). This was the position during the so-called "anti-globalisation" protests at the turn of the 21st century, when the issue of global inequality and poverty was forced to the front of politics (for a time). In response, the likes of the Economist portraying itself and the big businesses seeking lower costs and higher profits as the real champions of the poor (particularly in the third world).

In this perspective growth is the key to reducing (absolute) poverty rather than, say, redistribution, struggle for reforms by means of direct action and popular self-organisation or (heaven forbid!) social revolution. The logic is simple. Economic growth of 1% per year will double an economy in 70 years, while 3% does so in just over 23 years and 5% growth takes a mere 15 years. Thus the standard right-wing argument is that we should promote "free market" capitalism as this is a growth machine par excellence. In fact, any form of redistribution or social struggle is considered counter-productive in this viewpoint as it is harms overall growth by either scaring away capital from a country or blunts the incentives of the elite to strive to "produce" more wealth. Over time, wealth will (to coin a well-worn phrase) "trickle down" from the wealthy to the many.

What to make of this claim? Again, it does contain an element of truth. As capitalism is a "grow or die" economy (see section D.4), obviously the amount of wealth available to society increases for **all** as the economy expands. So the poor will, in general, be better off **absolutely** in any growing economy (at least in economic terms). This was the case under Soviet state capitalism as well: the poorest worker in the 1980s was obviously far better off economically than one in the 1920s. As such, what counts is **relative** differences between classes and periods within a growth economy. Given the thesis that free-market capitalism will benefit the poor **especially**, we have to ask: is this actually true and, of so, can the other classes benefit equally well? This means we need to ask whether the assumption to concentrate on **absolute** poverty or inequality rather that **relative** values makes more sense. Similarly, we need to question the assumption that "free market" capitalism is the growth machine its supporters assert and whether the benefits of the growth it produces does, in fact, "trickle down." Questioning these assumptions is essential.

The key problem with evaluating such claims is, of course, the fact that an economy, like a society, is a very complex system which evolves through time. There are few opportunities for "controlled experiments" with which to test differing analyses and theories. This means that any attempt to analysis these claims must be based on looking at different countries and time periods in order to contrast them. Thus we will look at the same countries at different periods (the more social democratic post-war period to the more neo-liberal post-1980s and more neo-liberal countries with those in which free-market "reforms" have not been pushed as far). As we will show, the track record of "free(r) market" capitalism has been, at best, distinctly unimpressive and, at worse, significantly poorer.

However, this appeal to reality will not convince many supporters of capitalism. For the true believer in the capitalist market, this kind of evidence does not create doubt in their ideas, only the conviction that the experiments did not go far enough. Thus, for the ideologue, freer market capitalism handily tell us nothing about free market capitalism — unless, of course, they can be portrayed as an "economic miracle" (regardless of the facts). For "advocates of the market," the sanctity of private property and private contracts is held as an inalienable natural right. To refute charges that this Will simply benefit the already wealthy they spend much time arguing that unfettered capitalism is also the only economic system which will produce the greatest benefit for the greatest number. In other words, that absolute capitalist markets and private property rights coincides **exactly** with personal interest. A clearer example of wishful thinking could hardly be asked for. Yet it is not hard to see what function this plays. Few people will be persuaded by their assumptions on property and markets, given the common sense objection that free exchange between the weak and the strong will, obviously, benefit the latter more. Yet more people may be convinced to go along with "free market" proposals by considerations of economic efficiency and the hope that the poor will see their living standards improve over time (particularly if "experts" with economics degrees are involved as people often assume they know what they are talking about).

Now, the empirical track-record of what is called capitalism is decidedly mixed. There are three courses of action open to the market advocate. The first is to embrace the property-rights argument wholeheartedly, and say that we should adopt pure capitalism even if it hurts a large percentage of the population because it is the right thing to do. This would be unconvincing for most people as economic austerity and serf-like working conditions in return for protecting the power and property rights of the few who actually own the wealth would find few (sane or disinterested) supporters. Then it could be argues that the empirical track-record of "actually existing" capitalism should be ignored in favour of economic ideology as reality is simply not pure enough. That, again, would be unconvincing for the obvious reason that we would be being asked to have faith in the validity of economics (as we have noted before, this would not be wise given its surreal assumptions and non-scientific nature). This would have one positive side-effect, as doing this would mean that that "market advocates" would have to stop claiming that all the good things we have are due to something (capitalism) that does not exist. So that option is unlikely to have many supporters or convince many. Finally, it could be argued that contrary to appearances capitalism really **does** benefit everyone. While this option is not compatible with intellectual honesty, it is by the far the most popular within the ranks of "market advocates." This is undoubtedly because the wealth and corporations are always willing to pay well for people happy to defend their power and profits against the reality they produce.

So what of the claim that capitalism is the best way to help them poor, that capitalism will especially benefit working class people? To make sense (i.e. to be more than simply a rhetoric assertion), it must rest on two basic notions. Firstly, that "free market" capitalism will have a higher growth rate than alternative forms of that system (such state capitalism or regulated capitalism). Secondly, that inequality will be less and share of wages in the national income more in "free market" than in other systems (this must be the case, otherwise "free market" reforms do not **especially** help working class people). We will discuss the first claim here, before discussing the track record of neo-liberalism in the next section followed a discussion of the history of capitalism and free trade in section C.10.2. We then analysis the failings of the equality defence in section C.10.3 before ending with a discussion on the limitations of looking at income and growth in evaluating how capitalism benefits the working class (section C.10.4). As we show, there is substantial evidence to suggest that the standard defences of "free market" capitalism are not up to much. Let us be clear and state there is generally a positive correlation between economic growth and the income of the poor. We are not attacking economic growth as such but rather asking whether neo-liberalism's own defence actually stands up.

Looking at the historical picture, then, yes, capitalism does produce much more economic growth than previous social systems such as slavery and feudalism. However, defending capitalism on the basis that it better than a slave based economy is hardly a strong foundation (particularly when capitalists are happy to locate to dictatorships which have slave-like labour conditions). The more substantive argument is based on the assumption that "free market" capitalism produces faster economic growth than other forms of that system and that growth of the economic pie is more important than how it is distributed. In other words, the same (or even smaller) share of a bigger pie in the future is better than a bigger share of the existing pie. This means we need to look at the economic performance of capitalist economies, comparing the neo-liberal ones to regulated social democratic ones. We would expect the former to be performing significantly better than the latter in addition to being more dynamic **after** reforms than before. The reality hardly matches the claims.

The attempt to compare and contrast economies can be found in, say, the works of Milton Friedman to show the superiority of his beloved "free market" capitalism. However, as economist Thomas Balogh notes, to prove that *"socialistic policies"* had crippled Britain's economic growth since 1945 Friedman began *"by misrepresenting the size of the public sector ... he chooses a ratio which, though irrelevant, gives spurious support to his thesis."* Equally, Friedman compares post-war Britain to post-war Japan and West Germany, conveniently failing to note that both hardly had minimal states (for example, West Germany had approximately the same level of state spending as the UK and Japan had the social planning of its Ministry of Industry and Trade). As Balogh notes, the *"consequences of socialism are then illustrated by reference to the weak economic performance of Britain in comparison with Japan and Germany since 1945. This is an odd comparison to choose when judging the impact of 'socialism' on Britain. Surely what we need is to compare the British performance during a period of sustained boom under 'Friedmanism', e.g. in the period 1900–13, with the record under 'socialism,' say 1945–75."* However, to do that would mean noting that the average annual rate of growth per head of GNP between 1900 and 1913 was a mere 0.2%, compared to 2.2% between 1948 and 1975. Even taking other starting dates (such as the slump year 1893) produces a smaller rate of growth that the post-war period. [**The Irrelevance of Conventional Economics**, p. 181]

Nor do things get better when we look at the Friedman influenced Thatcher government which turned the UK into a poster-child for neo-liberalism. Here, yet again, the facts do not really support the claims in favour of "free(r) markets". As Ian Gilmore, a moderate conservative MP at the time, points out *"[d]uring the Thatcher years growth was lower than in any period of similar length since the war."* He notes *"the vast discrepancy between what the Thatcherites claimed for their policies and what actually happened."* Unsurprisingly, there was an *"unparalleled rise in poverty,"* as *"relative poverty grew significantly during the 1980s,"* from a nearly a tenth in 1979 to nearly a fifth in 1987. In 1979, the poorest fifth had just under 10% of post-tax income and the richest fifth had 37%. Ten years later, this had fallen to 7% and risen to 43% (*"The rich got rich, and the poor* *got poorer"*). *"Not only did the poor not share in the limited growth that took place between 1979 and 1990, the poor were relatively poorer than they had been on 1979."* [**Dancing with Dogma**, pp. 83–4, p. 87, p. 142, p. 138 and p. 172] we will return to this issue in section C.10.3.

Things did not get any better in the 1990s. Growth in GDP per capita was steadily decreased in the UK, from 2.3% per annum between 1950 and 1970, to 2.1% between 1970 and 1979 and to 1.9% between 1979 and 1997. For the US, a similar process was at work (from 2.0%, to 2.3% to 1.5%). At best, it can be said that the growth rates of Germany and France between 1979 and 1997 were worse (at 1.7% and 1.4%, respectively). However, before 1979 their growth was much higher (at 5.1%/4.5% between 1950 and 1970 and 2.8%/3.3% between 1970 and 1979, respectively). Growth in labour productivity per hour worked is hardly impressive, being 2.3% between 1979 and 1997 compared to 0.8% for the US, 2.4% for France and 2.2% for Germany. This is well below the 1950–1970 figure of 3.0% and only slightly better than 2.1% during the strike bound 1970s. In 1979, the UK was 9th of 15 EU members in OECD measures of prosperity. By 1995, it was 11th before rising back to 10th in 1999. In summary, *"the idea that Britain has a clearly superior economy to the continent is a delusion."* [Adair Turner, **Just Capital: The Liberal Economy**, p. 200, pp. 199–200 and p. 196]

The best that can be said of Thatcherism is that during the 1980s, *"Britain put an end to three decades of relative decline and caught up some lost ground versus continental leaders … But Britain's absolute productivity and prosperity performance is still below the European average and its pace of catch-up has been slow."* Combine this with longer working hours compared to the rest of Europe, we have a situation in the UK where *"too many companies relying on low wages and a flexible labour market to remain competitive, rather than on investment in capital equipment and technique."* Looking at the historical picture, it should be stressed that the UK has been in decline since the 1880s, when it remained the only developed nation to embrace free trade and that between the 1950s and 1970s, the *"absolute growth rates per capita … compared well with the inter-war years and with the period of British leadership in the nineteenth century."* This lack of success for neo-liberal reforms can also be seen in New Zealand. The economic results of its liberalisation project were just as poor. Between 1984–98 per capita income grew only about 5.4%, or 0.4% per annum, well below the EU average and one of the lowest rates of increase among the OECD countries. [Turner, **Op. Cit.**, p. 196, p. 212, p. 199 and p. 240fn] Needless to say, be cause the rich got richer and rebellious workers controlled, both the UK and New Zealand were proclaimed "economic miracles."

This lack of dynamism is not limited just to the UK or New Zealand. As left-wing economist Andrew Glyn notes, the *"fact that there was no general improvement in growth in the 1980s could be explained away by the fact that the … policies … were only picking up steam. But the real puzzle is the 15 years since 1990. Why [have these free market policies] … failed to bring an increase in the growth rate."* In fact, growth per year has steadily fallen since 1973 with 1990–2004 the lowest rate yet for the USA, Europe and Japan. This applies to other economic indicators as well. *"The fact that output per head has been growing more slowly since 1990 than it did in the turbulent period 1973–9, never mind the Golden Age, must be a severe disappointment to those who believed that unleashing the free market would restore rapid growth."* He summarises the evidence by pointing out that *"economic performance overall has been unspectacular."* [**Capitalism Unleashed**, pp. 130–1 and p. 151]

As Chomsky summarises, *"neoliberal-style programs began to take shape in the 1970s"* and since then real wages *"for the majority have largely stagnated or declined … the relatively weak benefits* *system has declines as well. Incomes are maintained only be extending working hours well beyond those in similar societies, while inequality has soared"* (as has personal debt). Moreover, *"this is a vast change from the preceding quarter century, when economic growth was the highest on record for a protracted period and also egalitarian. Social indicators, which closely tracked economic growth until the mid-1970s, then diverged, declining to the level of 1960 by the year 200O."* [**Failed States**, p. 211]

The assumption is that producing free(r) markets and a pure(r) capitalism will result in higher growth and so rising living standards. *"So far,"* note two experts, *"the promises have not been realised. As trade and financial markets have been flung open, incomes have risen not faster, but slower. Equality among nations has not improved, with many of the poorest nations suffering an absolute decline in incomes. Within nations, inequality seems to have worsened … the trend to towards more inequality."* In the two decades after 1980, *"overall income growth slowed dramatically."* For example, the rich countries saw annual per capita income growth fall from 4.8% (1965–80) to 1.4% (1980–95). Medium countries saw a fall from 3.8% to 3.1% (excluding China, this was 3.2% to 0.6% as China rose from 4.1% to 8.6%). For the poorest nations, there was a rise from 1.4% to 2.0% but this becomes 1.2% to 0.1% when India is excluded (India saw a rise from 1.5% to 3.2%). In fact, income dropped by -0.4% a year between 1980 and 1995 for the least developed countries (it had risen 0.4% a year between 1965 and 1980). *"In more advanced countries … income growth was lower in the 1990s than in the 1980s. Over the entire post-1980 period, it was substantially below that of the 1960s and 1970s."* In America, for example, annual growth of per capita income has dropped from 2.3% between 1960–79, to 1.5% between 1979 and 1989 and 1.0% between 1989 and 1996 (per capita income growth up to 1998 was 1.4% per year, still less than the 1.6% per cent between 1973 and 1980 and 1980s and about half the growth over the 1960 to 1973 period). Given that income equality improved during the 1960s and 1970s, before worsening after 1980 for most countries, particularly the USA, this means that even these most increases flowed overwhelming to those at the top of the income hierarchy. In America, the working hours for a middle-class family has increased by 10.4% between 1979 and 1997. In other words, working class people are working more for less. In most advanced nations, there has *"not been a sizeable increase in poverty,"* the *"exceptions [being] the USA and the United Kingdom, where poverty grew, respectively, by 2.4 and 5.4 percentage points between 1979 and 1991."* [Jeff Faux and Larry Mishel, *"Inequality and the Global Economy"*, pp. 93–111, Will Hutton and Anthony Giddens (eds.), **On The Edge**, pp. 93–4, p. 96, p. 97, p. 98, p. 101, p. 102 and p. 100]

This lack of rise in growth is a definite feature of neo-liberalism. The promises of the "free market" capitalism have not borne fruit:

> *"Growth did not accelerate. It slowed down. During the 1960s, the average rate of growth of world GDP per capita was 3.5% per annum … The average rate of growth of world GDP per capital was 2.1% per annum during the 1970s, 1.3% per annum during the 1980s and 1% per annum during the 1990s. This growth was more volatile compared with the past, particularly in the developing world. the growth was also unevenly distributed across countries …*
>
> *"Economic inequalities have increased in the late twentieth century as the income gap between rich and poor countries, between rich and the poor in the world's population, as also between rich and poor people within countries, has widen. The ratio of GDP per capital in the richest country to GDP per capita in the poorest country of the world rose*

from 35:1 in 1950 to 42:1 in 1970 and 62:1 in 1990. The ratio of GDP per capita in the 20 richest countries to GDP per capita in the poorest 20 countries of the world rose from 54:1 during 1960–62 to 121:1 during 2000–20002. The income gap between people has also widened over time. The ratio of the average GNP per capita in the richest quintile of the world's population to the poorest quintile in the world's population rose from 31:1 in 1965 to 60:1 in 1990 and 74:1 in 1997 … Income distribution within countries also worsened … Between 1975 and 2000, the share of the richest 1% in gross income rose from 8% to 17% in the US, from 8.8% to 13.3% in Canada and from 6.1% to 13% in the UK." [Deepak Nayyar, *"Globalisation, history and development: a tale of two centuries,"* pp. 137–159, **Cambridge Journal of Economics**, Vol. 30, No. 1, pp. 153–4 and p. 154]

In fact, between 1950 and 1973 there was a vastly superior economic performance compared to what came before and what came after. If laissez-faire capitalism would benefit "everyone" more than "really existing capitalism," the growth rate would be **higher** during the later period, which more closely approximated laissez faire. It is not. As such, we should always remember that if anything is proclaimed an "economic miracle" it is unlikely to actually be so, at least for the working class. Looking at the American triumphantism of the late 1990s, it was easy to forget that in the 1980s and early 1990s, despair at the US economy was commonplace. Then people looked to Japan, just as they had looked to Europe in the 1960s.

We must also note that there is a standard response by believers on "laissez-faire" capitalism when inconvenient facts are presented to them, namely to stress that we have not reached the market utopia yet and more reforms are required (*"a feature of hard-line free-market analysis [is] that when liberalisation does not work the reason is always timidity and the solution is obvious. Complete the job."* [Glyn, **Op. Cit.**, p. 143]). Another possible defence would be to stress that the results would have been worse if the reforms had not been implemented. These are, of course, possibilities but given the rhetoric used by the defenders of capitalism on the wonders and efficiency of free markets, it seems strange that making them freer would have such negative effects.

Looking at the history of capitalism, it appears that social-democratic capitalism, with strong unions and a welfare state, produces not only more growth but also more equitable growth (as one expert notes, *"[i]f the 'welfare state' were abolished and taxes reduced accordingly, society would become a great deal more unequal."* [John Hills, **Inequality and the State**, p. 195]). Movements to more laissez-faire capitalism has resulted not only in lower growth but also growth which accumulates in fewer hands (which makes sense considering the basic anarchist insight that a free exchange benefits the stronger of the two parties). As such, based on its own criteria (namely economic growth), then neo-liberalism has to be judged a failure. Do not get us wrong. It is possible to still advocate laissez-faire capitalism on ethical grounds (if that is the right word). It is simply doubtful that it will produce the boost in economic growth (or employment) that its advocates suggest. It may do, of course, as "actually existing" capitalism is still far from the pure system of the textbooks but it is significant that movements towards the ideal have produced **less** growth along with greater inequality and relative poverty.

This is **not** to suggest that anarchists support social-democratic capitalism rather than more laissez-faire forms. Far from it — we seek to end all forms of that system. However, it is significant that the more equal forms of capitalism based on strong and militant unions produced better results than "free(r) market" forms. This suggests that the standard right-wing argument that collective organising and fighting to keep an increased share of the wealth we produce harms the overall economy and so harmful in the long run are deeply flawed. Instead, it is the **lack** of any struggle for equality and freedom that is correlated with bad overall economic performance. Of course, such struggles are a pain for the capitalist class. Rather than produce a *"road to serfdom,"* social-democracy created the full employment environment which produced a rebellious population. The move towards "free(r) markets" was a response to this social struggle, an attempt to enserf the population which has proven to be somewhat successful. As such, Kalecki's 1940s prediction we quoted in section B.4.4 has been proven correct: the ruling class would prefer social peace (i.e. obedience) rather than higher growth (particularly if they get to monopolise most of the gains of that lower growth).

Finally, we should note that there is a slight irony to see right-wingers saying that "pure(r)" capitalism would benefit the poor especially. This is because they usually reject the idea that aggregate economic statistics are a meaningful concept or that the government should collate such data (this is a particular feature of the "Austrian" school of economics). As such, it would be near impossible to determine if living standards had improved any faster than under the current system. Given the history of "actually existing" capitalism, it is probably wise that many "market advocates" do so. Moreover, any subjective evaluation, such as asking people, which resulted in a negative response would be dismissed out of hand as "envy." Ironically, for an ideology which says it bases itself on "subjective" evaluations, economists are always ready to ignore any which conflict with their ideas. Needless to say, even if it could be proven beyond doubt that "pure(r)" capitalism did **not** help the poor but rather enriched the wealthy then almost all "free market" capitalists would **not** change their ideas. This is because, for them, the outcomes of the market are hallowed and if they result in increased poverty then so be it. It just shows that the poor are lazy and not worth higher incomes. That they sometimes utilise the rhetoric of social concern simply shows that most people still have concern and solidarity for their fellows, a concern which capitalism has not managed to totally remove (much to the chagrin of the likes of von Hayek — see chapter 11 of Alan Haworth's **Anti-Libertarianism** for a short but relevant discussion of this).

C.10.1 Hasn't neo-liberalism benefited the world's poor?

Until the wave of so-called "anti-globalisation" protests (a more accurate term would be "global justice" protests) erupted in the late 1990s, there was no real need for the neo-liberal agenda to justify its performance. When opposition could not be ignored, then it had to be undermined. This lead to a host of articles and books justifying neo-liberalism in terms of it helping the world's poorest peoples. This has meant denying the reality of 30 years of neo-liberal reforms in favour of concentrating on absolute poverty figures.

This is understandable. As we discuss in the section C.10.4, absolute inequality and poverty is a good means of making discussion of the real issues meaningless. Moreover, as noted above, as capitalism must grow to survive wealth will tend to increase for all members of society over time. The real question is whether "free(r) markets increase or reduce growth rates and how they impact on relative levels of poverty and inequality. Given that the last few decades indicate how free(r) markets result in increased inequality, it is obvious why defenders of capitalism would seek to focus attention on absolute income. While denied by some, inequality has risen under globalisation. Those who deny it usually do so because the doctrines of the powerful are at stake.

Some, in spite of the evidence, are that world-wide economic inequality has fallen thanks to global capitalism.

At the forefront of such claims is **the Economist** magazine, which played its usual role of ideological cheerleader for the ruling class. Discussing *"Global economic inequality"*, the magazine argued that the claim that inequality has risen is false. Ironically, their own article refutes its own conclusions as it presented a graph which showed an upward relationship between economic growth from 1980 to 2000 and original income level for a large group of countries. This means that global economic inequality **has** increased — as they admit, this means *"that the poor are falling behind, and that cross-country inequality is getting worse."* [*"More or less equal?"*, **The Economist**, 11th March, 2004]

However, this conclusion is ideologically incorrect and so something must be done to achieve the correct position in order to defend capitalism against the anti-capitalist bias of reality. They did this by adding another chart which weights each point by population. This showed that two of the largest countries of their group, China and India, grew among the fastest. Using this data they make the claim that inequality has, in fact, fallen under neo-liberalism. Once you look at individuals rather than countries then the claim can be made that world-wide inequality has been falling under "free(r) market" capitalism. While an impressive piece of ideological obfuscation, the argument ignores changes **within** countries. The article states that *"average incomes in India and China are going up extremely rapidly"* but not every person receives the average. The average hides a lot. For example, 9 homeless people have an average income of £0 but add a multi-millionaire and the average income of the ten people is in the millions. On average, at the end of a game of poker everyone has the same amount of money they started with. As such, to ignore the fact that inequality increased dramatically both countries during the 1990s is disgraceful when trying to evaluate whether poverty has actually decreased or not. And it should be obvious that if inequality is increasing **within** a country then it must also be increasing internationally as well.

Significantly, *"where governments adopted the [neo-liberal] Washington Consensus, the poor have benefited less from growth."* [Joseph E. Stiglitz, **Globalization and its Discontents**, p. 79] The mantra that economic growth is so wonderful is hard to justify when the benefits of that growth are being enjoyed by a small proportion of the people and the burdens of growth (such as rising job insecurity, loss of benefits, wage stagnation and decline for the majority of workers, declining public services, loss of local communities and so forth) are being borne by so many. Which does seem to be the case under neo-liberalism (which, undoubtedly, explains why it is portrayed so positively in the business press).

To be fair, the article does note the slow and declining incomes in the past 20 years in sub-Saharan Africa but rest assured, the magazine stresses, this area *"suffers not from globalisation, but from lack of it."* This means that this area can be ignored when evaluating the results of neo-liberalism. Yet this is unconvincing as these nations are hardly isolated from the rest of the world. As they are suffering from debt and western imposed structural adjustment programs it seems illogical to ignore them — unless it is a way to improve neo-liberalism's outcomes by evading its greatest failures.

Then there is the comparison being made. The Economist looks solely at the years 1980–2000 yet surely the right comparison would be between this period and the twenty years before 1980? Once that is done, it becomes clear why the magazine failed to do so for *"economic growth and almost all of the other indicators, the last 20 years have shown a very clear decline in progress as compared with the previous two decades."* While it is *"commonly believed that the shift towards* *globalisation has been a success, at least regarding growth,"* in fact *"the progress achieved in the two decades of globalisation has been considerably less than the progress in the period from 1960 to 1980."* For low and middle-income countries, performance is *"much worse … than the period from 1960 to 1980." "Summing up the evidence on per capita income growth, countries at every level of per capita GDP performed worse on average in the period of globalisation than in the period from 1960 to 1980."* [Mark Weisbrot, Dean Baker, Egor Kraev and Judy Chen, **The Scorecard on Globalization 1980–2000: Twenty Years of Diminished Progress**] In fact:

> *"The poorest group went from a per capita GDP growth rate of 1.9 percent annually in 1960–80, to a decline of 0.5 percent per year (1980–2000). For the middle group (which includes mostly poor countries), there was a sharp decline from an annual per capita growth rate of 3.6 percent to just less than 1 percent. Over a 20-year period, this represents the difference between doubling income per person, versus increasing it by just 21 percent."* [**Op. Cit.**]

Nor should we forget that there is a *"gallery of nations whose economies soured shortly after their leaders were lauded by the global policy elite for pursuing sound economic fundamentals."* [Jeff Faux and Larry Mishel, **Op. Cit.**, p. 94] This process of proclaiming the success of neo-liberalism before it implodes started with the original neo-liberal experiment, namely Pinochet's Chile whose economy imploded just after Milton Friedman proclaimed it an "economic miracle" (see section C.11).

Latin America has suffered the most attention from neo-liberalism and its institutions so it would be useful to look there for evaluating the claims of its supporters (*"the IMF talks with pride about the progress that Latin America made in market reforms"* [Stiglitz, **Op. Cit.**, p. 79]). Rather than success story, there has been *"a long period of economic failure: for the prior 20 years, 1980–1999, the region grew by only 11 percent (in per capita terms) over the whole period. This is the worst 20-year growth performance for more than a century, even including the years of the Great Depression."* By comparison, *"for the two decades from 1960–1979, Latin America experienced per capita GDP growth of 80 percent."* In fact, *"using the 1960–1979 period as a baseline, the quarter century for 1980–2004 is dismal. Annual growth in GDP per capita registers a mere 0.5 percent, as opposed to 3.0 percent over the previous period. Countries that are now considered relatively successful are not doing very well compared to past performance. For example, Mexico registers 0.8 percent annual per capita growth for 1980–2004, as compared with 3.3 percent for 1960–79. For Brazil, which one had one of the fastest growing economies in the world, per capita growth is only 0.8 percent annually for 1980–2004, as compared with 4.9 percent for 1960–79."* For Latin America as a whole, real per-capita growth was 3.0% in the 1960s, 2.9% in the 1970s, -0.3% in the 1980s and 1.4% in the 1990s. This means that for 1980–1999, *"the region's per capita GDP grew at an annual rate of only 0.5 percent, a cumulative total of 11 percent for the two decades."* By comparison, *"from 1960–1979, per capita growth was 3.0 percent, or 80 percent for these two decades."* [Mark Weisbrot and David Rosnick, **Another Lost Decade?: Latin America's Growth Failure Continues into the 21st Century**] Looking at Mexico, for example, since NAFTA per capita GDP growth in Mexico has averaged less than 1.0% annually. This is an extremely poor growth record for a developing country. Successful developing countries, such as South Korea and Taiwan have managed to sustain per capita GDP growth rates that have averaged more than 4.0% since the sixties. In fact, Mexico managed to sustain a per capita GDP growth rate of more than 4.0% in the period from 1960 to 1980, when it was following a path of import substitution. But, then, neither South Korea nor Taiwan followed the dictates of neo-liberalism.

Over all it is important to stress that neo-liberalism has failed its own test:

> *"Economic growth over the last twenty years, the period during which [neo-liberalism] policies ... have been put into place, has been dramatically reduced ... to assume that the World Bank and the IMF have brought 'growth-enhancing policies' to their client countries goes against the overwhelming weight of the evidence over the last two decades ... In short, there is no region of the world that the Bank or Fund can point to as having succeeded through adopting the policies that they promote — or in many cases, impose — upon borrowing countries."* [Mark Weisbrot, Dean Baker, Robert Naiman, and Gila Neta, **Growth May Be Good for the Poor — But are IMF and World Bank Policies Good for Growth?**]

As Chomsky summarises, the periods of fastest and prolonged growth have not coincide with phases of extensive liberalisation. In fact, neoliberal reforms have *"been accompanied by much slower rates of growth and reduced progress on social indicators ... There are exceptions to the general tendency: high growth rates were recorded among those who ignored the rules (and with tremendous inequality and other severe side effects in China and India)."* Growth rates have, in fact, fell by *"over half"* compared to the preceding period of statist policies (particularly when measured per capita). [**Op. Cit.**, pp. 216–7] For most countries, growth was higher in the 1950s, 1960s and even the 1970s. This suggests that neo-liberalism fails even its own tests as noted by one economist who compared the reality of successful development to the neo-liberal myth:

> *"the poor growth records of developing countries over the last two decades suggest this line of defence [i.e. it brings higher growth] is simply untenable ... The plain fact is that the Neo-Liberal 'policy reforms' have not been able to deliver their central promise — namely, economic growth."* [Ha-Joon Chang, **Kicking Away the Ladder**, p. 128]

Then there is the issue of what the magazine fails to mention. For a start, it excludes the ex-Stalinist regimes in Eastern Europe. This is understandable for obvious reasons. If these nations were included, then their rising inequality and poverty since they became part of the global market would have to be mentioned and this would make its defence of neo-liberalism much harder (as would the fact life expectancies fell to Third World levels). As economist Joseph Stiglitz points out, the neo-liberal reforms brought the ex-Stalinist countries *"unprecedented poverty."* In 1989, only 2% of Russians lived in poverty, by the late 1998 that number had soared to 23.8%, using the $2 a day standard. More than 40% had less that $4 a day. Other post-Stalinist countries *"have seen comparable, if not worse, increases in poverty."* Overall, these reform package has *"entailed one of the largest increases in poverty in history."* [**Globalization and its Discontents**, p. 6, p. 153 and p. 182]

The GDP in the former Stalinist states fell between 20% and 40% in the decade after 1989, an economic contraction which can only be compared to the Great Depression of the 1930s. Of the 19 ex-Stalinist economies, only Poland's GDP exceeded that of 1989, the year transition began. In only 5 was GDP per capita more than 80% of the 1989 level. [Chang, **Op. Cit.**, p. 129] Only a small minority saw their real wages rise; the vast majority experienced a spectacular fall in living standards. It took the Czech Republic, for example eight years until average real wages reached their 1989 level. Unemployment became widespread. In 2005, Slovakia had 27% of its under-25s are unemployed while in Poland 39% of under-25s were without a job (the highest figure in Europe) and 17% of the population were below the poverty line.

Overall, between 1985 and 2000, growth in GDP per capita was negative in 17 transition countries while the *"incidence of poverty increased in most countries of Latin America, the Caribbean and Sub-Saharan Africa during the 1980s and the 1990s. Much of Eastern Europe and Central Asia experiences a sharp rise in poverty during the 1990s."* East, Southwest and South Asia did experience a steady decline in the incidence of poverty, but *"most of this improvement is accounted for by changes in just two countries, with large populations, China and India."* [Deepak Nayyar, **Op. Cit.**, p. 154, pp. 154–5 and p. 155] Hardly an inspiring result.

And what of the actual economic regimes in China and India? One left-wing economist notes that *"in the early stages of China's high growth period there was an expansion of state employment, including in the dynamic and crucial manufacturing sector … in its most recent phase, private capital accumulation dominates the growth process in China, although the state still strongly influences the pattern of investment through its control of the credit system and its policy of creating 'national champions' in sectors such as cars and steel."* Not to mention, of course, its role in the labour market. There is no freedom to organise — the country is, in effect, one big workplace and the state bosses do not tolerate freedom of association, assembly and speech any more than any other company. Unsurprisingly, labour discipline *"is very harsh"* and workers may find it difficult to change jobs and migrate to urban areas. [Andrew Glyn, **Op. Cit.**, p. 87 and p. 94]

As one expert notes, in the case of both India and China *"the main trade reforms took place **after** the onset of high growth. Moreover, these countries' trade restrictions remain among the highest in the world."* In India, its *"trend growth rate increased substantially in the early 1980s"* while *"serious trade reform did not start until 1991–93 … tariffs were actually higher in the rising growth period of the 1980s than in the low-growth 1970s."* Thus claims of *"the beneficial effects of trade liberalisation on poverty have to be seen as statements based on faith rather than evidence."* [Dani Rodrik, **Comments on 'Trade, Growth, and Poverty by D. Dollar and A. Kraay**] As Chomsky notes, there is a deliberate policy which *"muddles export orientation with neo-liberalism, so that if a billion Chinese experience high growth under export-orientated policies that radically violate neo-liberal principles, the increase in average global growth rates can be hailed as a triumph of the principles that are violated."* [**Op. Cit.**, p. 217] It should also be mentioned that both these states avoided the 1980s debt crisis by avoiding Western banks in the 1970s. They also maintain capital controls, so that hot money cannot flow freely in and out, and have large state sectors.

At least the **Economist** itself notes that *"[n]either country is an exemplar of free market capitalism — far from it."* That says it all about the defenders of free market capitalism; they defend their ideas by pointing to countries which do not apply them!

It should be stressed that this praise for the "free market" using regimes which hardly meet the criteria has a long history. This has included both Japan and the East Asian Tigers in the 1970s and 1980s as *"the spectacular growth of these countries … is fundamentally due to activist industrial, trade and technology policies (ITT) by the state."* [Chang, **Op. Cit.**, p. 49] As an expert on these economies notes, *"the legend is not fully consistent with the way the governments have in practice behaved,"* namely adopting *"over a long period of time a much more aggressive, dirigistic set of industrial policies than free-trading principles would justify."* In fact, their *"governments were deeply committed to increasing and sustaining high levels of investment and to steering its composition."* He bemoans the *"assumption that only those features of economic policy consistent with neoclassical principles could have contributed to good economic performance"* and so explanations for such *"accordingly ignore non-neoclassical features."* [Robert Wade, *"What can Economics Learn from East Asian Success?"*, pp. 68–79, **Annals of the American Academy of Political and Social Science**, vol. 505, pp. 70–1, p. 72 and p. 68]

This analysis was proved right when, ironically, the praise turned to attack when the 1997 crisis erupted and all the features previously ignored or denied where brought onto the central stage to explain the slump (*"When their bubbles imploded, the same countries were denounced by the policy elites for something called 'crony capitalism' — a year earlier, the term had been 'business-friendly environment.'"* [Jeff Faux and Larry Mishel, **Op. Cit.**, p. 94]). As Robert Wade noted, *"the perception shifted from 'miracle Asia' to 'Asian crony state capitalism' almost over night,"* a term used *"to convey a told-you-so moral about the dangers of government intervention."* [*"From 'miracle' to 'cronyism': explaining the Great Asian Slump"*, pp. 673–706, **Cambridge Journal of Economics**, Vol. 22, No. 6, p. 699 and p. 700] Ironically, Japan's 1990s woes and the 1997 crisis both occurred **after** those states liberalised their economies (as recommended by, of course, economists and the IMF). Unsurprisingly, we discover Milton Friedman pointing (in 2002!) to the *"dramatic success of the market-orientated policies of the East Asian tigers"* as if they gave support to his ideological position of laissez-faire capitalism. [**Op. Cit.**, p. ix]

Then there is the issue of "economic liberty" as such. Milton Friedman stated in 2002 that the *"limited increase in economic freedom has changed the face of China, strikingly confirming our faith in the power of free markets."* [**Op. Cit.**, pp. viii-ix] Faith is the right word, as only the faithful could fair to note that there is no free market in China as it does not have basic freedoms for labour. How much "economic freedom" is there for workers under a brutal dictatorship? How can it be claimed, with a straight face, that there is an *"increase in economic freedom"* in such regimes? It seems, therefore, that for right-wing economists that their *"faith"* in "free markets" is *"confirmed"* by an authoritarian system that obviously and constantly violates the freedom of labour. But then again, workers have never been considered highly by the profession. What has always counted is the freedom of the boss and, consequently, a regime that secures that is always praised (and we discuss in section C.11, Friedman has a track record in this).

The selectively of the supporters of "free market" capitalists is truly staggering. Take, as an example, globalisation and anti-globalisation protests. Supports of the trade deals accused critics as being against "free trade" and, by implication, against freedom. Yet the deals they supported were based on accepting the current labour standards across the world. This means accepting the labour conditions of states, usually dictatorships, which habitually deny a free market (even a capitalist one) to its workers — all in the name of the free market! Which makes the "free market" supporters of neo-liberalism utter hypocrites. They are happy to accept a "free market" in which the denial of freedom of workers to form unions is an intrinsic part. It also suggests that the much attacked critics of "trade" deals who demand that basic standards of freedom for workers be incorporated into them are those who truly support "free trade" and the "free market." Those who advocate unrestricted trade with dictatorial regimes (where workers are thrown in prison, at best, or assassinated, at worse, if they organise or talk about unions and protests) are engaging in the worse form of doublethink when they appropriate the term "freedom" for their position.

It is easy to understand why supporters of capitalism do so. In such regimes, capital is free and the many abuses of freedom are directed towards the working class. These suppress wages and the resulting competition can be used to undermine workers wages, conditions and freedoms back home. This is why neo-liberals and such like agree to a range of global policies that give substantial freedoms to capitalists to operate unhindered around the world while, at the same time, fiercely resistant to any demands that the freedom of workers be given equal concern (this why Chomsky talks about the *"international global justice movement, ludicrously called 'anti-globalisation' because they favour globalisation that privileges the interests of people, not investors and financial institutions."* [**Op. Cit.**, p. 259]). In other words, free markets are fine for capitalists, but not for workers. And if anyone disagrees, they turn round and accuse their critics of being opposed to "freedom"! As such, anti-globalisation protesters are right. People in such regimes are not free and it is meaningless to talk of the benefits of "free markets" when a free market in labour does not exist. It does, of course, show how genuine the defenders of capitalism are about freedom.

So has global poverty fallen since the rise of neo-liberalism in 1970s? Perhaps it has, but only if you apply the World Bank measure (i.e. a living standard of less than a dollar a day). If that is done then the number of individuals in dire poverty is (probably) falling (although Joseph Stiglitz states that *"the actual number of people living in poverty … actually increased by almost 100 million"* in the 1990s and he argues that globalisation as practised *"has not succeeded in reducing poverty."* [**Op. Cit.**, p. 5 and p. 6]). However, the vast bulk of those who have risen out of dire poverty are in China and India, that is in the two countries which do not follow the neo-liberal dogma. In those that did follow the recommendations of neo-liberalism, in Africa, Latin America and Eastern Europe, poverty and growth rates are much worse. Chang states the obvious:

> *"So we have an apparent 'paradox' here — at least if you are a Neo-Liberal economist. All countries, but especially developing countries, grew much faster when they used 'bad' policies during the 1960–1980 period than when they used 'good' ones during the following two decades … Now, the interesting thing is that these 'bad; policies are basically those that the NDCs [Now Developed Countries] had pursued when they were developing countries themselves. Given this, we can only conclude that, in recommending the allegedly 'good' policies, the NDCs are in effect 'kicking away the ladder' by which they have climbed to the top."* [**Op. Cit.**, p. 129]

Hardly a glowing recommendation for the prescriptions favoured by the Economist and other supporters of free market capitalism. Nor very convincing support for solving the problems of neo-liberalism with yet more globalisation (of the same, neo-liberal, kind). One thing is true, though. The accepted wisdom of the age if that the road to prosperity and international acceptance is "economic liberalisation" or some of euphemism for opening economies to foreign investment. What this really means is that authoritarian regimes that allow their subjects to be exploited by international capital rather than state bureaucracies will find apologists among those who profit from such transactions or get paid by them. That this involves violation of the freedom of working class people and the labour "market" does not seem to bother them for, they stress, in long term material benefits this will create outweigh such restrictions on the eternal and sacred laws of economics. That "freedom" is used to justify this just shows how debased that concept has become under capitalism and within capitalist ideology.

C.10.2 Does "free trade" benefit everyone?

As we discussed in the last section, the post-1980 era of neo-liberal globalisation and "free(r) markets" has not been as beneficial to the developing world as the defenders of neo-liberalism suggest. In fact, these economies have done worse under neo-liberalism than they did under state-aided forms of development between 1950 and 1980. The only exceptions post-1980 have been those states which have rejected the dogmas of neo-liberalism and used the state to foster economic development rather than rely on "free trade."

It would, of course, be churlish to note that this is a common feature of capitalist development. Industrialisation has always been associated with violations of the sacred laws of economics and freedom for workers. In fact, the central conceit of neo-liberalism is that it ignores the evidence of history but this is unsurprising (as noted in section C.1.2, economics has a distinct bias against empirical evidence). This applies to the notion of free trade as well as industrialisation, both of which show the economists lack of concern with reality.

Most economists are firm supporters of free trade, arguing that it benefits all countries who apply it. The reason why was first explained by David Ricardo, one of the founding fathers of the discipline. Using the example of England and Portugal and wine and cloth, he argued that international trade would benefit both countries even if one country (Portugal) produced both goods more cheaply than the other because it was relative costs which counted. This theory, called comparative advantage, meant that it would be mutually beneficial for both countries to specialise in the goods they had a relative advantage in and trade. So while it is cheaper to produce cloth in Portugal than England, it is cheaper still for Portugal to produce excess wine, and trade that for English cloth. Conversely, England benefits from this trade because its cost for producing cloth has not changed but it can now get wine at closer to the cost of cloth. By each country specialising in producing one good, the sum total of goods internationally increases and, consequently, everyone is better off when these goods are traded. [**The Principles of Political Economy and Taxation**, pp. 81–3]

This argument is still considered as the bed-rock of the economics of international trade and is used to refute arguments in favour of policies like protectionism. Strangely, though, economists have rarely compared the outcome of these policies. Perhaps because as Chomsky notes, *"if you want to know how well those theorems actually work, just compare Portugal and England after a hundred years of development."* [**Understanding Power**, p. 254] One economist who did was the German Friedrich List who, in 1837, urged people *"to turn his attention to Portugal and to England and to compare the economies of these two countries. I am sure that he can have no doubts as to which country is prosperous and which has lost its economic independence, is dead from an intellectual, commercial and industrial point of view, and is decadent, poverty stricken and weak."* [**The Natural System of Political Economy**, pp. 169–70] Unsurprisingly, List used this example to bolster his case for protectionism. Little has changed. Allan Engler notes that *"[a]fter nearly 200 years, comparative advantage had given Portugal no noticeable advantage."* While the UK became the leading industrial power, Portugal remained a poor agricultural economy: *"Britain's manufacturing industries were the most efficient in the world, Portugal had little choice but to be an exporter of agricultural products and raw materials."* In 1988, Portugal's per capita GDP was less than one third that of the UK. When "Purchasing power parity" is factored in, Portugal's per capita GDP was barely more than half of the UK. [**Apostles of Greed**, p. 132]

Nor should we forget that free trade takes the economic agent as the country. Unlike an individual, a nation is divided by classes and marked by inequalities of wealth, power and influence. Thus while free trade may increase the sum-total of wealth in a specific country, it does not guarantee that its benefits or losses will be distributed equally between social classes, never mind individuals. Thus capitalists may favour free trade at specific times because it weakens the bargaining power of labour, so allowing them to reap more income at the workers' expense (as producers and consumers). Taking the example of the so-called "free trade" agreements of the 1990s, there was no reason to believe that benefits of such trade may accrue to all within a given state nor that the costs will be afflicted on all classes. Subsequent developments confirmed such a perspective, with the working class suffering the costs of corporate-led "globalisation" while the ruling class gained the benefits. Not that such developments bothered most economists too much, of course. Equally, while the total amount of goods may be increased by countries pursuing their comparative advantage it does not automatically follow that trade between them will distribute the benefits equally either between the countries or within them. As with exchange between classes, trade between countries is subject to economic power and so free trade can easily lead to the enrichment of one at the expense of the other. This means that the economically powerful will tend to support free trade as they will reap more from it.

Therefore the argument for free trade cannot be abstracted from its impact or the interests it serves, as Joan Robinson pointed out:

> *"When Ricardo set out the case against protection he was supporting British economic interests. Free trade ruined Portuguese industry. Free trade for **others** is in the interests of the strongest competitor in world markets, and a sufficiently strong competitor has no need for protection at home. Free trade doctrine, in practice, is a more subtle form of Mercantilism. When Britain was the workshop of the world, universal free trade suited her interests. When (with the aid of protection) rival industries developed in Germany and the United States, she was still able to preserve free trade for her own exports in the Empire."* [**Collected Economic Papers**, vol. 5, p. 28]

This echoes the analysis of List who that the British advocacy of free trade was primarily political in nature and not to mention hypocritical. Its political aim was to destroy potential competitors by flooding their markets with goods, so ruining their industrial base and making them exporters of raw materials for British industry rather than producers of finished goods. He argued that a *"study of the true consequences"* of free trade *"provide the key to England's commercial policy from that day to this. The English have always been cosmopolitans and philanthropists in theory but always monopolists in practice."* [**Op. Cit.**, p. 167] Moreover, such a position was hypocritical because Britain industrialised by means of state intervention and now sought to deny that option to other nations.

List advocated that the state should protect infant industries until such time as they could survive international competition. Once industrialised, the state could then withdraw. He did not deny that free trade may benefit agricultural exporters, but only at the expense of industrial development and spill-over benefits it generates for the economy as a whole. In other words, free trade harmed the less-developed nation in terms of its economic prosperity and independence in the long run. Protectionism allowed the development of local industrial capitalism while free trade bolstered the fortunes of foreign capitalist nations (a Hobson's choice, really, from an anarchist perspective). This was the situation with British capitalism, as *"Britain had very high tariffs* *on manufacturing products as late as the 1820s, some two generations after the start of its Industrial Revolution … Measures other than tariff protection were also deployed"* (such as banning imports from competitors). [Chang, **Op. Cit.**, p. 22] Needless to say, trade unions were illegal during this period of industrialisation and troops were regularly deployed to crush strikes, riots and rebellions. Economist Thomas Balogh confirms this analysis:

> *"The fact is that Britain's economic growth forged ahead of its European competitors while it was exploiting an effective monopoly of the steam engine, from 1780 to 1840. Through most of that period the nation had a high and complicated tariff …, massive public investment and spending … and an extensive public welfare system with wage supplements and welfare allowances indexed to basic costs of living …*
>
> *"There followed a long period, from about 1840 to 1931, when Britain did indeed have the freest trade and relatively speaking the cheapest government and (until 1914) the smallest public sector among the industrially developing nations, Yet, for competitiveness, that century saw the relative decline of the country. Numerous competing countries, led by the US and Germany, emerged and overtook and passed Britain in output and income per head. Every one of them had protective tariffs, and a bigger (relative) public sector than the British."* [**Op. Cit.**, p. 180]

Significantly, and highly embarrassingly for neo-classical economists, the one nation which embraced free trade ideology most, namely the UK in the latter half of the 19th century, suffered economic decline in comparison to its competitors who embraced protectionist and other statist economic policies. It would be churlish to note that this is the exact opposite of what the theory predicts.

In historical terms, List has been proven correct numerous times. If the arguments for free trade were correct, then the United States and Germany (plus Japan, South Korea, etc., more recently), would be economic backwaters while Portugal would have flourished. The opposite happened. By the 1900s, Britain was overtaken economically by America and Germany, both of whom industrialised by means of protectionism and other forms of state intervention. As such, we should not forget that Adam Smith confidently predicted that protectionism in America would *"would retard instead of accelerating the further increase in the value of their annual progress, and would obstruct instead of promoting the progress of their country towards real wealth and greatness."* He considered it best that capital be *"employed in agriculture"* rather than manufacturing. [**The Wealth of Nations**, p. 328 and p. 327]). The historical record hardly supports Smith's predictions as *"throughout the nineteenth century and up to the 1920s, the USA was the fastest growing economy in the world, despite being the most protectionist during almost all of this period … Most interestingly, the two best 20-year GDP per capita growth performances during the 1830–1910 period were 1870–1890 (2.1 per cent) and 1890–1910 (two per cent) — both period of particularly high protectionism. It is hard to believe that this association between the degree of protectionism and overall growth is purely coincidental."* [**Op. Cit.**, p. 30]

As with the UK, America *"remained the most ardent practitioner of infant industry protection until the First World War, and even until the Second."* Like UK, the state played its role in repressing labour, for while unions were usually not technically illegal, they were subject to anti-trust laws (at state and then federal level) as well as force during strikes from troops and private police forces. It was *"only after the Second World War that the USA — with its industrial supremacy unchallenged — finally liberalised it trade and started championing the cause of free trade."* [Chang, **Op. Cit.**, p. 28 and p. 29] Unsurprisingly, faced with growing international competition it practised protectionism and state aid while keeping the rhetoric of free trade to ensure that any potential competitor has its industries ruined by being forced to follow policies the US never applied in the same situation. Chomsky summarises:

> *"So take a look at one of the things you don't say if you're an economist within one of the ideological institutions, although surely every economist has to know it. Take the fact that there is not a single case on record in history of any country that has developed successfully through adherence to 'free market' principles: none."* [**Op. Cit.**, p. 255]

Not that this has disabused most economists from repeating Ricardo's theory as if it told the full story of international trade or has been empirically verified. As Chang puts it, his approach of studying the actual history of specific countries and generalising conclusions *"is concrete and inductive"* and *"contrasts strongly with the currently dominant Neoclassical approach based on abstract and deductive methods."* This has meant that *"contemporary discussion on economic development policy-making has been peculiarly ahistoric."* [**Op. Cit.**, p. 6] This is unsurprising, as there is a distinct tendency within mainstream economics not to check to see if whether the theory conforms to reality. It is as if we **know** that capitalist economics is true, so why bother to consider the evidence. So no matter how implausible a given theory is, capitalist economics simply asks us to take them on trust. Perhaps this is because they are nothing more than logical deductions from various assumptions and comparing them to reality would expose not only the bankruptcy of the theory but also the bogus claims that economics relates to reality or is a science?

That these theories survive at all is due to their utility to vested interests and, of course, their slightly complicated logical beauty. It should be noted, in passing, that the free trade argument is based on **reducing** international competition. It recommends that different countries specialise in different industries. That this would make sense for, say, a country with industry (marked by increasing returns to scale and significant spill-over effects into other areas of the economy) rather than one based on agriculture (marked by decreasing returns to scale) goes without saying. That the policy would turn the world into a provider of raw materials and markets rather than a source of competitors for the most advanced nation is just one of these co-incidences capitalist economics suffers from.

As such, it is not a coincidence that both the classic "free trade" and current neo-liberal position does allow a nation to secure its dominance in the market by forcing the ruling elites in **other** nations to subscribe to rules which hinder their freedom to develop in their own way. As we discuss in section D.5, the rise of neo-liberalism can be viewed as the latest in a long series of imperialist agendas designed to secure benefits of trade to the West as well as reducing the number of rivals on the international market. As Chang notes, Britain's move to free trade after 1846 *"was based on its then unchallenged economic superiority and was intricately linked with its imperial policy."* The stated aim was to halt the move to industrialisation in Europe by promoting agricultural markets. Outside of the West, *"most of the rest of the world was forced to practice free trade through colonialism and … unequal treaties."* These days, this policy is implemented via international organisations which impose Western-dominated rules. As Chang notes, the *"developed countries did not get where they are now through policies and the institutions that they* *recommend to developing countries today. Most of them actively used 'bad' trade and industrial policies … practices that these days are frowned upon, if not actively banned, by the WTO."* [**Op. Cit.**, p. 16, p. 23, p. 16 and p. 2]

In other words, the developed countries are making it difficult for the developing countries to use policies and institutions which they themselves so successfully used previously. This, as with the "free trade" arguments of the 19th century, is simply a means of controlling economic development in other countries to reduce the number of potential competitors and to secure markets in other countries. In addition, we must also stress that the threat of capital flight within western countries also raises competitive pressures for labour and so has the added benefit of helping tame rebellious workers in the imperialist nations themselves. These factors help explain the continued support for free trade theory in economic circles in spite of the lack of empirical evidence in its favour. But then again, given that most economists cannot understand how one class exploits another by means of exchange within a national market due to its economic power, it would be surprising if they could see it within international markets.

To generalise, it appears that under capitalism there are two main options for a country. Either it submits itself to the dictates of global finance, embracing neo-liberal reforms and seeing its growth fall and inequality rise or (like every other successful industrialiser) it violates the eternal laws of economics by using the state to protect and govern its home market and see growth rise along with inequality. As Chang notes, looking at the historical record a *"consistent pattern emerges, in which all the catching-up economies use activist industrial, trade and technology (ITT) policies … to promote economic development."* He stresses *"it was the UK and the USA, the supposed homes of free trade policy, which used tariff protection most aggressively."* The former *"implemented the kinds of ITT policies that became famous for their use in … Japan, Korea and Taiwan."* [**Op. Cit.**, pp. 125–6, p. 59 and pp. 60–1] In addition, another aspect of this process involves repressing the working class so that **we** pay the costs for industrialising. Unions were illegal when Britain used its ITT policies while the *"labour market in Taiwan and Korea, for example, has been about as close to a free market as it is possible to get, due in part to government repression of unions."* [*"What can Economics Learn from East Asian Success?"*, **Op. Cit.**, p. 70] Given that unions are anathema to neo-classical and Austrian economics, it is understandable why their repression should be considered relatively unproblematic (in fact, according to economic ideology repressing unions can be considered to be in the interests of the working class as, it is claimed, unions harm non-unionised workers — who knew that bosses and their states were such philanthropists?).

Neither option has much to recommend it from an anarchist perspective. As such, our stating of facts associated with the history of "actually existing" capitalism should not be construed to imply that anarchists support state-run development. Far from it. We are simply noting that the conclusion of history seems to be that countries industrialise and grow faster when the state governs the market in significant ways while, at the same time, repressing the labour movement. This is unsurprising, for as we discuss in section D.1, this process of state intervention is part and parcel of capitalism and, as noted in section F.8, has always been a feature of its rise in the first place (to use Marx's expression, a process of *"primitive accumulation"* has always been required to create capitalism). This does not mean, just to state the obvious, that anarchists support protectionism against "free trade." In a class system, the former will tend to benefit local capitalists while the latter will benefit foreign ones. Then there is the social context. In a predominantly rural economy, protectionism is a key way to create capitalism. For example, this was the case in 19th century America and it should be noted that the Southern slave states were opposed to protectionism, as where the individualist anarchists. In other words, protectionism was a capitalist measure which pre-capitalists and anti-capitalists opposed as against their interests. Conversely, in a developed capitalist economy "free trade" (usually very selectively applied) can be a useful way to undermine workers wages and working conditions as well as foreign capitalist competitors (it may also change agriculture itself in developing countries, displacing small peasant farmers from the land and promoting capitalist agriculture, i.e. one based on large estates and wage labour).

For the anarchist, while it is true that in the long run option two does raise the standard of living faster than option one, it should always be remembered that we are talking about a **class** system and so the costs and benefits will be determined by those in power, not the general population. Moreover, it cannot be assumed that people in developing countries actually want a Western lifestyle (although the elites who run those countries certainly do, as can be seen from the policies they are imposing). As Bookchin once noted, *"[a]s Westerners, 'we' tend to assume out of hand that 'they' want or need the same kind of technologies and commodities that capitalism produced in America and Europe … With the removal of imperialism's mailed fist, a new perspective could open for the Third World."* [**Post-Scarcity Anarchism**, pp. 156–7]

Suffice to say, there are other means to achieve development (assuming that is desired) based on working class control of industry. Given this, the only genuine solution for developing countries would be to get rid of their class systems and create a society where working people take control of their own fates, i.e. anarchism. Hence we find Proudhon, for example, stating he *"oppose[d] the free traders because they favour interest, while they demand the abolition of tariffs."* He advocated the opposite, supporting free trade *"as a consequence of the abolition of interest"* (i.e. capitalism). Thus the issue of free trade cannot be separated from the kind of society practising it nor from the creation of a free society. Abolishing capitalism in one country, he argued, would lead to other nations reforming themselves, which would *"emancipate their lower classes; in a word, to bring about revolution. Free trade would then become equal exchange."* [**The General Idea of the Revolution**, pp. 235–8] Unless that happens, then no matter whether protectionism or free trade is applied, working class people will suffer its costs and will have to fight for any benefits it may bring.

C.10.3 Does "free market" capitalism benefit everyone, *especially* working class people?

One defence of capitalism is that, appearances and popular opinion to the contrary, it is benefits working class people **more** than the ruling class.

This argument can be found in right-liberal economist Milton Friedman's defence of capitalism in which he addresses the claim that *"the extension and development of capitalism has meant increased inequality."* Not so, he states. *"Among the Western countries alone,"* he argues, *"inequality appears to be less, in any meaningful sense, the more highly capitalist the country is … With respect to changes over time, the economic progress achieved in the capitalist countries has been accompanied by a drastic diminution in inequality."* In fact, *"a free society [i.e. capitalism] in fact tends towards greater material equality than any other yet tried."* Thus, according to Friedman, a *"striking fact, contrary to popular conception, is that capitalism leads to less inequality than alternative systems of organisation and that the development of capitalism has greatly lessened the extent of inequality.*

Comparisons over space and time alike confirm this." [**Capitalism and Freedom**, p. 168, pp. 169–70, p. 195 and p. 169]

Friedman makes other claims to the superiority of capitalism. Thus he states that not only do non-capitalist societies *"tend to have wider inequality than capitalist, even as measured by annual income"* in such systems inequality *"tends to be permanent, whereas capitalism undermines status and introduces social mobility."* Like most right-wingers, he stresses the importance of social mobility and argues that a society with little change in position *"would be the more unequal society."* Finally, he states that *"[o]ne of the most striking facts which run counter to people's expectations has to do with the source of income. The more capitalistic a country is, the smaller the fraction of income for the use of what is generally regarded as capital, and the larger the fraction paid for human services."* [**Op. Cit**., pp. 171–2, p. 171 and pp. 168–9]

Friedman, as he regularly did, failed to present any evidence to support his claims or any of his *"striking fact[s]"* so it is hard to evaluate the truthfulness of any of this specific assertions. One possible way of doing so would be to consider the actual performance of specific countries before and after 1980. That year is significant as this marked the assumption of office of Thatcher in the UK and Reagan in the US, both of whom were heavily influenced by Friedman and other supporters of "free market" capitalism. If his claims were true, then we would expect **decreases** in equality, social mobility and the share of *"human services"* before 1980 (the period of social Keynesian policies) and **increases** in all three after. Sadly for Friedman (and us!), the facts are counter to his assertions — equality, mobility and share of income for *"human services"* all decreased post-1980.

As we showed in section B.7, inequality rose **and** social mobility fell since 1980 in the USA and the UK (social democratic nations have a better record on both). As far as the share of income goes, that too has failed to support his assertions. Even in 1962, the facts did not support his assertion as regards the USA. According to figures from the U.S. Department of Commerce the share of labour in 1929 was 58.2% and this rose to 69.5% by 1959. Even looking at just private employees, this was a rise from 52.5% to 58% (income for government employees, including the military went from 5.7% to 12.2%). In addition, "proprietor's income" (which represents income to the owner of a business which combines work effort and ownership, for example a farmer or some other self-employed worker) fell, with farm income going from 6.8% to 3.0%, while other such income dropped from 10.1% to 8.7%. [Walter S. Measday, *"Labor's Share in the National Income,"* **The Quarterly Review of Economics & Business**, Vol. 2, No. 3, August 1962] Unless Friedman would argue that 1929 America was more statist than 1959, it seems that his assertion was false even when it was first made. How did his comment fare after he made it? Looking at the period after 1959 there was continuing increase in labour share in the national income, peaking in the 1970s before steadily dropping over the following decades (it dropped to below 1948 levels in 1983 and stayed there). [Alan B. Krueger, *"Measuring Labor's Share"*, **The American Economic Review**, vol. 89, No.2, May 1999] Since then the downward trend has continued.

It would be churlish to note that the 1970s saw the rise of influence of Friedman's ideas in both countries and that they were applied in the early 1980s.

There are problems with using labour share. For example it moves with the business cycle (rising in recessions and falling in booms). In addition, there can be other forms of labour compensation as well as wages. Looking at total compensation to labour, this amounts to around 70% of total US income between 1950 and 2000 (although this, too, peaked in the 1970s before falling [Krueger, **Op. Cit**.]). However, this "labour" income can be problematic. For example, employer provided health care is considered as non-wage compensation so it is possible for rising health care costs to be reflected in rising labour compensation yet this hardly amounts to a rising labour share as the net gain would be zero. Then there is the question of government employees and welfare benefits which, of course, are considered labour income. Unfortunately, Friedman provides no clue as to which statistics he is referring to, so we do not know whether to include total compensation or not in evaluating his claims.

One group of economists have taken the issue of government transfers into account. Since 1979, there has been an *"increased share of capital income (such as rent, dividends, interest payments, and capital gains) and a corresponding smaller share earned as wages and salaries."* Most families receive little or no capital income, but it is *"a very important source of income to the top 1% and especially the top 0.1% (who receive more than a third of all capital income)."* In 1959, total labour income was 73.5% while capital income was 13.3% of market-based income (personal income less government transfers). By 1979, these were 75.8% and 15.1%, respectively. The increases for both are due to a fall in "proprietor's income" from 13.3% to 9.1%. By 2000, capital income had risen to 19.1% while labour's share had fallen to 71.8% (proprietor's income remained the same). This *"shift away from labour income and toward capital income is unique in the post-war period and is partly responsible for the ongoing growth of inequality since 1979."* [Lawrence Mishel, Jered Bernstein, and Sylvia Allegretto, **The State of Working America 2006/7**, p. 76 and p. 79]

It should be noted that Friedman repeated the standard economist (and right-wing) argument that a better way to increase wages than unions or struggle is to make workers more productive. That lifts everyone's standard of living. At least it used to. Between 1945 and 1980, worker wages did, indeed, track productivity increases. This was also the high period of union density in America. After 1980, that link was broken. By a strange co-incidence, this was the Friedman-inspired Reagan effectively legalised and encouraged union busting. Since then, productivity increases are going almost entirely to the top tenth of the population, while median incomes have stagnated. Without unions and robust worker bargaining power, productivity increases have not been doing much for workers. Not that people like Friedman actually mentioned that rather significant fact.

Then there is the issue of *"human services"* itself. This is **not** the same as labour income at all as it includes, for example, management pay. As we indicated in section C.3, this "labour" income is better thought of as **capital** income as that specific labour is rooted in the control of capital. That this is the case can be seen by the numerous defences of exploding CEO pay by right-wing think tanks, journals and economists as well as the lack of concern about the inflationary nature of such massive "pay" rises (particularly when contrasted to the response over very slight increases in workers' pay). This means that "labour" income could remain constant while CEO salaries explode and worker wages stagnant or even fall, as is the case in both the US (and UK) since 1980. In such circumstances, looking at "human services" becomes misleading as returns to capital are listed as "labour" simply because they are in the form of bosses pay. Equally, CEO perks and bonuses would be included as "labour" non-wage compensation.

To see what this means we must use an example. Take a country with 100 people with a combined income of £10,000. The average income would be £100 each. Taking a labour/capital split of 70/30, we get an income of labour of £7000 and an income to capital of £3000. Assuming that 5% of the population own the capital stock, that is an average income of £600 each while labour gets an average of £73.68. However, 10% of the population are managers and assuming another 70/30 split between management and worker income this means that management gets

£2100 in total (an average of £210) while workers get £4900 (an average of £57.65). This means that the owners of capital get 6 times the national average income, managers just over twice that amount and workers just over half the average. In other words, a national statistic of 70% labour income hides the reality that workers, who make up 85% of the population, actually get less than half the income (49%). Capital income, although less, is distributed to fewer people and so causes massive inequality (15% of the population get an average income of £340, nearly 6 times more than the average for the remaining 85% while the upper 5% get over 10 times). If the share of management in labour income rises to 35%, then workers wages fall and inequality rises while labour income remains constant at 70% (management's average income rises to £363.33 while workers' falls to £53.53). It should be stressed this example **underestimates** inequality in capitalist economies, particularly ones which had the misfortunate to apply Friedman's ideas.

Looking further a field, this pattern has been repeated everywhere "free(r) market" capitalism has been imposed. In Chile equality and labour's share increased during the 1960s and early 1970s, only for both to plummet under Pinochet's Friedman-inspired neo-liberal regime (see section C.11 for the grim details of *"economic liberty"* there). In Thatcher's Britain, inequality rose while labour share and social mobility fell. Between 1978 and 1990, the share of wages and salaries in household income in the UK fell from 65.8% to 57.4%. The share for capital income (rent, interest and dividends) more than doubled (from 4.9% to 10.0%).Unsurprisingly, this rise *"directly contributed to the increase in overall inequality"* (48% of all investment income went to the richest tenth of households). [John Hill, **Inequality and the State**, p. 88]

Looking at how increases in income and wealth were distributed, we find that gains since 1979 went predominantly to the rich. Before that, the income of all sections of society grew at roughly the same level between 1961 and 1979. Most of the increase was near the mean, the one exception was the lowest tenth whose incomes rose significantly higher than the rest). This meant that *"over the 1960s and 1970s as a whole all income groups benefited from rising incomes, the lowest rising fastest."* After 1978 *"the pattern broke down"* and incomes for the highest tenth rose by 60–68 percent while at the medium it grew by about 30% between 1979 and 1994/5. The lower down the income distribution, the lower the growth (in fact, after housing costs the income of bottom 10% was 8% lower in 1994/5 than in 1979). As in America during the same period a fence turned into stairs as the nearer to the bottom the slower income grew, the nearer the top the faster income grew (i.e. roughly equal growth turned into growth which increased as income increased — see section B.7.1). Between 1979 and 1990/91, the bottom 70% saw their income share fall. During the Major years, from 1992 to 1997, inequality stopped growing simply because hardly anyone's income grew. Over all, between 1979 and 2002/3, the share of all incomes received by the bottom half fell from 22% to 37%. This is more than the whole of the bottom half combined. The bottom 10% saw their share of income fall from 4.3% to 3% (after housing costs, this was 4.0% to 2.0%). Only the top tenth saw their income increase (from 20.6% to 28%). About 40% of the total increase in real net incomes went to the top tenth between 1979 and 2002–3. 17% of the increase in after-tax incomes went to the top 1%, about 13% went to the top 0.5% (*"Wealth is much more unequally distributed than incomes."*). [John Hills, **Op. Cit.**, p. 20, p. 21, p. 23 and p. 37]

Unsurprisingly, income inequality widened considerably (which more than reversed all the moves towards equality of income that had taken place since 1945) and Britain went from being one of the more equal countries in the industrialised countries to being one of the most unequal. The numbers below half the median income rose. In the 1960s, this was roughly 10%, before falling to 6% in 1977. It then *"the rose sharply"* and peaked at 21% in 1991/92 before stabilising at 18–19%. After housing costs, this meant a rise from 7% to 25% below half the average income, falling to 23%. It should be noted that the pre-Thatcher period gives *"the lie to the notion that 'relative' poverty can never be reduced."* In summary, by the early 1990s *"relative poverty was twice the level it had been in the 1960s, and three times what it had been in the late 1970s."* It seems needless to add that social mobility fell. [John Hills, **Op. Cit.**, p. 48, p. 263 and pp. 120–1]

The same can be said of Eastern Europe. This is particularly significant, for if Friedman's assertions were right then we would expect that the end of Stalinism in Eastern Europe would have seen a decrease in inequality. As in Chile, Britain, New Zealand and America, the opposite occurred — inequality exploded. By the start of the 21st century Eastern Europe was challenging neo-liberal Britain at the top of the European income inequality tables.

The historical record does not give much support to claims that free(r) market capitalism is best for working class people. Real wage growth rose to around 5% per year in the early 1970s, before falling substantially to under 2% from the 1980s onwards for 13 OECD countries. In fact, *"real wage have growth very slowly in OECD countries since 1979, an extraordinary turn-round from the 3–5% growth rates of the 1960s."* In the US, the median wage was actually less in 2003 than in 1979. Average wages actually declined until 1995, then they increased somewhat so that the average growth rate for the 1990s was less than 0.5% a year. Europe and Japan have done only a little better, with growth of around 1% per year. This is unsurprising, given the rise in returns to capital after 1979 for *"real wages do not automatically grow as fast as labour productivity. The general increase in the share of profits . . pulls real wage growth behind productivity growth."* Within the labour force, inequality has risen. Wage differentials *"are considerably higher in the UK/US group than in Europe"* and have grown faster. Real wages for the top 10% grew by 27.2% between 1979 and 2003, compared to 10.2% in the middle (real wages for the bottom 10% did not grow). In Europe, *"real wages grew at the bottom at a similar rate to the average."* The top 1% of wage-earners in the USA doubled their total wage share between 1979 and 1998 from 6.2% to 10.9%, whilst the top 0.1% nearly tripled their share to 4.1%. Almost all of the increase in the top 10% went to the top 5%, and about two-thirds to the top 1%. In France, the share of the top 1% remained the same. Overall, *"labour's position tended to be more eroded in the more free market economies like the USA and UK than in European economies where social protection [including trade unionism] was already stronger."* [Andrew Glyn, **Op. Cit.**, p. 6 p. 116, p. 117, p. 118 and p. 127]

Looking at inequality and poverty, the conclusion is that liberalisation of markets *"tend to bring greater inequality."* In fact, the rise in the UK was strongest in the 1980s, the Thatcher period while New Zealand *"saw as big an increase in inequality as the UK."* The USA *"maintained its position as the most unequal country with inequality increasing in both decades."* In summary, *"the increase in inequality has been noticeably greater in the inegalitarian liberal economies than in Northern Europe."* Moreover, *"liberal countries have larger proportions of their populations in poverty"* than European ones. Unsurprisingly, New Zealand and the UK (both poster-childs for neo-liberalism) *"had the biggest increases in numbers in poverty between the mid-1980s and 2000."* In the mid-1990s, 20–25% of workers in the UK, Canada and USA were earning less than 65% of median earnings, compared to 5–8% in Scandinavia and Belgium. This rise income inequality *"tend to reproduce themselves through the generations."* There *"is far **less** social mobility in the USA"* than in Scandinavia, Germany and Canada and there has been a *"severe decline in social mobility"* in the UK after the Friedman-inspired Thatcherism of the 1980s and 1990s. Unsurprisingly, there has been *"a rise in the importance of property incomes."*, with the ratio of property income to labour income rising from 15% in the USA in 1979 to 18% in 2002. In France it went from 7% to 12% and is around 8% in Norway and Finland. [**Op. Cit**., p. 167, p. 168, p. 169, p. 171, p. 169, p. 173, p. 174 and p. 170]

Needless to say, given the lack of evidence presented when Friedman first published his book in 1962, the 40th anniversary edition was equally fact free. Given that 40 years is more than enough time to evaluate his claims particularly given that approximately half-way through this period, Friedman's ideas became increasingly influential and applied, in varying degrees in many countries (particularly in the UK under Thatcher and the US under Reagan). Friedman does not mention the developments in equality, mobility or labour share in 2002, simply making the general statement that he was *"enormously gratified by how well the book has withstood time."* Except, of course, where reality utterly contradicted it! This applies not only to his claims on equality, income shares and poverty, but also the fundamental basis of his Monetarist dogma, namely the aim to control the *"behaviour of the stock of money"* by means of *"a legislated rule instructing the monetary authority to achieve a specified rates of growth in the stock of money."* [**Op. Cit**., p. ix and p. 54] As we indicated in section C.8, the devastating results of applying this centre-piece of his ideology means that it hardly *"withstood time"* by any stretch of the imagination! In other words, we have a case of self-refutation that has few equals.

To conclude, as defences of capitalism based on equality are unlikely to survive contact with reality, the notion that this system is really the best friend of the working person and the poor needs to be defended by other means. This is where the growth argument we debunked in the last two sections comes in. Neither has much basis in reality.

Of course, the usual excuse should be noted. It could be argued that the reason for this lack of correlation of reality with ideology is that capitalism is not "pure" enough. That, of course, is a valid argument (as Friedman notes, Thatcher and Reagan *"were able to curb leviathan, through not to cut it down."* [**Op. Cit**., p. vii]). State intervention has hardly disappeared since 1980 but given the lush praise given to the "magic" of the market you would expect **some** improvement. When Friedman died in 2006, the praise from the right-wing and business press was extensive, listing him as one of the most, if not **the** most, influential economist of the late 20th century. It seems strange, then, to suggest that the market is now **less** free than at the height of the post-war Keynesian period. To do so would suggest that Reagan, Thatcher and Pinochet had little or no impact on the economy (or that they made it worse in terms of state intervention). In other words, that Friedman was, in fact, the **least** influential economist of the late 20th century (as opposed to one of the worse, if we compare his assertions to reality before and after the policies they inspired were implemented). However, he helped make the rich richer, so the actual impact of what he actually suggested for the bulk of the population can be cheerfully ignored.

C.10.4 Does growth automatically mean people are better off?

In the above sections we have discussed the effects of neo-liberal reforms purely in terms of economic statistics such as growth rates and so on. This means we have critiqued capitalism in its own terms, in terms of its supporters own arguments in its favour. As shown, in terms of equality, social mobility and growth the rise of "free(r) market" capitalism has not been all its supporters have asserted. Rather than produce more equality, less poverty and increased growth, the opposite has occurred. Where some progress on these areas have occurred, such as in Asia, the countries have **not** embraced the neo-liberal model.

However, there is a deeper critique to be made of the notion that capitalism benefits everyone, especially the poor. This relates to the **quality** of life, rather than the quantity of money available. This is an extremely important aspect to the question of whether "free market" capitalism will result in everyone being "better off." The typical capitalist tendency is to consider quantitative values as being the most important consideration. Hence the concern over economic growth, profit levels, and so on, which dominate discussions on modern life. However, as E.P. Thompson makes clear, this ignores important aspects of human life:

> *"simple points must be made. It is quite possible for statistical averages and human experiences to run in opposite directions. A per capita increase in quantitative factors may take place at the same time as a great qualitative disturbance in people's way of life, traditional relationships, and sanctions. People may consume more goods and become less happy or less free at the same time … [For example] real wages [may have] advanced … but at the cost of longer hours and greater intensity of labour … In statistical terms, this reveals an upward curve. To the families concerned it might feel like immiseration.*
>
> *"Thus it is perfectly possible … [to have an] improvement in average material standards … [at the same time as] intensified exploitation, greater insecurity, and increasing human misery … most people [can be] 'better off' than their forerunners had been fifty years before, but they had suffered and continued to suffer this … improvement as a catastrophic experience."* [**The Making of the English Working Class**, p. 231]

Thompson was specifically referring to the experience of the British industrial revolution on the working class but his analysis is of general note (its relevance goes far beyond evaluating past or current industrialisation processes). This means that concentrating on, say, absolute poverty or income growth (as defenders of neo-liberalism do) means to ignore the quality of life which this increased income is associated with. For example, a peasant farmer who has to leave his farm for employment in a factory may consider having bosses dictating his every move, an increased working day and intensity of work more significant than, say, a net increase in his income. That this farmer may have been driven off his farm as a result of neo-liberal or other "reforms" is another factor which has to be taken into account. If, to suggest another possibility, Health and Safety regulations reduce work speeds, then national output will be reduced just as unions will stop firms making their workers labour more intensely for longer. However, increased output at the expense of those who do the work is not unproblematic (i.e. real wages may increase but at the cost of longer hours, less safety and greater intensity of labour). Another obvious example would be the family where the husband gets "downsized" from a good manufacturing job. He may get a lower paying service industry job, which forces his wife (and perhaps children) to get a job in order to make ends meet. Family income may increase slightly as a result, but at a heavy cost to the family and their way of life. Therefore the standard of living in the abstract may have increased, but, for the people in question, they would feel that it had deteriorated considerably. As such, economic growth need not imply rising standards of living in terms if the **quality** of life decreases as incomes rise.

This is, in part, because if the economy worked as neoclassical theory demanded, then people would go to work not knowing how much they would be paid, how long they would be employed for or, indeed, whether they had a job at all when they got there. If they rented their home, they would not even know whether they had a home to come back to. This is because every price would have to be subject to constant change in order to adjust to equilibrium. Insecurity, in other words, is at the heart of the economy and this is hardly productive of community or "family" values (and other expressions used in the rhetoric of the right while they promote an economic system which, in practice, undermines them in the name of profit). In other words, while a society may become materially better off over time, it becomes worse off in terms of **real** wealth, that is those things which make life worth living. Thus capitalism has a corrosive effect on human relationships, the pleasure of productive activity (work), genuine freedom for the many, how we treat each other and so on. The corrosive effects of economics are not limited simply to the workplace but seep into all other aspects of your life.

Even assuming that free market capitalism could generate high growth rates (and that assumption is not borne out in the real world), this is not the end of the matter. How the growth is distributed is also important. The benefits of growth may accumulate to the few rather than the many. Per capita and average increases may hide a less pleasant reality for those at the bottom of the social hierarchy. An obvious example would be a society in which there is massive inequality, where a few are extremely rich and the vast majority are struggling to make ends meet. Such a society could have decent growth rates and per capita and average income may grow. However, if such growth is concentrated at the top, in the hands of the already wealthy, the reality is that economic growth does not benefit the many as the statistics suggest. As such, it is important to stress that average growth may not result in a bettering for all sections of a society. In fact, *"there are plenty of instances in which the poor, and the majority of the population. have been left behind in the era of globalisation — even where per capita income has grown."* This is not limited to just developing countries. Two episodes like this occurred in the United States, with data showing that *"the per capita income of the poor falling from 1979–84, and 1989–94, while per capita income rose."* Overall, the US has seen its median wage and real wages for the bottom 20th of its populations fall between 1973 and 1997 while *"per capita income in the US has risen by 70 percent. For the median wage and bottom-quintile wage to actually **fall** during this same period is an economic change of momentous proportions, from the point of view of the majority of Americans."* [Mark Weisbrot, Dean Baker, Robert Naiman, and Gila Neta, **Growth May Be Good for the Poor — But are IMF and World Bank Policies Good for Growth?**] This is a classic example of society with substantial inequality seeing the benefits of growth accrue to the already rich. To state the obvious, **how** the benefits of growth are distributed cannot be ignored.

In addition, consumerism may not lead to the happiness or the "better society" which many economists imply to be its results. If consumerism is an attempt to fill an empty life, it is clearly doomed to failure. If capitalism results in an alienated, isolated existence, consuming more will hardly change that. The problem lies within the individual and the society within which they live. Hence, quantitative increases in goods and services may not lead to anyone "benefiting" in any meaningful way. Similarly, there is the issue of the quality of the production and consumption produced by economic growth. Values like GDP do not tell us much in terms of what was produced and its social and environmental impact. Thus high growth rates could be achieved by the state expanding its armed forces and weaponry (i.e. throwing money to arms corporations) while letting society go to rot (as under Reagan). Then there is awkward fact that negative social developments, such as pollution and rising crime, can contribute to a rising value for GDP). This happens because the costs of cleaning up, say, an oil spill involves market transactions and so gets added to the GDP for an economy.

As such, the notion of growth **as such** is good should be rejected in favour of a critical approach to the issue which asks growth for what and for whom. As Chomsky puts it, *"[m]any indigenous people apparently do not see any reason why their lives, societies, and cultures should be disrupted or destroyed so that New Yorkers can sit in SUVs in traffic gridlock."* [**Failed States**, p. 259] Under capitalism, much "productivity" is accounted for by economic activity that is best described as wasteful: military spending; expanding police and prison bureaucracies; the spiralling cost of (privatised) healthcare; suburban sprawl; the fast-food industry and its inevitable ill effects on health; cleaning up pollution; specifying and defending intellectual and other property rights; treating the illnesses caused by over-work, insecurity and stress; and so on. As Alexander Berkman once noted, capitalism spawns many forms of "work" and "productive" activity which only make sense within that system and could *"be automatically done away with"* in a sane society. [**What is Anarchism?**, pp. 223–5] Equally, "productivity" and living standards can stand at odds with each other. For example, if a country has a lower working week and take longer holidays, these would clearly depress GDP. This is the case with America and France, with approximately equal productivity the later spends less time in work and more time off. Yet it takes a capitalist ideologue to say that such a country is worse off as a nation for all that time people spend enjoying themselves.

These issues are important to remember when listening to "free market" gurus discussing economic growth from their "gated communities," insulated from the surrounding deterioration of society and nature caused by the workings of capitalism. In other words, quality is often more important than quantity. This leads to the important idea that some (even many) of the requirements for a truly human life cannot be found on any market, no matter how "free" it may be. Equally, a "free" market can lead to unfree people as they driven to submit themselves to the authority of bosses do to economic pressures and the threat of unemployment.

So it can be said that laissez-faire capitalism will benefit all, **especially** the poor, only in the sense that all can potentially benefit as an economy increases in size. Of course, the mantra that economic growth is so wonderful is hard to justify when the benefits of that growth are being enjoyed by a small proportion of the people and the burdens of growth (such as rising job insecurity, loss of benefits, wage stagnation and decline for the majority of workers, declining public services, loss of local communities and so forth) are being borne by so many (as is the case with the more to freer markets from the 1980s). If we look at actually existing capitalism, we can start to draw some conclusions about whether a pure laissez-faire capitalism will actually benefit working people. The United States has a small public sector by international standards and in many ways it is the closest large industrial nation to the unknown ideal of pure capitalism. It is also interesting to note that it is also number one, or close to it, in the following areas [Richard Du Boff, **Accumulation and Power**, pp. 183–4]:

- lowest level of job security for workers, with greatest chance of being dismissed without notice or reason.
- greatest chance for a worker to become unemployed without adequate unemployment and medical insurance.
- less leisure time for workers, such as holiday time.
- one of the most lopsided income distribution profiles.

- lowest ratio of female to male earnings, in 1987 64% of the male wage.
- highest incidence of poverty in the industrial world.
- among the worse rankings of all advanced industrial nations for pollutant emissions into the air.
- highest murder rates.
- worse ranking for life expectancy and infant morality.

It seems strange that the more laissez-faire system has the worse job security, least leisure time, highest poverty and inequality if laissez-faire will **especially** benefit the poor or working people. In fact, we find the more free market the regime, the worse it is for the workers. Americans have longer hours and shorter holidays than Western Europeans and more people live in poverty. 22% of American children grow up in poverty, which means that it ranks 22nd out of the 23 industrialised nations, ahead of only Mexico and behind all 15 of the pre-2004 EU countries.

According to a 2007 United Nation report, the worse places to be a child are in neo-liberal societies such as the UK and USA (the UK was bottom, at number 21 one below the US). The UNICEF report dealt with the condition of children in advanced capitalist countries and found that both the UK and US are way down the list on education, health, poverty, and well-being. While UNICEF preferred to state that this is because of a "dog eat dog society", it is hardly a coincidence that these two societies have most embraced the principles of neo-liberalism and have repeatedly attacked the labour movement, civil society in general as well as the welfare state in the interests of capital. In contrast, the social democratic northern European countries which have best results. One could also point out, for example, that Europeans enjoy more leisure time, better health, less poverty, less inequality and thus more economic security, greater intergenerational economic mobility, better access to high-quality social services like health care and education, and manage to do it all in a far more environmentally sustainable way (Europe generates about half the CO2 emissions for the same level of GDP) compared to the US or the UK.

A definite case of what is good for the economy (profits) is bad for people. To state the obvious, an economy and the people in that economy are not identical. The former can be doing well, but not the latter — particularly if inequality is skewing distribution of any rising incomes. So while the economy may be doing well, its (median) participant (and below) may see very little of it.

Of course, defenders of laissez-faire capitalism will point out that the United States, like the UK and any other real country, is far from being laissez-faire. This is true, yet it seems strange that the further an economy moves from that "ideal" the better conditions get for those who, it is claimed, will especially benefit from it. As such, non-believers in pure capitalism have cause for dissent although for the typical "market advocate" such comparisons tell us littler — unless they happen to bolster their case then "actually existing" capitalism can be used as an example.

Ultimately, the real issue is to do with quality of life and relative changes. Yet the argument that capitalism helps the poorest most via high economic growth is rooted in comparing "free market" capitalism with historical example, i.e. in the notion of **absolute** inequality rather than **relative** inequality and poverty. Thus poverty (economic, cultural and social) in, say, America can be dismissed simply on the grounds that poor people in 2005 have more and better goods than those in 1905. The logic of an absolute position (as intended, undoubtedly) is such as to make even discussing poverty and inequality pointless as it is easy to say that there are **no** poor people in the West as no one lives in a cave. But, then again, using absolute values it is easy to prove that there were no poor people in Medieval Europe, either, as they did not live in caves and, compared to hunter gatherers or the slaves of antiquity, they had much better living standards. As such, any regime would be praiseworthy, by the absolute standard as even slavery would have absolutely better living standards than, say, the earliest humans.

In this respect, the words of Adam Smith are as relevant as ever. In **The Wealth of Nations** Smith states the following:

> *"By necessaries I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without. A linen shirt, for example, is, strictly speaking, not a necessary of life. The Greeks and Romans lived, I suppose, very comfortably though they had no linen. But in the present times, through the greater part of Europe, a creditable day-labourer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty which, it is presumed, nobody can well fall into without extreme bad conduct … Under necessaries, therefore, I comprehend not only those things which nature, but those things which the established rules of decency have rendered necessary to the lowest rank of people."* (Book Five, Chapter II, Article IV)

As usual, Adam Smith is right while his erstwhile ideological followers are wrong. They may object, noting that strictly speaking Smith was talking of *"necessaries"* rather than poverty. However, his concept of necessaries implies a definition of poverty and this is obviously based not on some unchanging biological concept of subsistence but on whatever *"the custom of the country"* or *"the established rules of decency"* consider necessary Marx made the same point his later works, when he distanced himself from his earlier notion that capitalism resulted in **absolute** impoverishment. As he put it in volume 1 of **Capital**, *"the number and extent of [the worker's] so-called necessary requirements, as also the manner and extent they are satisfied, are themselves products of history, and depend therefore to a great extent on the level of civilisation attained by a country … In contrast, therefore, with the case of other commodities, the determination of the value of labour-power contains a historical and moral element."* [p. 275]

It is ironic that those today who most aggressively identify themselves as disciples of Smith are also the people who are most opposed to definitions of poverty that are consistent with this definition of "necessaries" (this is unsurprising, as those who invoke his name most usually do so in pursuit of ideas alien to his work). This is done for the usual self-interested motives. For example, Thatcher's government originally had little problem with the concept of relative poverty and *"[o]nly when its policies had led to a conspicuous growth of relative poverty was the idea denounced, and the decision taken by the government … that absolute poverty (undefined and unqualified) was the only reality."* [Ian Gilmore, **Op. Cit.**, p. 136] Smith's perspective, significantly, is that followed by most poverty researchers, who use a relative measure in evaluating poverty rates. The reason is unsurprising as poor is relative to the living standards and customs of a time and place. Some sceptic might regurgitate the unoriginal response that the poor in the West are rich compared to people in developing countries, but they do not live in those countries. True, living standards have improved considerably over time but comparing the poor of today with those of centuries past is also meaningless. The poor today are poor relative to what it takes to live and develop their individual potentials in their own societies, not in (for example) 18^{th} century Scotland or half-way across the globe (even Milton Friedman had to grudging admit that *"poverty is in part a relative matter."* [**Op. Cit.**, p. 191]). Considering the harmful effects of relative inequality we indicated in section B.1, this position is perfectly justified.

The notion of absolute poverty being the key dates back to at least Locke who argued in his **Second Treatise** on government that in America *"a King of a large and fruitful Territory there feeds, lodges, and is clad worse than a day Labourer in England."* (section 41) Ignoring the dubious anthropological assertions, his claim was made as part of a general defence of enclosing common land and turning independent workers into dependent wage slaves. The key to his argument is that the accumulation of property and land beyond that useable by an individual along with the elimination of customary rights for poor individuals was justified because owners of the enclosed land would hire workers and increase the overall wealth available. This meant that the dispossessed workers (and particularly their descendants) would be better off materially (see C.B MacPherson's **The Political Theory of Possessive Individualism: From Hobbes to Locke** for an excellent discussion of this). The links with the current debate on globalisation are clear, with so-called "market advocates" and "individualists" providing extensive apologetics for capital moving to authoritarian regimes which systematically violate individual rights and the principles of the "free" market precisely in terms of the increased material wealth this (eventually) produces. But then it is easy for bosses, tenured professors and well paid think-tank experts to pontificate that such sacrifices (for others, of course) are worth it in the long run.

This apparently strange transformation of "individualists" into "collectivists" (justifying the violation of individual rights in terms of the greater good) has a long precedent. Indeed, it can only be considered strange if you are ignorant of the nature and history of capitalism as well as the contortions its defenders have inflicted on themselves (and by yet another of these strange co-incidences that so regularly afflicts capitalism and its supporters, the individuals whose liberty and rights are considered expendable are always members of the working class). So the notion of absolute poverty has always been associated with defending inequalities of wealth and power as well as providing justification in terms of long term benefit for the violation of the "freedom" and "individual rights" they claim to defend. Significantly, the contemporary representatives of the landlords who imposed enclosures framed their arguments precisely in terms of restricting the independence (i.e. freedom) of the working population. As Marxist David McNally summarises after providing extensive quotes, it was *"precisely these elements of material and spiritual independence that many of the most outspoken advocates of enclosure sought to destroy."* They *"were remarkably forthright in this respect. Common rights and access to common lands, they argued, allowed a degree of social and economic independence, and thereby produced a lazy, dissolute mass of rural poor … Denying such people common lands and common rights would force them to conform to the harsh discipline imposed by the market in labour."* [**Against the Market**, p. 19] This would only be considered paradoxical if you equate freedom with capitalism.

The underlying assumption under all this is that liberty (at least for working class people) is less important than material wealth, a vision rightly attacked when Stalinism seemed to be out-performing the West in terms of growth before the 1970s. Yet the question, surely, is would individuals freely agree to be subjected to the dictates of a boss for 10–12 hours a day if other alternatives had not closed off by state intervention? As we discuss in section F.8, the answer has always been no. This is the case today. For example, Naomi Klein interviews one boss of a third-world sweatshop who explained that *"for the lowly province worker, working inside an enclosed factory is better than being outside."* One of his workers rebutted this, stating *"Our rights are being trampled"* and the he said that *"because he has not experienced working in a factory and the conditions inside."* Another noted that *"of course he would say that we prefer this work — it is beneficial to him, but not to us."* Another states the obvious: *"But we are landless, so we have no choice but to work in the economic zone even though it is very hard and the situation is unfair."* [quoted by Klein, **No Logo**, p. 220 and p. 221] It should noted that the boss has, of course, the backing of a great many economists (including many moderately left-wing ones) who argue that sweatshops are better than no jobs and that these countries cannot afford basic workers' rights (as these are class societies, it means that their ruling class cannot afford to give their workers the beneficial aspects of a free market, namely the right to organise and associate freely). It is amazing how quickly an economist or right-liberal will proclaim that a society cannot expect the luxury of a free market, at least for the working class, and how these "individualists" will proclaim that the little people must suffer in order for the greater good to be achieved.

As for the regimes within these factories, Klein notes that they are extremely authoritarian. The largest free-trade zone in the Philippines is *"a miniature military state inside a democracy"* and the *"management is military-style, the supervisors often abusive."* As would be expected, *"no questioning of authority is expected or permitted"* and in some *"strikes are officially illegal"* (rather than unofficially banned). [**Op. Cit.**, p. 204, p. 205 and p. 214] As with the original industrial revolution, capitalism takes advantages of other forms of social hierarchy in developing countries. As Stephen A. Marglin noted, the women and children, *"who by all accounts constituted the overwhelming majority of factory workers in the early days, were there not because they choose to be but because their husbands and fathers told them to be. The application of revealed preference to their presence in the factory requires a rather elastic view of the concept of individual choice."* [*"What do Bosses do?"*, pp. 60–112, **The Review of Radical Political Economics**, vol. 6, No. 2, p. 98] In other words, while the workers **may** be better off in terms of wages they are not better off in terms of liberty, equality and dignity. Luckily there are economists around to explain, on their behalf, that these workers cannot afford such luxuries.

Looking beyond the empirical investigation, we should point out the slave mentality behind these arguments. After all, what does this argument actually imply? Simply that economic growth is the only way for working people to get ahead. If working people put up with exploitative working environments, in the long run capitalists will invest some of their profits and so increase the economic cake for all. So, like religion, "free market" economics argue that we must sacrifice in the short term so that (perhaps) in the future our living standards will increase (*"you'll get pie in the sky when you die"* as Joe Hill said about religion). Moreover, any attempt to change the "laws of the market" (i.e. the decisions of the rich) by collective action will only harm the working class. If the defenders of capitalism were genuinely interested in individual freedom they would be urging the oppressed masses to revolt rather than defending the investing of capital in oppressive regimes in terms of the freedom they are so willing to sacrifice when it comes to workers. But, of course, these defenders of "freedom" will be the first to point out that such revolts make for a bad investment climate — capital will be frightened away to countries with a more "realistic" and "flexible" workforce (usually made so by state repression).

In other words, capitalist economics praises servitude over independence, kow-towing over defiance and altruism over egoism. The "rational" person of neo-classical economics does not confront authority, rather he accommodates himself to it. For, in the long run, such self-negation will pay off with a bigger cake with (it is claimed) correspondingly bigger crumbs "trickling" downwards. In other words, in the short-term, the gains may flow to the elite but in the future we will all gain as some of it will trickle (back) down to the working people who created them in the first place. But, unfortunately, in the real world uncertainty is the rule and the future is unknown. The history of capitalism shows that economic growth is quite compatible with stagnating wages, increasing poverty and insecurity for workers and their families, rising inequality and wealth accumulating in fewer and fewer hands (the example of the USA and Chile from the 1970s to 1990s and Chile spring to mind). And, of course, even **if** workers kow-tow to bosses, the bosses may just move production elsewhere anyway (as tens of thousands of "down-sized" workers across the West can testify). For more details of this process in the USA see Edward S. Herman's article *"Immiserating Growth: The First World"* in Z Magazine, July 1994.

For anarchists it seems strange to wait for a bigger cake when we can have the whole bakery. If control of investment was in the hands of those it directly effects (working people) then it could be directed into socially and ecologically constructive projects rather than being used as a tool in the class war and to make the rich richer. The arguments against "rocking the boat" are self-serving (it is obviously in the interests the rich and powerful to defend a given income and property distribution) and, ultimately, self-defeating for those working people who accept them. In the end, even the most self-negating working class will suffer from the negative effects of treating society as a resource for the economy, the higher mobility of capital that accompanies growth and effects of periodic economic and long term ecological crisis. When it boils down to it, we all have two options — you can do what is right or you can do what you are told. "Free market" capitalist economics opts for the latter.

C.11 Doesn't neo-liberalism in Chile prove that the free market benefits everyone?

Chile is considered by some to be one of the economic success stories of the modern world. It can be considered as the first laboratory for neo-liberal economic dogma, first under Pinochet's dictatorship and later when his regime had been replaced by a more democratic one. It can be considered as the template for the economic vision later applied by Reagan and Thatcher in the West. What happened in Chile was repeated (to some degree) wherever neo-liberal policies were implemented. As such, it makes a good case study to evaluate the benefits of free(r) market capitalism and the claims of capitalist economics.

For the right, Chile was pointed to as a casebook in sound economics and is held up as an example of the benefits of capitalism. Milton Friedman, for example, stated in 1982 that Military Junta *"has supported a fully free-market economy as a matter of principle. Chile is an economic miracle."* [quoted by Elton Rayack, **Not so Free to Choose**, p. 37] Then US President George Bush praised the Chilean economic record in December 1990 when he visited that country, stating Chile deserved its *"reputation as an economic model"* for others to follow.

However, the reality of the situation is radically different. As Chilean expert Peter Winn argues, *"[w]e question whether Chile's neoliberal boom ... should be regarded as a miracle. When confronted by such a claim, scholars and students should always ask: a miracle for* ***whom*** *— and at what cost?"* [*"Introduction"*, Peter Winn (ed.), **Victims of the Chilean Miracle**, p. 12] As we will prove, Chile's "economic miracle" is **very** class dependent. For its working class, the neo-liberal reforms of the Pinochet regime have resulted in a worsening of their lives; if you are a capitalist then it has been a miracle. That the likes of Friedman claim the experiment as a "miracle" shows where their sympathies lie — and how firm a grasp they have of reality.

The reason why the Chilean people become the first test case for neo-liberalism is significant. They did not have a choice. General Pinochet was the figure-head of a military coup in 1973 against the democratically elected left-wing government led by President Allende. This coup was the culmination of years of US interference by the US in Chilean politics and was desired by the US **before** Allende took office in November 1970 (*"It is the firm and continuing policy that Allende be overthrown by a coup,"* as one CIA memo put it in October of that year [quoted by Gregory Palast, *"A Marxist threat to cola sales? Pepsi demands a US coup. Goodbye Allende. Hello Pinochet"*, **The Observer**, 8/11/1998]). Then American president Richard Nixon imposed an embargo on Chile and began a covert plan to overturn the Allende government. In the words of the US ambassador to Chile, the Americas *"will do all in our power to condemn Chileans to utmost poverty."* [quoted by Noam Chomsky, **Deterring Democracy**, p. 395]

According to notes taken by CIA director Richard Helms at a 1970 meeting in the Oval Office, his orders were to *"make the economy scream."* This was called Project FUBELT and its aims were clear: *"The Director [of the CIA] told the group that President Nixon had decided that an Allende regime in Chile was not acceptable to the United States. The President asked the Agency to prevent*

Allende from coming to power or to unseat him." [*"Genesis of Project FUBELT"* document dated September 16, 1970] Not all aid was cut. During 1972 and 1973 the US increased aid to the military and increased training Chilean military personnel in the United States and Panama. In other words, the coup was helped by US state and various US corporations both directly and indirectly, by undermining the Chilean economy.

Thousands of people were murdered by the forces of "law and order" and Pinochet's forces *"are conservatively estimated to have killed over 11,000 people in his first year in power."* [P. Gunson, A. Thompson, G. Chamberlain, **The Dictionary of Contemporary Politics of South America**, p. 228] Military units embarked on an operation called the Caravan of Death to hunt down those they considered subversives (i.e. anyone suspected or accused of holding left-wing views or sympathies). Torture and rape were used extensively and when people did not just disappear, their mutilated bodies were jumped in plain view as a warning to others. While the Chilean government's official truth and reconciliation committee places the number of disappeared at roughly 3,000, church and human rights groups estimate the number is far higher, at over 10,000. Hundreds of thousands fled into exile. Thus ended Allende's "democratic road to Socialism." The terror did not end after the coup and dictatorship's record on human rights was rightly denounced as barbaric.

Friedman, of course, stressed his *"disagreement with the authoritarian political system of Chile."* [quoted by Rayack, **Op. Cit.**, p. 61] For the time being we will ignore the obvious contradiction in this "economic miracle", i.e. why it almost always takes authoritarian/fascistic states to introduce "economic liberty." Rather we will take the right at its word and concentrate on the economic facts of the free-market capitalism imposed on the Chilean people. They claim it was a free market and given that, for example, Friedman was leading ideologue for capitalism we can assume that the regime approximated the workings of such a system. We will discuss the illogical nature and utter hypocrisy of the right's position in section D.11, where we also discuss the limited nature of the democratic regime which replaced Pinochet and the real relationship between economic and political liberty.

Faced with an economic crisis, in 1975 Pinochet turned to the ideas of Milton Friedman and a group of Chilean economics who had been taught by him at the University in Chicago. A short meeting between Friedman and Pinochet convinced the dictator to hand economic policy making to Friedman's acolytes (who became known as "the Chicago Boys" for obvious reasons). These were free-market economists, working on a belief in the efficiency and fairness of the free market and who desired to put the laws of supply and demand back to work. They set out to reduce the role of the state in terms of regulation and social welfare as these, they argued, had restricted Chile's growth by reducing competition, lowering growth, artificially increasing wages, and leading to inflation. The ultimate goal, Pinochet once said, was to make Chile *"not a nation of proletarians, but a nation of entrepreneurs."* [quoted by Thomas E. Skidmore and Peter H. Smith, **Modern Latin America**, p. 137]

The role of the Chicago Boys cannot be understated. They had a close relationship with the military from 1972, and according to one expert had a key role in the coup:

> *"In August of 1972 a group of ten economists under the leadership of de Castro began to work on the formulation of an economic programme that would replace [Allende's one]... In fact, the existence of the plan was essential to any attempt on the part of the armed forces to overthrow Allende as the Chilean armed forces did not have any*

> *economic plan of their own."* [Silvia Borzutzky, *"The Chicago Boys, social security and welfare in Chile"*, **The Radical Right and the Welfare State**, Howard Glennerster and James Midgley (eds.), p. 88]

This plan also had the backing of certain business interests. Unsurprisingly, immediately after the coup, many of its authors entered key Economic Ministries as advisers. [Rayack, **Op. Cit.**, p. 52] It is also interesting to note that *"[a]ccording to the report of the United States Senate on covert actions in Chile, the activities of these economists were financed by the Central Intelligence Agency (CIA)."* [Borzutzky, **Op. Cit.**, p. 89] Obviously some forms of state intervention were more acceptable than others.

April 1975 saw the Chicago Boys assume *"what was in effect dictatorial control over economic policy … The monetarists were now in a commanding position to put in place Friedman's recommendations, and they didn't hesitate."* The actual results of the free market policies introduced by the dictatorship were far less than the "miracle" claimed by Friedman and a host of other right-wingers. The initial effects of introducing free market policies was a shock-induced depression which resulted in GDP dropping by 12.9% year "shock treatment" was imposed saw the GDP fall by 12.9% (Latin America saw a 3.8% rise), real wages fell to 64.9% of their 1970 level and unemployment rising to 20 percent. Even Pinochet *"had to concede that the social cost of the shock treatment was greater than he expected."* [Rayack, **Op. Cit.**, p. 56, p. 41 and p. 57] For Friedman, his *"only concern"* with the plan was *"whether it would be pushed long enough and hard enough."* [quoted by Joseph Collins and John Lear, **Chile's Free-Market Miracle: A Second Look**, p. 29] Unsurprisingly, the *"rigorous imposition of the neoliberal economic model after 1975 soon threatened [workers] job security too"* and they *"bore the brunt"* of the changes in terms of *"lost jobs and raised work norms."* [Winn, *"No Miracle for Us,"* Peter Winn (ed.), **Op. Cit.**, p. 131]

After the depression of 1975, the economic started to grow again. This is the source of claim of an "economic miracle." Friedman, for example, used 1976 as his base-line, so excluding the depression year of 1975 which his recommended shock treatment deepened. This is dishonest as it fails to take into account not only the impact of neo-liberal policies but also that a deep recession often produces a vigorous upsurge:

> *"By taking 1975, a recession year in which the Chilean economy declined by 13 percent, as the starting point of their analysis, the Chicago Boys obscured the fact that their 'boom' was more a recovery from the deep recession than a new economic expansion. From 1974 to 1981, the Chilean economy grew at a modest 1.4 percent a year on average. Even at the height of the 'boom' in 1980, effective unemployment was so high — 17 percent — that 5 percent of the workforce were in government make-work programs, a confession of failure for neoliberals who believe in the market as self-correcting and who abhor government welfare programs. Nor did the Chicago Boys call attention to the extreme concentration of capital, precipitous fall in real wages and negative redistribution of income that their policies promoted, or their disincentives to productive investment."* [Peter Winn, *"The Pinochet Era"*, **Op. Cit.**, pp. 28–9]

Between 1975 and 1982, the regime implemented numerous economic reforms based on the suggestions of the Chicago Boys and their intellectual gurus Friedman and von Hayek. They privatised numerous state owned industries and resources and, as would be expected, the privatisations were carried out in such a way as to profit the wealthy. *"The denationalisation process,"* notes Rayack, *"was carried out under conditions that were extremely advantageous for the new owners … the enterprises were sold at sharply undervalues prices."* Only large conglomerates could afford them, so capital became even more concentrated. [**Op. Cit**., p. 67] When it privatised its interests in the forestry processing plants in the country the government followed the privatisation of other areas of the economy and they *"were sold at a discount, according to one estimate, at least 20 per cent below their value."* Thus *"the privatisations were bargain sell-offs of public assets,"* which amounted to a *"subsidy from the national treasury to the buyers of 27 to 69 percent"* and so *"[c]ontrol of the common wealth of the entire nation passed to a handful of national and foreign interests that captured most of the subsidy implicit in the rock bottom prices."* [Joseph Collins and John Lear, **Chile's Free-Market Miracle: A Second Look**, p. 206, p. 54 and p. 59]

By 1978, the Chicago Boys *"were pressing for new laws that would bring labour relations in line with the neoliberal economic model in which the market, not the state, would regulate factors of production."* [Winn, *"The Pinochet Era"*, Winn (ed.), **Op. Cit**., p. 31] According to Pinochet's Minister of Labour (1978–81), the Labour relations had been *"modernised"* and that *"politicised"* labour leaders and their *"privileged fiefdoms"* had been eliminated, with workers no longer having *"monopolies"* on job positions. Rather than government intervention, negotiation between capital and labour was now left to *"individual responsibility and the discipline of the market."* The stated aim was to *"introduce democracy into the world of Chilean unions and resolve problems that for decades had been obstacles for the progress of workers."* [quoted by Joseph Collins and John Lear, *"Working in Chile's Free Market"*, pp. 10–29, **Latin American Perspectives**, vol. 22, No. 1, pp. 10–11 and p. 16] The hypocrisy of a technocratic bureaucrat appointed by a military dictatorship talking about introducing democracy into unions is obvious. The price of labour, it was claimed, now found its correct level as set by the "free" market.

All of which explains Friedman's 1991 comment that the *"real miracle of Chile"* was that Pinochet *"support[ed] a free market regime designed by principled believers in a free market."* [**Economic Freedom**, **Human Freedom**, **Political Freedom**] As to be expected with Friedman, the actual experience of implementing his dogmas refuted both them and his assertions on capitalism. Moreover, working class paid the price.

The advent of the "free market" led to reduced barriers to imports *"on the ground the quotas and tariffs protected inefficient industries and kept prices artificially high. The result was that many local firms lost out to multinational corporations. The Chilean business community, which strongly supported the coup in 1973, was badly affected."* [Skidmore and Smith, **Op. Cit**., p. 138] The decline of domestic industry cost thousands of better-paying jobs. Looking at the textile sector, firms survived because of *"lowered labour costs and increased productivity."* The sector has *"low real wages, which dramatically altered"* its international competitiveness. In other words, the Chilean textile industry *"had restructured itself on the back of its workers."* [Peter Winn, *"No Miracle for Us"*, Winn (ed.), **Op. Cit**., p. 130] The mines were *"enormously profitable after 1973 because of increased labour discipline, the reduction in costs due to the contraction of real wages, and an increase in production based on expansion programs initiated during the late 1960s."* [Thomas Miller Klubock, *"Class, Community, and Neoliberalism in Chile"*, **Op. Cit**., p. 241] This was the **real** basis of the 1976 to 1981 "economic miracle" Friedman praised in 1982.

As with most neo-liberal experiments, the post-1975 "miracle" was built on sand. It was *"a speculative bubble that was hailed as an 'economic miracle' until it burst in the 1981–82 bank crash that brought the deregulated Chilean economy down in its wake."* It was *"largely short-term speculative capital … producing a bubble in stock market and real estate values"* and *"by 1982 the economy* *was in shambles and Chile in the throes of its worse economic crisis since the depression of the 1930s. A year later, massive social protests defied Pinochet's security forces."* [Winn, **Op. Cit.**, p. 38] Thus *"the bottom fell out of the economy"* and Chile's GDP fell 14% in one year. In the textile industry alone, an estimated 35 to 45% of companies failed. [Collins and Lear, **Op. Cit.**, p. 15]

So after 7 years of free(r) market capitalism, Chile faced yet another economic crisis which, in terms of unemployment and falling GDP was even greater than that experienced during the terrible shock treatment of 1975. Real wages dropped sharply, falling in 1983 to 14% below what they had been in 1970. Bankruptcies skyrocketed, as did foreign debt and unemployment. [Rayack, **Op. Cit.**, p. 69] Chile's GNP *"fell by more than 15 percent, while its real disposable GNP declined by 19 percent. The industrial sector contracted by more than 21 percent and construction by more than 23 percent. Bankruptcies tripled … It was a crisis comparable to the Great Depression of the 1930s, which affected Chile more severely than any other country in the world."* The same can be said of this crisis, for while GNP in Chile feel 14% during 1982–3, the rest of Latin America experienced 3.5% drop as whole. [Winn, **Op. Cit.**, p. 41 and p. 66] By 1983, the Chilean economy was devastated and it was only by the end of 1986 that Gross Domestic Product per capita (barely) equalled that of 1970. Unemployment (including those on government make-work programmes) had risen to a third of the labour force by mid-1983. By 1986, per capita consumption was actually 11% lower than the 1970 level. [Skidmore and Smith, **Op. Cit.**, p. 138]

Faced with this massive economic collapse (a collapse that somehow slipped Friedman's mind when he was evaluating the Chilean experiment in 1991), the regime organised a massive bailout. The "Chicago Boys" resisted this measure, arguing with dogmatic arrogance that there was no need for government intervention or policy changes because they believed in the self-correcting mechanisms of the market would resolve any economic problem. However, they were applying a simplistic textbook version of the economy to a complex reality which was spectacularly different from their assumptions. When that reality refused to respond in the way predicted by their ideological musing, the state stepped in simply because the situation had become so critical it could not avoid it.

The regime did do some things to help the unemployed, with 14% of the labour force enrolled in two government make-work programs that paid less than the minimum wage by October 1983. However, aid for the capitalist class was far more substantial. The IMF offered loans to Chile to help it out of mess its economic policies had helped create, but under strict conditions (such as making the Chilean public responsible for paying the billions in foreign loans contracted by **private** banks and firms). The total bailout cost 3% of Chile's GNP for three years, a cost which was passed on to the population (this *"socialisation of private debts were both striking and unequal"*). This follows the usual pattern of "free market" capitalism — market discipline for the working class, state aid for the elite. During the "miracle," the economic gains had been privatised; during the crash the burden for repayment was socialised. In fact, the regime's intervention into the economy was so extensive that, *"[w]ith understandable irony, critics lampooned the 'Chicago road to socialism.'"* [Winn, **Op. Cit.**, p. 66 and p. 40]

Significantly, of the 19 banks that the government had privatised, all but five failed. These along with the other bankrupt firms fell back into government hands, a fact the regime sought to downplay by failing to classify them as public companies. Once the debts had been *"assumed by the public,"* their *"assets were sold to private interests."* Significantly, the *"one bank that had not been privatised and the other publicly owned companies survived the crisis in relatively good shape"* and almost all of them were *"turning a profit, generating for the government in profits and taxes*

25 percent of its total revenues ... Thus the public companies that had escaped the Chicago Boy's privatisations ... enabled a financially strapped government to resuscitate the failed private banks and companies." [Collins and Lear, **Chile's Free-Market Miracle: A Second Look**, pp. 51–2]

Needless to say, the recovery (like the illusionary boom) was paid for by the working class. The 1982 crash meant that *"something had to give, and the Chicago Boys decided that it would be wages. Wages, they explained, should be allowed to find their natural level."* An 1982 decree *"transferred much of the burden of recovery and profitability to workers and became central to Chile's economic recovery throughout the rest of the decade."* [Collins and Lear, **Op. Cit.**, p. 20 and p. 19] For the miners, between late 1973 and May 1983, real average wages dropped by 32.6% and workers' benefits were reduced (for example, the free medical attention and health care that had been won in the 1920s were dropped). [Thomas Miller Klubock, *"Class, Community, and Neoliberalism in Chile,"* Winn (ed.), **Op. Cit.**, p. 217] As Peter Winn summarises:

> *"Chile's workers, who had paid the social costs of the illusory neoliberal 'miracle,' now paid as well the highest price for the errors of their nation's military rulers and Chicago Boy technocrats and the imprudence of their country's capitalists. Plant closing and layoffs drove the effective unemployment rate above 30 percent, while real wages for those lucky enough to retain their jobs fell by nearly 11 percent in 1979–82 and by some 20 percent during the 1980s. In addition, inflation jumped to over 20 percent in both 1982 and 1983, and the budget surplus gave way to a deficit equal to 3 percent of the GNP by 1983. By then, Chile's foreign debt was 13 percent higher than its GNP ... Chile's economy contracted 400 percent more in 1982–83 than the rest of Latin America."* [*"The Pinochet Era"*, Winn (ed.), **Op. Cit.**, pp. 41–2]

Unsurprisingly, for the capitalist class things were somewhat different. Private banks *"were bailed out by the government, which spent $6 billion in subsidies during 1983–85 (equal to 30 percent of the GNP!) but were made subject to strict government regulation designed to assure their solvency. Controls were also placed on flows of foreign capital."* [Winn, **Op. Cit.**, p. 42] The government also raised tariffs from 10% to between 20 and 35% and the peso was drastically devalued. [Collins and Lear, **Op. Cit.**, p. 15] Pinochet's state took a more active role in promoting economic activity. For example, it developed new export industries which *"benefited from a series of subsidies, privatisations, and deregulations that allowed for unrestricted exploitation of natural resources of limited renewability. Equally important were low wages, great flexibility of employers vis-à-vis workers, and high levels of unemployment."* [Collins and Lear, **Op. Cit.**, p. 20] The forestry sector was marked by government hand-outs to the already rich. Joseph Collins and John Lear argue that the neoliberals' *"stated goals were to curtail sharply the direct role of government in forestry and to let market mechanisms determine the prices and direct the use of resources. Yet government intervention and subsidies were in fact central to reorienting the benefits of forestry production away from the rural population towards a handful of national and foreign companies."* [**Op. Cit.**, p. 205]

By 1986, the economy had stabilised and the crisis was over. However, the recovery was paid for by the working class as *"wages stayed low"* even as the economy began to recover. Low wages were key to the celebrated 'miracle' recovery. From 1984 to 1989 the gross national product grew an average of 6 percent annually. By 1987 Chile had recovered the production levels of 1981, and by 1989 production levels exceeded 1981 levels by 10 percent. The average wage, by contrast, was 5 percent lower at the end of the decade than it had been in 1981 — almost 10 percent lower than the average 1970 wage. The drop in the minimum wage *"was even more drastic."* Public unrest during the economic crisis made it politically difficult to eliminate, so it *"was allowed to erode steadily in the face of inflation. By 1988, it was 40 percent lower in real terms than it had been in 1981 … In that year 32 percent of the workers in Santiago earned the minimum wage or less."* Thus, *"recovery and expansion after 1985 depended on two ingredients that are unsustainable over the long term and in a democratic society,"* namely *"an intensified exploitation of the labour force"* and *"the unregulated exploitation of nonrenewable natural resources such as native forests and fishing areas, which amounted to a one-time subsidy to domestic conglomerates and multinationals."* [Collins and Lear, **Op. Cit.**, **Op. Cit.**, p. 83, p. 84 and p. 35]

In summary, *"the experiment has been an economic disaster."* [Rayack, **Op. Cit.**, p. 72]

C.11.1 Who benefited from Chile's "economic miracle"?

Given that Chile was hardly an "economic miracle," the question arises why it was termed so by people like Friedman. To answer that question, we need to ask who actually benefited from the neo-liberalism Pinochet imposed. To do this we need to recognise that capitalism is a class system and these classes have different interests. We would expect any policies which benefit the ruling elite to be classed as an "economic miracle" regardless of how adversely they affect the general population (and vice versa). In the case of Chile, this is precisely what happened.

Rather than benefit everyone, neo-liberalism harmed the majority. Overall, by far the hardest group hit was the working class, particularly the urban working class. By 1976, the third year of Junta rule, real wages had fallen to 35% below their 1970 level. It was only by 1981 that they has risen to 97.3% of the 1970 level, only to fall again to 86.7% by 1983. Unemployment, excluding those on state make-work programmes, was 14.8% in 1976, falling to 11.8% by 1980 (this is still double the average 1960s level) only to rise to 20.3% by 1982. [Rayack, **Op. Cit.**, p. 65] Between 1980 and 1988, the real value of wages grew only 1.2 percent while the real value of the minimum wage declined by 28.5 percent. During this period, urban unemployment averaged 15.3 percent per year. [Silvia Borzutzky, **Op. Cit.**, p. 96] Even by 1989 the unemployment rate was still at 10% (the rate in 1970 was 5.7%) and the real wage was still 8% lower than in 1970. Between 1975 and 1989, unemployment averaged 16.7%. In other words, after nearly 15 years of free market capitalism, real wages had still not exceeded their 1970 levels and unemployment was still higher. As would be expected in such circumstances the share of wages in national income fell from 42.7% in 1970 to 33.9% in 1993. Given that high unemployment is often attributed by the right to strong unions and other labour market "imperfections," these figures are doubly significant as the Chilean regime, as noted above, reformed the labour market to improve its "competitiveness."

After 1982, *"stagnant wages and the unequal distribution of income severely curtailed buying power for most Chileans, who would not recover 1970 consumption levels until 1989."* [Collins and Lear, **Op. Cit.**, p. 25] By 1988, *"the average real wage had returned to 1980 levels, but it was still well below 1970 levels. Moreover, in 1986, some 37 percent of the labour force worked in the informal sector, where wages were lower and benefits often nonexistent. Many worked for minimum wage which in 1988 provided only half of what an average family required to live decently — and a fifth of the workers didn't even earn that. A survey … concluded that nearly half of Chileans lived in poverty."* [Winn, *"The Pinochet Era"*, **Op. Cit.**, p. 48] This was far more in absolute and relative terms than at any time in the in the preceding three decades. [Collins and Lear, *"Working in Chile's Free Market"*, **Op. Cit.**, p. 26]

Per capita consumption fell by 23% from 1972–87. The proportion of the population below the poverty line (the minimum income required for basic food and housing) increased from 20% to 44.4% between 1970 and 1987. Per capita health care spending was more than halved from 1973 to 1985, setting off explosive growth in poverty-related diseases such as typhoid, diabetes and viral hepatitis. On the other hand, while consumption for the poorest 20% of the population of Santiago dropped by 30%, it rose by 15% for the richest 20%. [Noam Chomsky, **Year 501**, pp. 190–191] The percentage of Chileans without adequate housing increased from 27 to 40 percent between 1972 and 1988, despite the claims of the government that it would solve homelessness via market friendly policies.

So after two decades of neoliberalism, the Chilean worker can look forward to *"a job that offers little stability and low wages, usually a temporary one or one in the informal economy … Much of the growth in jobs after the 1982–1983 crash came in economic sectors characterised by seasonal employment … [and are] notorious for their low pay, long hours, and high turnover."* In 1989, over 30% of jobs were in the formal sector in the Santiago metropolitan area with incomes less than half the average of those in the formal sector. For those with jobs, *"the work pace intensified and the work day lengthened … Many Chileans worked far longer than the legal maximum work week of 48 hours without being paid for the extra hours. Even free-market celebrants … admit that extra unpaid hours remain a serious problem"* in 1989. In fact, it is *"commonly assumed that employees work overtime without pay or else"* and, unsurprisingly, the *"pattern resembles the European production systems of the mid-19th century."* [Collins and Lear, **Op. Cit.**, p. 22 pp. 22–3, p. 23, p. 24 and p. 25] Unsurprisingly, as in neo-liberal America, wages have become divorced from productivity growth. Even in the 1990s, *"there is evidence that productivity growth outpaced real wage growth by as much as a ratio 3:1 in 1993 and 5:1 in 1997."* [Volker Frank, *"Politics without Policy"*, **Op. Cit.**, p. 73]

Similar comments are possible in regards to the privatised pension system, regarded by many right-wingers as a success and a model for other countries. However, on closer inspection this system shows its weaknesses — indeed, it can be argued that the system is only a success for those companies making extensive profits from it (administration costs of the Chilean system are almost 30% of revenues, compared to 1% for the U.S. Social Security system [Doug Henwood, **Wall Street**, p. 305]). For working people, it is a disaster. According to SAFP, the government agency which regulates the system, 96% of the known workforce were enrolled in February 1995, but 43.4% of these were not adding to their funds. Perhaps as many as 60% do not contribute regularly (given the nature of the labour market, this is unsurprising). Unfortunately, regular contributions are required to receive full benefits. Critics argue that only 20% of contributors will actually receive good pensions.

Workers need to find money for health care as their *"remuneration has been reduced to the wage, ending most benefits that workers had gained over the years [before the coup]. Moreover, the privatisation of such social services as health care and retirement security … [has meant] the costs were now taken entirely from employee earnings."* Unsurprisingly, *"[l]onger work days and a stepped-up pace of work increased the likelihood of accidents and illness. From 1982 to 1985 the number of reported workplace accident almost doubled. Public health experts estimate, however, that over three-quarters of workplace accidents went unreported, in part because over half of the workforce is without any kind of accident insurance."* [Collins and Lear, **Op. Cit.**, p. 20 and p. 25]

It is interesting to note that when this programme was introduced, the armed forces and police were allowed to keep their own generous public plans. If the plans **were** are as good as their supporters claim, you would think that those introducing them would have joined them. Obviously what was good enough for the masses were not suitable for the rulers and the holders of the guns they depended upon. Given the subsequent fate of that scheme, it is understandable that the ruling elite and its minions did not want middle-men to make money off their savings and did not trust their pensions to the fluctuations of the stock market. Their subjects, however, were less lucky. All in all, Chile's privatised social security system *"transferred worker savings in the form of social security contributions from the public to the private sector, making them available to the country's economic groups for investment. Given the oligopic concentration of wealth and corporate control under Pinochet, this meant handing the forced savings of workers over to Chile's most powerful capitalists."* That is, *"to shore up capital markets through its transfer of worker savings to Chile's business elites."* [Winn, *"The Pinochet Era"*, **Op. Cit.**, p. 64 and p. 31]

The same applies to the health system, with the armed forces and national police and their dependants having their own public health care system. This means that they avoid the privatised health system which the wealthy use and the run-down public system which the majority have access to. The market ensures that for most people, *"the actual determining factor is not 'choice,' but one's ability to pay."* By 1990, only 15% of Chileans were in the private system (of these, nearly 75% are form the top 30% of the population by income). This means that there are three medical systems in Chile. The well-funded public one for armed forces and police, a good to excellent private system for the elite few and a *"grossly under-funded, rundown, over-burdened"* one *"for some 70% of Chileans."* Most *"pay more and receive less."* [Collins and Lear, **Op. Cit.**, p. 99 and p. 246]

The impact on individuals extended beyond purely financial considerations, with the Chilean labour force *"once accustomed to secure, unionised jobs [before Pinochet] ... [being turned] into a nation of anxious individualists ... [with] over half of all visits to Chile's public health system involv[ing] psychological ailments, mainly depression. 'The repression isn't physical any more, it's economic — feeding your family, educating your child,' says Maria Pena, who works in a fishmeal factory in Concepcion. 'I feel real anxiety about the future', she adds, 'They can chuck us out at any time. You can't think five years ahead. If you've got money you can get an education and health care; money is everything here now.'"* Little wonder, then, that *"adjustment has created an atomised society, where increased stress and individualism have damaged its traditionally strong and caring community life... suicides have increased threefold between 1970 and 1991 and the number of alcoholics has quadrupled in the last 30 years ... [and] family breakdowns are increasing, while opinion polls show the current crime wave to be the most widely condemned aspect of life in the new Chile. 'Relationships are changing,' says Betty Bizamar, a 26-year-old trade union leader. 'People use each other, spend less time with their family. All they talk about is money, things. True friendship is difficult now.'"* [Duncan Green, **Op. Cit.**, p. 96 and p. 166]

The experiment with free market capitalism also had serious impacts for Chile's environment. The capital city of Santiago became one of the most polluted cities in the world due the free reign of market forces. With no environmental regulation there is general environmental ruin and water supplies have severe pollution problems. [Noam Chomsky, **Year 501**, p. 190] With the bulk of the country's experts being based on the extraction and low processing of natural resources, eco-systems and the environment have been plundered in the name of profit and property. The depletion of natural resources, particularly in forestry and fishing, is accelerating due to the self-interested behaviour of a few large firms looking for short term profit.

So, in summary, Chile's workers *"were central target's of [Pinochet's] political repression and suffered greatly from his state terror. They also paid a disproportionate share of the costs of his regime's regressive social policies. Workers and their organisations were also the primary targets of Pinochet's labour laws and among the biggest losers from his policies of privatisation and deindustrialisation."* [Winn, *"Introduction"*, **Op. Cit.**, p. 10]

Given that the majority of Chile's people where harmed by the economic policies of the regime, how can it be termed a "miracle"? The answer can be found in another consequence of Pinochet's neo-classical monetarist policies, namely *"a contraction of demand, since workers and their families could afford to purchase fewer goods. The reduction in the market further threatened the business community, which started producing more goods for export and less for local consumption. This posed yet another obstacle to economic growth and led to increased concentration of income and wealth in the hands of a small elite."* [Skidmore and Smith, **Op. Cit.**, p. 138]

It is the increased wealth of the elite that we see the true "miracle" of Chile. When the leader of the Christian Democratic Party returned from exile in 1989 he said that economic growth that benefited the top 10% of the population had been achieved (Pinochet's official institutions agreed). [Noam Chomsky, **Deterring Democracy**, p. 231] This is more than confirmed by other sources. According to one expert in the Latin American neo-liberal revolutions, the elite *"had become massively wealthy under Pinochet."* [Duncan Green, **The Silent Revolution**, p. 216] In 1980, the richest 10% of the population took 36.5% of the national income. By 1989, this had risen to 46.8%. By contrast, the bottom 50% of income earners saw their share fall from 20.4% to 16.8% over the same period. Household consumption followed the same pattern. In 1970, the top 20% of households had 44.5% of consumption. This rose to 51% in 1980 and to 54.6% in 1989. Between 1970 and 1989, the share going to the other 80% fell. The poorest 20% of households saw their share fall from 7.6% in 1970 to 4.4% in 1989. The next 20% saw their share fall from 11.8% to 8.2%, and middle 20% share fell from 15.6% to 12.7%. The next 20% saw their share of consumption fall from 20.5% to 20.1%. In other words, *"at least 60 percent of the population was relatively, if not absolutely, worse off."* [James Petras and Fernando Ignacio Leiva, **Democracy and Poverty in Chile**, p. 39 and p. 34]

In summary, *"the distribution of income in Chile in 1988, after a decade of free-market policies, was markedly regressive. Between 1978 and 1988 the richest 10 percent of Chileans increased their share of national income from 37 to 47 percent, while the next 30 percent saw their share shrink from 23 to 18%. The income share of the poorest fifth of the population dropped from 5 to 4 percent."* [Collins and Lear, **Op. Cit.**, p. 26] In the last years of Pinochet's dictatorship, the richest 10% of the rural population saw their income rise by 90% between 1987 and 1990. The share of the poorest 25% fell from 11% to 7%. The legacy of Pinochet's social inequality could still be found in 1993, with a two-tier health care system within which infant mortality is 7 per 1000 births for the richest fifth of the population and 40 per 1000 for the poorest fifth. [Duncan Green, **Op. Cit.**, p. 108 and p. 101] Between 1970 and 1989, labour's share of the national income fell from 52.3% to 30.7% (it was 62.8% in 1972). Real wages in 1987 were still 81.2% of their 1980–1 level. [Petras and Leiva, **Op. Cit.**, p. 34, p. 25 and p. 170]

Thus Chile has been a "miracle" for the capitalist class, with its successes being *"enjoyed primarily (and in many areas, exclusively) by the economic and political elites. In any society shot through with enormous inequalities in wealth and income, the market ... works to concentrate wealth and* *income."* There has been *"a clear trend toward more concentrated control over economic resources … Economic concentration is now greater than at any other time in Chile's history"* with multinational corporations reaping *"rich rewards from Chile's free-market policies"* (*"not surprisingly, they enthusiastically applaud the model and push to implant it everywhere"*). Ultimately, it is *"unconscionable to consider any economic and social project successful when the percentage of those impoverished … more than doubled."* [Collins and Lear, **Chile's Free-Market Miracle: A Second Look**, p. 252 and p. 253]

Thus the wealth created by the Chilean economy in during the Pinochet years did **not** "trickle down" to the working class (as claimed would happen by "free market" capitalist dogma) but instead accumulated in the hands of the rich. As in the UK and the USA, with the application of "trickle down economics" there was a vast skewing of income distribution in favour of the already-rich. That is, there has been a 'trickle-up' (or rather, a **flood** upwards). Which is hardly surprising, as exchanges between the strong and weak will favour the former (which is why anarchists support working class organisation and collective action to make us stronger than the capitalists and why Pinochet repressed them).

Overall, *"in 1972, Chile was the second most equal country in Latin America; by 2002 it was the second most **un**equal country in the region."* [Winn, *"The Pinochet Era"*, **Op. Cit.**, p. 56] Significantly, this refutes Friedman's 1962 assertion that *"capitalism leads to less inequality … inequality appears to be less … the more highly capitalist the country is."* [**Capitalism and Freedom**, p. 169] As with other countries which applied Friedman's ideas (such as the UK and US), inequality soared in Chile. Ironically, in this as in so many cases, implementing his ideas refuted his own assertions.

There are two conclusions which can be drawn. Firstly, that Chile is now **less** capitalist after applying Friedman's dogmas. Secondly, that Friedman did not know what he was talking about. The second option Seems the most likely, although for some defenders of the faith Chile's neo-liberal experiment may not have been "pure" enough. However, this kind of assertion will only convince the true believer.

C.11.2 What about Chile's economic growth and low inflation?

Given the actual results of the experiment, there are only two areas left to claim an "economic miracle." These are combating inflation and increasing economic growth. Neither can be said to be "miraculous."

As far as inflation goes, the Pinochet regime **did** reduce it, eventually. At the time of the time of the CIA-backed coup it was around 500% (given that the US undermined the Chilean economy — *"make the economy scream"*, Richard Helms, the director of the CIA — high inflation would be expected). By 1982 it was 10% and between 1983 to 1987, it fluctuated between 20 and 31%. It took eight years for the Chicago Boys to control inflation and, significantly, this involved *"the failure of several stabilisation programmes at an elevated social cost … In other words, the stabilisation programs they prescribed not only were not miraculous — they were not successful."* [Winn, *"The Pinochet Era"*, **Op. Cit.**, p. 63] In reality, inflation was not controlled by means of Friedman's Monetarism but rather by state repression as left-wing Keynesian Nicholas Kaldor points out:

> *"The rate of growth of the money supply was reduced from 570 per cent in 1973 … to 130 per cent in 1977. But this did not succeed in moderating the growth of the money GNP or of the rise in prices, because — lo and behold! — no sooner did they succeed in*

> *moderating the growth of the money supply down, than the velocity of circulation shot up, and inflation was greater with a lower rate of growth of the money supply … they have managed to bring down the rate of growth of prices … And how? By the method well tried by Fascist dictatorships. It is a kind of incomes policy. It is a prohibition of wage increases with concentration camps for those who disobey and, of course, the prohibition of trade union activity and so on. And so it was not monetarism that brought the Chilean inflation down … [It was based on] methods which by-passed the price mechanism."* [**The Economic Consequences of Mrs Thatcher**, p. 45]

Inflation was controlled by means of state repression and high unemployment, a combination of the incomes policy of Hitler and Mussolini and Karl Marx (i.e., Friedman's "natural rate of unemployment" we debunked in section C.9). In other words, Monetarism and "free market" capitalism did not reduce inflation (as was the case with Thatcher and Reagan was well).

Which leaves growth, the only line of defence possible for the claim of a Chilean "Miracle." As we discussed in section C.10, the right argue that relative shares of wealth are not important, it is the absolute level which counts. While the share of the economic pie may have dropped for most Chileans, the right argue that the high economic growth of the economy meant that they were receiving a smaller share of a bigger pie. We will ignore the well documented facts that the **level** of inequality, rather than absolute levels of standards of living, has most effect on the health of a population and that ill-health is inversely correlated with income (i.e. the poor have worse health that the rich). We will also ignore other issues related to the distribution of wealth, and so power, in a society (such as the free market re-enforcing and increasing inequalities via "free exchange" between strong and weak parties, as the terms of any exchange will be skewed in favour of the stronger party, an analysis which the Chilean experience provides extensive evidence for with its "competitive" and "flexible" labour market). In other words, growth without equality can have damaging effects which are not, and cannot be, indicated in growth figures.

So we will consider the claim that the Pinochet regime's record on growth makes it a "miracle" (as nothing else could). However, when we look at the regime's growth record we find that it is hardly a "miracle" at all — the celebrated economic growth of the 1980s must be viewed in the light of the two catastrophic recessions which Chile suffered in 1975 and 1982. As Edward Herman points out, this growth was *"regularly exaggerated by measurements from inappropriate bases (like the 1982 trough)."* [**The Economics of the Rich**]

This point is essential to understand the actual nature of Chile's "miracle" growth. For example, supporters of the "miracle" pointed to the period 1978 to 1981 (when the economy grew at 6.6 percent a year) or the post 1982–84 recession up-swing. However, this is a case of "lies, damn lies, and statistics" as it does not take into account the catching up an economy goes through as it leaves a recession. During a recovery, laid-off workers go back to work and the economy experiences an increase in growth due to this. This means that the deeper the recession, the higher the subsequent growth in the up-turn. So to see if Chile's economic growth was a miracle and worth the decrease in income for the many, we need to look at whole business cycle, rather than for the upturn. If we do this we find that Chile had the second worse rate of growth in Latin America between 1975 and 1980. The average growth in GDP was 1.5% per year between 1974 and 1982, which was lower than the average Latin American growth rate of 4.3% and lower than the 4.5% of Chile in the 1960's. [Rayack, **Op. Cit.**, p. 64]

This meant that, in per capita terms, Chile's GDP only increased by 1.5% per year between 1974–80. This was considerably less than the 2.3% achieved in the 1960's. The average growth in GDP was 1.5% per year between 1974 and 1982, which was lower than the average Latin American growth rate of 4.3% and lower than the 4.5% of Chile in the 1960s. Between 1970 and 1980, per capita GDP grew by only 8%, while for Latin America as a whole, it increased by 40%. Between the years 1980 and 1982 during which all of Latin America was adversely affected by depression conditions, per capita GDP fell by 12.9 percent, compared to a fall of 4.3 percent for Latin America as a whole. [Rayack, **Op. Cit.**, p. 57 and p. 64]

Thus, between 1970 and 1989, Chile's GDP *"grew at a slow pace (relative to the 1960s and to other Latin American countries over the same period) with an average rate of 1.8–2.0 per cent. On a per capita basis … GDP [grew] at a rate (0.1–0.2 per cent) well below the Latin American average … [B]y 1989 the GDP was still 6.1 per cent below the 1981 level, not having recovered the level reached in 1970. For the entire period of military rule (1974–1989) only five Latin American countries had a worse record. Some miracle!"* [Petras and Leiva, **Op. Cit.**, p. 32]

Thus the growth "miracles" refer to recoveries from depression-like collapses, collapses that can be attributed in large part to the free-market policies imposed on Chile! Overall, the growth "miracle" under Pinochet turns out to be non-existent. The full time frame illustrates Chile's lack of significant economic and social process between 1975 and 1989. Indeed, the economy was characterised by instability rather than real growth. The high levels of growth during the boom periods (pointed to by the right as evidence of the "miracle") barely made up for the losses during the bust periods.

All in all, the experience of Chile under Pinochet and its "economic miracle" indicates that the costs involved in creating a free market capitalist regime are heavy, at least for the majority. Rather than being transitional, these problems have proven to be structural and enduring in nature, as the social, environmental, economic and political costs become embedded into society. The murky side of the Chilean "miracle" is simply not reflected in the impressive macroeconomic indictors used to market "free market" capitalism, indicators themselves subject to manipulation as we have seen.

C.11.3 Did neo-liberal Chile confirm capitalist economics?

No. Despite claims by the likes of Friedman, Chile's neo-liberal experiment was no "economic miracle" and, in fact, refuted many of the key dogmas of capitalist economics. We can show this by comparing the actual performance of "economic liberty" with Friedman's predictions about it.

The first thing to note is that neo-liberal Chile hardly supports the claim that the free market is stable. In fact, it was marked by deep recessions followed by periods of high growth as the economic recovered. This resulted in overall (at best) mediocre growth rates (see last section).

Then there is the fact that the Chilean experiment refutes key neo-classical dogmas about the labour market. In **Capitalist and Freedom**, Friedman was at pains to attack trade unions and the idea that they defended the worker from coercion by the boss. Nonsense, he asserted, the *"employee is protected from coercion by the employer because of other employers for whom he can work."* [pp. 14–5] Thus collective action in the form of, say, unions is both unnecessary and, in fact, harmful. The ability of workers to change jobs is sufficient and the desire of capitalist economists is always to make the real labour market become more like the ideal market of perfect competition — lots of atomised individuals who are price takers, not price setters. While big business gets ignored, unions are demonised.

The problem is that such "perfect" labour markets are hard to create outside of dictatorships. Pinochet's reign of terror created such a market. Faced with the possibility of death and torture if they stood up for their rights, the only **real** alternative most workers had was that of finding a new job. So while the labour market was far from being an expression of "economic liberty," Chile's dictatorship **did** produce a labour market which almost perfectly reflected the neo-classical (and Austrian) ideal. Workers become atomised individuals as state terror forced them to eschew acting as trade unionists and seeking collective solutions to their (individual and collective) problems. Workers had no choice **but** to seek a new employer if they felt they were being mistreated or under-valued. Terror created the preconditions for the workings of an ideal capitalist labour market. Friedman's talk of "economic liberty" in Chile suggests that Friedman thought that a "free market" in labour would work "as if" it were subject to death squads. In other words, that capitalism needs an atomised workforce which is too scared to stand up for themselves. Undoubtedly, he would prefer such fear to be imposed by purely "economic" means (unemployment playing its usual role) but as his work on the "natural rate of unemployment" suggests, he is not above appealing to the state to maintain it.

Unfortunately for capitalist ideology, Chile refuted that notion, with its workers subject to the autocratic power of the boss and having to give concession after concession simply to remain in work. Thus the *"total overhaul of the labour law system [which] took place between 1979 and 1981 … aimed at creating a perfect labour market, eliminating collective bargaining, allowing massive dismissal of workers, increasing the daily working hours up to twelve hours and eliminating the labour courts."* [Silvia Borzutzky, **Op. Cit.**, p. 91] In reality, the Labour code simply reflected the power property owners have over their wage slaves and *"was solidly probusiness. It was intended to maximise the flexibility of management's use of labour and to keep any eventual elected government from intervening on behalf of labour in negotiations between employers and workers."* This was hidden, of course, by *"populist rhetoric."* [Collins and Lear, **Op. Cit.**, p. 16] In fact, the Plan Laboral *"was intended to definitely shift the balance of power in labour relations in favour of business and to weaken the workers and unions that formed the central political base of the Left."* [Winn, *"The Pinochet Era"*, **Op. Cit.**, p. 31]

Unsurprisingly, *"workers … have not received a fair share of the benefits from the economic growth and productivity increases that their labour has produced and that they have had to bear a disproportionate share of the costs of this restructuring in their wages, working conditions, job quality, and labour relations."* [Winn, *"Introduction"*, **Op. Cit.**, p. 10]

Chile, yet again, refuted another of Friedman's assertions about capitalism. In 1975, he wrongly predicted that the unemployed caused by the Monetarist recession would quickly find work, telling a Santiago audience that they would *"be surprised how fast people would be absorbed by a growing private-sector economy."* [quoted by Rayack, **Op. Cit.**, p. 57] Unemployment reached record levels for decades, as the free market regime *"has been slow to create jobs. During the 1960s unemployment hovered around 6 percent; by contrast, the unemployment level for the years 1974 to 1987 averaged 20 percent of the workforce. Even in the best years of the boom (1980–1981) it stayed as high as 18 percent. In the years immediately following the 1982 crash, unemployment — including government emergency work programs — peaked at 35 percent of the workforce."* Unsurprisingly, the *"most important rationalisation"* made by Chilean industry *"was the lowering of labour costs.*

This was accomplished through massive layoffs, intensifying the work of remaining workers, and pushing wage levels well below historic levels." This was aided by unemployment levels which *"officially averaged 20 percent from 1974 to 1987. Chronic high levels of unemployment afforded employers considerable leverage in setting working conditions and wage levels … Not surprisingly, workers who managed to hold onto their jobs were willing to make repeated concessions to employers, and in order to get jobs employees often submitted to onerous terms."* Between 1979 and 1982, more than a fifth of manufacturing companies failed and employment in the sector fell by over a quarter. In the decade before 1981, out of every 26 workers, 13 became unemployed, 5 joined the urban informal sector and 8 were on a government emergency employment program. It should be stressed that official statistics *"underestimate the real level of unemployment"* as they exclude people who worked just one day in the previous week. A respected church-sponsored institute on employment found that in 1988, unemployment in Santiago was as high as 21%. [Lear and Collins, **Op. Cit**., p. 22, p. 15, p. 16, p. 15 and p. 22]

The standard free-market argument is that unemployment is solved by subjecting the wage level to the rigours of the market. While wages will be lower, more people will be employed. As we discussed in section C.9, the logic and evidence for such claims is spurious. Needless to say, Friedman never revised his claims in the light of the empirical evidence produced by the application of his ideas.

Given the fact that "labour" (i.e., an individual) is not produced for the market in the first place, you can expect it to react differently from other "commodities." For example, a cut in its price will generally increase supply, not decrease it, simply because people have to eat, pay the rent and so forth. Cutting wages will see partners and children sent to work, plus the acceptance of longer hours by those who remain in work. As such, the idea that unemployment is caused by wages being too high has always been a specious and self-serving argument, one refuted not only by logic but that bane of economics, empirical evidence. This was the case with Chile's "economic miracle," where declining wages forced families to seek multiple incomes in order to survive: *"The single salary that could support a family was beyond the reach of most workers; the norm, in fact, was for spouses and children to take on temporary and informal jobs … Even with multiple incomes, many families were hard-pressed to survive."* [Lear and Collins, **Op. Cit**., p. 23] Which, of course, refutes "free market" capitalist claim that the labour market is like any other market. In reality, it is not and so it is hardly surprising that a drop in the price of labour **increased** supply nor that the demand for labour did not increase to in response to the drop in its real wage.

Lastly, there is the notion that collective action in the market by the state or trade unions harms the general population, particularly the poor. For neo-classical and Austrian economists, labour is the source of all of capitalism's problems (and any government silly enough to pander to the economically illiterate masses). Pinochet's regime allowed them to prove this was the case. Again Chile refuted them.

The "Chicago Boys" had no illusions that fascism was required to create free market capitalism. According to Sergio de Castro, the architect of the economic programme Pinochet imposed, fascism was required to introduce "economic liberty" because *"it provided a lasting regime; it gave the authorities a degree of efficiency that it was not possible to obtain in a democratic regime; and it made possible the application of a model developed by experts and that did not depend upon the social reactions produced by its implementation."* [quoted by Silvia Borzutzky, *"The Chicago Boys, social security and welfare in Chile"*, **The Radical Right and the Welfare State**, Howard Glennerster and James Midgley (eds.), p. 90] They affirmed that *"in a democracy we could not have done one-fifth of what we did."* [quoted by Winn, *"The Pinochet Era"*, Winn (ed.), **Op. Cit.**, p. 28]

Given the individualistic assumptions of neo-classical and Austrian economics, it is not hard to conclude that creating a police state in order to control industrial disputes, social protest, unions, political associations, and so on, is what is required to introduce the ground rules the capitalist market requires for its operation. As socialist Brian Barry argues in relation to the Thatcher regime in Britain which was also heavily influenced by the ideas of "free market" capitalists like Milton Friedman and Frederick von Hayek:

> *"Some observers claim to have found something paradoxical in the fact that the Thatcher regime combines liberal individualist rhetoric with authoritarian action. But there is no paradox at all. Even under the most repressive conditions ... people seek to act collectively in order to improve things for themselves, and it requires an enormous exercise of brutal power to fragment these efforts at organisation and to force people to pursue their interests individually… left to themselves, people will inevitably tend to pursue their interests through collective action — in trade unions, tenants' associations, community organisations and local government. Only the pretty ruthless exercise of central power can defeat these tendencies: hence the common association between individualism and authoritarianism, well exemplified in the fact that the countries held up as models by the free-marketers are, without exception, authoritarian regimes."* [*"The Continuing Relevance of Socialism"*, Robert Skidelsky (ed.), **Thatcherism**, p. 146]

Little wonder, then, that Pinochet's regime was marked by authoritarianism, terror and rule by savants. Indeed, *"[t]he Chicago-trained economists emphasised the scientific nature of their programme and the need to replace politics by economics and the politicians by economists. Thus, the decisions made were not the result of the will of the authority, but they were determined by their scientific knowledge. The use of the scientific knowledge, in turn, would reduce the power of government since decisions will be made by technocrats and by the individuals in the private sector."* [Silvia Borzutzky, **Op. Cit.**, p. 90] However, as Winn points out:

> *"Although the Chicago Boys justified their policies with a discourse of liberty, they were not troubled by the contradiction of basing the economic freedom they promoted on the most dictatorial regime in Chilean history — or in denying workers the freedom to strike or bargain collectively. At bottom, the only freedom that they cared about was the economic liberty of those Chileans and foreigners with capital to invest and consume, and that 'freedom,' de Castro believed, was best assured by an authoritarian government and a passive labour force. In short, their notions of freedom were both selective and self-serving."* [**Op. Cit.**, p. 28]

Of course, turning authority over to technocrats and private power does not change its nature — only who has it. Pinochet's regime saw a marked shift of governmental power away from protection of individual rights to a protection of capital and property rather than an abolition of that power altogether. As would be expected, only the wealthy benefited. The working class were subjected to attempts to create a "perfect labour market" — and only terror can turn people into the atomised commodities such a market requires. Perhaps when looking over the nightmare of

Pinochet's regime we should ponder these words of Bakunin in which he indicates the negative effects of running society by means of science books and "experts":

> *"human science is always and necessarily imperfect… were we to force the practical life of men — collective as well as individual — into rigorous and exclusive conformity with the latest data of science, we would thus condemn society as well as individuals to suffer martyrdom on a Procrustean bed, which would soon dislocate and stifle them, since life is always an infinitely greater thing than science."* [**The Political Philosophy of Bakunin**, p. 79]

The Chilean experience of rule by free market ideologues prove Bakunin's points beyond doubt. Chilean society was forced onto the Procrustean bed by the use of terror and life was forced to conform to the assumptions found in economics textbooks. And as we proved above, only those with power or wealth did well out of the experiment. From an anarchist perspective, the results were all too sadly predictable. The only surprising thing is that the right point to the experiment as a success story.

Since Chile has become (mostly) a democracy (with the armed forces still holding considerable influence) the post-Pinochet governments have made minor reforms. For example, *"tax increases targeted for social spending for the poor"* allowed them to *"halve the 1988 45 percent poverty rate bequeathed by Pinochet."* In fact, the *"bulk of this spending"* was aimed at *"the poorest of the poor, the 25 percent of the population classified as destitute in 1988."* [Winn, *"The Pinochet Era,"* **Op. Cit.**, p. 50, p. 52 and p. 55]

However, while this *"curtailed absolute poverty, they did not reduce inequality … From 1990 to 1996 the share of the national income of the poorest 20 percent of the population stagnated beneath 4 percent, while that of the richest 20 percent inched up from 56 percent to 57 percent … the distribution of income was one of the most unequal in the world. In Latin America, only Brazil was worse."* [Paul W Drake, *"Foreword"*, Winn (ed.), **Op. Cit.**, p. xi] The new government raised the minimum wage in 1990 by 17% in real terms, with another rise of approximately 15% two years later. This had a significant on income as *"a substantial number of the Chilean labour force receives wages and salaries that are only slightly above the minimum wage."* [Volker Frank, *"Politics without Policy"*, Winn (ed.), **Op. Cit.**, p. 73 and p. 76] In stark contrast to the claims of neo-classical economics, the rise in the minimum wage did not increase unemployment. In fact, it **dropped** to 4.4%, in 1992, the lowest since the early 1970s.

Overall, increased social spending on health, education and poverty relief has occurred since the end of the dictatorship and has lifted over a million Chileans out of poverty between 1987 and 1992 (the poverty rate has dropped from 44.6% in 1987 to 23.2% in 1996, although this is still higher than in 1970). However, inequality is still a major problem as are other legacies from the Pinochet era, such as the nature of the labour market, income insecurity, family separations, alcoholism, and so on. Yet while *"both unemployment and poverty decreased, in part because of programs targeted at the poorest sectors of the population by centre-left governments with greater social concern than the Pinochet dictatorship,"* many problems remain such as *"a work week that was among the longest in the world."* [Winn, *"Introduction"*, **Op. Cit.**, p. 4]

Chile has moved away from Pinochet's "free-market" model in other ways to. In 1991, Chile introduced a range of controls over capital, including a provision for 30% of all non-equity capital entering Chile to be deposited without interest at the central bank for one year. This reserve requirement — known locally as the encaje — amounts to a tax on capital flows that is higher the shorter the term of the loan. As William Greider points out, Chile *"has managed in the last decade to achieve rapid economic growth by abandoning the pure free-market theory taught by American economists and emulating major elements of the Asian strategy, including forced savings and the purposeful control of capital. The Chilean government tells foreign investors where they may invest, keeps them out of certain financial assets and prohibits them from withdrawing their capital rapidly."* [**One World, Ready or Not**, p. 280]

Needless to say, while state aid to the working class has increased somewhat, state welfare for business is still the norm. After the 1982 crash, the Chilean Economic Development Agency (CORFO) reverted to its old role in developing Chilean industry (after the coup, it did little more than just selling off state property at discount prices to the wealthy). In other words, the post-recession "miracle" of the 1980s was due, in part, to a state organisation whose remit was promoting economic development, supporting business with new technology as well as technical and financial assistance. It, in effect, promoted joint public-private sectors initiatives. One key example was its role in funding and development of new resource-sector firms, such as the forestry sector ad the fishing industry. While free-marketeers have portrayed the boom natural-resource extraction as the result of the "free market," in reality private capital lacked the initiative and foresight to develop these industries and CORFO provided aid as well as credits and subsidies to encourage it. [James M. Cypher, *"Is Chile a Neoliberal Success?"*, **Dollars & Sense**, September/October 2004] Then there is the role of Fundación Chile, a public-private agency designed to develop firms in new areas where private capital will not invest. This pays for research and development before selling its stake to the private sector once a project becomes commercially viable. [Jon Jeter, *"A Smoother Road To Free Markets,"* **Washington Post**, 21/01/2004] In other words, a similar system of state intervention promoted by the East-Asian Tigers (and in a similar fashion, ignored by the ideologues of "free market" capitalism — but, then, state action for capitalists never seems to count as interfering in the market).

Thus the Chilean state has violated its "free market" credentials, in many ways, very successfully too. While it started in the 1980s, post-Pinochet has extended this to include aid to the working class. Thus the claims of free-market advocates that Chile's rapid growth in the 1990s is evidence for their model are false (just as their claims concerning South-East Asia also proved false, claims conveniently forgotten when those economies went into crisis). Needless to say, Chile is under pressure to change its ways and conform to the dictates of global finance. In 1998, Chile eased its controls, following heavy speculative pressure on its currency, the peso. That year economic growth halved and contracted 1.1% in 1999.

So even the neo-liberal jaguar has had to move away from a purely free market approach on social issues and the Chilean government has had to intervene into the economy in order to start putting back together the society ripped apart by market forces and authoritarian government. However, fear of the military has ensured that reforms have been minor and, consequently, Chile cannot be considered a genuine democracy. In other words, "economic liberty" has not produced genuine "political liberty" as Friedman (and others) claim (see section D.11). Ultimately, for all but the tiny elite at the top, the Pinochet regime of "economic liberty" was a nightmare. Economic "liberty" only seemed to benefit one group in society, an obvious "miracle." For the vast majority, the "miracle" of economic "liberty" resulted, as it usually does, in increased inequality, exploitation, poverty, pollution, crime and social alienation. The irony is that many right-wing free-marketeers point to it as a model of the benefits of capitalism.

C.12 Doesn't Hong Kong show the potentials of "free market" capitalism?

Given the general lack of laissez-faire capitalism in the world, examples to show its benefits are few and far between. Rather than admit that the ideal is simply impossible, conservative and right-"libertarian" ideologues scour the world and history for examples. Rarely do they let facts get in the way of their searching — until the example expresses some negative features such as economic crisis (repression of working class people or rising inequality and poverty are of little consequence). Once that happens, then all the statist features of those economies previously ignored or downplayed will be stressed in order to protect the ideal from reality.

One such example is Hong Kong, which is often pointed to by right-wingers as an example of the power of capitalism and how a "pure" capitalism will benefit all. It has regularly been ranked as first in the *"Index of Economic Freedom"* produced by the Heritage Foundation, a US-based conservative think tank ("economic freedom" reflecting what you expect a right-winger would consider important). Milton Friedman played a leading role in this idealisation of the former UK colony. In his words:

> *"Take the fifty-year experiment in economic policy provided by Hong Kong between the end of World War II and … when Hong Kong reverted to China.*
>
> *"In this experiment, Hong Kong represents the experimental treatment … I take Britain as one control because Britain, a benevolent dictator, imposed different policies on Hong Kong from the ones it pursued at home …*
>
> *"Nonetheless, there are some statistics, and in 1960, the earliest date for which I have been able to get them, the average per capita income in Hong Kong was 28 percent of that in Great Britain; by 1996, it had risen to 137 percent of that in Britain. In short, from 1960 to 1996, Hong Kong's per capita income rose from about one-quarter of Britain's to more than a third larger than Britain's … I believe that the only plausible explanation for the different rates of growth is socialism in Britain, free enterprise and free markets in Hong Kong. Has anybody got a better explanation? I'd be grateful for any suggestions."* [**The Hong Kong Experiment**]

It should be stressed that by "socialism" Friedman meant state spending, particularly that associated with welfare (*"Direct government spending is less than 15 percent of national income in Hong Kong, more than 40 percent in the United States."* [**Op. Cit.**]). What to make of his claims?

It is undeniable that the figures for Hong Kong's economy are impressive. Per-capita GDP by end 1996 should reach US$ 25,300, one of the highest in Asia and higher than many western nations. Enviable tax rates — 16.5% corporate profits tax, 15% salaries tax. In the first 5 years of the 1990's Hong Kong's economy grew at a tremendous rate — nominal per capita income and GDP levels (where inflation is not factored in) almost doubled. Even accounting for inflation, growth was brisk. The average annual growth rate in real terms of total GDP in the 10 years to 1995 was six per cent, growing by 4.6 per cent in 1995. However, looking more closely, we find a somewhat different picture than that painted by those claim Hong Kong as an example of the wonders of free market capitalism. Once these basic (and well known) facts are known, it is hard to take Friedman's claims seriously. Of course, there are aspects of laissez-faire to the system (it does not subsidise sunset industries, for example) however, there is much more to Hong Kong that these features. Ultimately, laissez-faire capitalism is more than just low taxes.

The most obvious starting place is the fact that the government owns all the land. To state the obvious, land nationalisation is hardly capitalistic. It is one of the reasons why its direct taxation levels are so low. As one resident points out:

> *"The main explanation for low tax rates … is not low social spending. One important factor is that Hong Kong does not have to support a defence industry … The most crucial explanation … lies in the fact that less than half of the government's revenues comes from direct taxation.*
>
> *"The Hong Kong government actually derives much of its revenue from land transactions. The territory's land is technically owned by the government, and the government fills its coffers by selling fifty-year leases to developers (the fact that there are no absolute private property rights to land will come as another surprise t boosters of 'Hong Kong-style' libertarianism) … The government has an interest in maintaining high property values … if it is to maintain its policy of low taxation. It does this by carefully controlling the amount of land that is released for sale … It is, of course, those buying new homes and renting from the private sector who pay the price for this policy. Many Hong Kongers live in third world conditions, and the need to pay astronomical residential property prices is widely viewed as an indirect form of taxation."* [Daniel A. Bell, *"Hong Kong's Transition to Capitalism"*, pp. 15–23, **Dissent**, Winter 1998, pp. 15–6]

The ownership of land and the state's role as landlord partly explains the low apparent ratio of state spending to GDP. If the cost of the subsidised housing land were accounted for at market prices in the government budget, the ratio would be significantly higher. As noted, Hong Kong had no need to pay for defence as this cost was borne by the UK taxpayer. Include these government-provided services at their market prices and the famously low share of government spending in GDP climbs sharply.

Luckily for many inhabitants of Hong Kong, the state provides a range of social welfare services in housing, education, health care and social security. The government has a very basic, but comprehensive social welfare system. This started in the 1950s, when the government launched one of the largest public housing schemes in history to house the influx of about 2 million people fleeing Communist China. Hong Kong's social welfare system really started in 1973, when the newly appointed governor *"announced that public housing, education, medical, and social welfare services would be treated as the four pillars of a fair and caring society."* He launched a public housing program and by 1998, 52 percent of the population *"live in subsidised housing, most of whom rent flats from the Housing Authority with rents set at one-fifth the market level (the rest have bought subsidised flats under various home-ownership schemes, with prices discounted 50 percent from those in the private sector)."* Beyond public housing, Hong Kong *"also has most of the standard features of welfare states in Western Europe. There is an excellent public health care system: private hospitals* *are actually going out of business because clean and efficient public hospitals are well subsidised (the government pays 97 percent of the costs).”* Fortunately for the state, the territory initially had a relatively youthful population compared with western countries which meant it had less need for spending on pensions and help for the aged (this advantage is declining as the population ages). In addition, the *“large majority of primary schools and secondary schools are either free of heavily subsidised, and the territory’s tertiary institutions all receive most of their funds from the public coffers.”* [Bell, **Op. Cit.**, pp. 16–7 and p. 17] We can be sure that when conservatives and right-“libertarians” use Hong Kong as a model, they are **not** referring to these aspects of the regime.

Given this, Hong Kong has *“deviated from the myth of a laissez-faire economy with the government limiting itself to the role of the ‘night watchman’”* as it *“is a welfare state.”* In 1995–6, it spent 47 percent of its public expenditure on social services (*“only slightly less than the United Kingdom”*). Between 1992 and 1998, welfare spending increased at a real rate of at least 10 percent annually. [Bell, **Op. Cit.**, p. 16] *“Without doubt,”* two experts note, *“the development of public housing in Hong Kong has contributed greatly to the social well-being of the Territory.”* Overall, social welfare *“is the third largest [state] expenditure … after education and health.”* [Simon X. B. Zhao and l. Zhand, *“Economic Growth and Income Inequality in Hong Kong: Trends and Explanations,”* pp. 74–103, **China: An International Journal**, Vol. 3, No. 1, p. 95 and p. 97] Hong Kong spent 11.6% of its GDP on welfare spending in 2004, for example.

Moreover, this state intervention is not limited to just social welfare provision. Hong Kong has an affordable public transport system in which the government has substantial equity in most transport systems and grants franchises and monopolised routes. So as well as being the monopoly owner of land and the largest landlord, the state imposes rent controls, operates three railways and regulates transport services and public utilities as monopoly franchises. It subsidises education, health care, welfare and charity. It has also took over the ownership and management of several banks in the 1980s to prevent a general bank run. Overall, since the 1960s *“the Hong Kong government’s involvement in everyday life has increases steadily and now reaches into many vital areas of socio-economic development.”* [Ming K Chan, *“The Legacy of the British Administration of Hong Kong: A View from Hong Kong,”* pp. 567–582, **The China Quarterly**, no. 151, p. 575 and p. 574] It also intervened massively in the stock market during the 1997 Asian crisis. Strangely, Friedman failed to note any of these developments nor point to the lack of competition in many areas of the domestic economy and the high returns given to competition-free utility companies.

The state did not agree to these welfare measures by choice, as they were originally forced upon it by fears of social unrest, first by waves of migrants fleeing from China and then by the need to portray itself as something more than an uncaring colonial regime. However, the other form of intervention it pursued **was** by choice, namely the collusion between the state and business elites. As one expert notes, the *“executive-led ‘administrative non-party’ state was heavily influenced by the business community”* with *“the composition of various government advisory boards, committees and the three councils”* reflecting this as *“business interests had an overwhelming voice in the consultation machinery (about 70% of the total membership).”* This is accurately described as a *“bureaucratic-cum-corporatist state”* with *“the interests of government and the private sector dominating those of the community.”* Overall, *“the government and private sector share common interests and have close links.”* [Mae Kam Ng, *“Political Economy and Urban Planning,”* **Progress in Planning**, P. Diamond and B. H. Massan (eds.), vol. 51, Part 1, p. 11 and p. 84] Sizeable fortunes will be made when there are interlocking arrangements between the local oligarchies and the state.

Another commentator notes that the myth of Hong Kong's laissez-faire regime *"has been disproved in academic debates more than a decade ago"* and points to *"the hypocrisy of laissez-faire colonialism"* which is marked by *"a government which is actively involved, fully engaged and often interventionist, whether by design or necessity."* He notes that *"the most damaging legacy [of colonial rule] was the blatantly pro-business bias in the government's decision-making."* There has been *"collusion between the colonial officialdom and the British economic elites."* Indeed, *"the colonial regime has been at fault for its subservience to business interests as manifested in its unwillingness until very recently, not because of laissez-faire but from its pro-business bias, to legislate against cartels and monopolies and to regulate economic activities in the interests of labour, consumers and the environment ... In other words, free trade and free enterprise with an open market ... did not always mean fair trade and equal opportunity: the regime intervened to favour British and big business interests at the expense of both fair play and of a level playing field for all economic players regardless of class or race."* [Ming K Chan, *"The Legacy of the British Administration of Hong Kong: A View from Hong Kong,"* pp. 567–582, **The China Quarterly**, no. 151, p. 577, p. 576, p. 575 and pp. 575–6] Bell notes that a British corporation *"held the local telephone monopoly until 1995"* while another *"holds all the landing rights at Hong Kong airport."* [**Op. Cit.**, p. 21]

Unsurprisingly, as it owns all the land, the government has *"a strong position in commanding resources to direct spatial development in the territory."* There is a *"three-tiered system of land-use plans."* The top-level, for example, *"maps out the overall land development strategy to meet the long-term socio-economic needs of Hong Kong"* and it is *"prepared and reviewed by the administration and there is no public input to it."* This planning system is, as noted, heavily influenced by the business sector and its *"committees operate largely behind closed doors and policy formulation could be likened to a black-box operation." "Traditionally,"* Ng notes, *"the closed door and Hong Kong centred urban planning system had served to maintain economic dynamism in the colony. With democratisation introduced in the 1980s, the planning system is forced to be more open and to serve not just economic interests."* [Mae Kam Ng, **Op. Cit.**, p. 11, p. 39, p. 37 and p. 13] As Chan stresses, *"the colonial government has continuously played a direct and crucial role as a very significant economic participant. Besides its control of valuable resources, the regime's command of the relevant legal, political and social institutions and processes also indirectly shapes economic behaviour and societal development."* [**Op. Cit.**, p. 574]

Overall, as Bell notes, *"one cannot help but notice the large gap between this reality and the myth of an open and competitive market where only talent and luck determine the economic winners."* [**Op. Cit.**, p. 16] As an expert in the Asian Tiger economies summarises:

> *"to conclude ... that Hong Kong is close to a free market economy is misleading ... Not only is the economy managed from outside the formal institutions of government by the informal coalition of peak private economic organisations, but government itself also has available some unusual instruments for influencing industrial activity. It owns all the land... It controls rents in part of the public housing market and supplies subsidised public housing to roughly half the population, thereby helping to keep down the cost of labour. And its ability to increase or decrease the flow of immigrants from China also gives it a way of affecting labour costs."* [Robert Wade, **Governing the Market**, p. 332]

This means that the Hong Kong system of "laissez-faire" is marked by the state having close ties with the major banks and trading companies, which, in turn, are closely linked to the life-time expatriates who largely run the government. This provides a *"point of concentration"* to conduct negotiations in line with an implicit development strategy. Therefore it is pretty clear that Hong Kong does not really show the benefits of "free market" capitalism. Wade indicates that we can consider Hong Kong as a *"special case or as a less successful variant of the authoritarian-capitalist state."* [**Op. Cit.**, p. 333]

There are other explanations for Hong Kong's high growth rates than simply "capitalism." Firstly, Hong Kong is a city state and cities have a higher economic growth rate than regions (which are held back by large rural areas). This is because the agricultural sector rarely achieves high economic growth rates and so in its absence a high growth rate is easier to achieve. Secondly, there is Hong Kong's location and its corresponding role as an entrepôt economy. Wade notes that *"its economic growth is a function of its service role in a wider regional economy, as entrepôt trader, regional headquarters for multinational companies, and refuge for nervous money."* [**Op. Cit.**, p. 331] Being between China and the rest of the world means its traders could act as a middleman, earning income from the mark-up they could impose on good going through the territory. This is why Hong Kong is often referred to as an entrepôt economy, a place that imports, stores, and re-exports goods. In other words, Hong Kong made a lot of its money because many Chinese exports and imports went through it and its traders marked-up the prices. It should be obvious if most of Western Europe's goods went through, say, Liverpool, that city would have a very good economic performance regardless of other factors. This option is hardly available to most cities, never mind countries.

Then there is the issue of state ownership of land. As Mae Kam Ng reports, monopoly ownership of all land by the state sets the context for super-profits by government and finance capital generally. [**Op. Cit.**, p. 13] Unsurprisingly, most government land *"is sold to just three real-estate developers"* who *"sit on huge tracts of land, drop-feeding apartments onto the market so as to maintain high property prices."* Between 1992 and 1996, for example, prices increased fourfold and profits doubled. The heads of two of the property firms were on the list of the world's ten richest men in 1998. *"Meanwhile, potential new entrants to the market are restricted by the huge cost of paying land-conversion premiums that are the bedrock of government revenues."* This is a *"cosy arrangement between the government and major developers."* [Daniel A. Bell, **Op. Cit.**, p. 16]

The role as headquarters for companies and as a financial centre also plays a part. It means an essential part of its success is that it gets surplus value produced elsewhere in the world. Handling other people's money is a sure-fire way of getting rich and this will have a nice impact on per-capita income figures (as will selling goods produced in sweat-shops in dictatorships like China). There has been a gradual shift in economic direction to a more service-oriented economy which has stamped Hong Kong as one of the world's foremost financial centres. This highly developed sector is served by some 565 banks and deposit-taking companies from over 40 countries, including 85 of the world's top 100 in terms of assets. In addition, it is the 8^{th} largest stock market in the world (in terms of capitalisation) and the 2^{nd} largest in Asia. By 1995, Hong Kong was the world's 10^{th} largest exporter of services with the industry embracing everything from accounting and legal services, insurance and maritime to telecommunications and media. The contribution of the services sectors as a whole to GDP increased from 60 per cent in 1970 to 83 per cent in 1994.

Meanwhile, manufacturing industry has moved to low wage countries such as southern China (by the end of the 1970's, Hong Kong's manufacturing base was less competitive, facing increasing costs in land and labour — in other words, workers were starting to benefit from economic growth and so capital moved elsewhere). The economic reforms introduced by Deng Xiaoping in southern China in 1978 where important, as this allowed capital access to labour living under a dictatorship (just as American capitalists invested heavily in Nazi Germany — labour rights were null, profits were high). It is estimated about 42,000 enterprises in the province have Hong Kong participation and 4,000,000 workers (nine times larger than the territory's own manufacturing workforce) are now directly or indirectly employed by Hong Kong companies. In the late 1980's Hong Kong trading and manufacturing companies began to expand further a field than just southern China. By the mid 1990's they were operating across Asia, in Eastern Europe and Central America. This shift, incidentally, has resulted in deindustrialisation and a *"decrease in real income among manual workers"* as they moved to the lower end service sector. [Simon X. B. Zhao and l. Zhand, **Op. Cit.**, p. 88]

Then there is the criteria Friedman uses, namely per-capita GDP. As we have repeated stressed, averages hide a lot of important and relevant information when evaluating a society. So it must be stressed that Friedman's criteria of per capita income is an average and, as such, hides the effect of inequality. This means that a society with huge numbers of poor people and a handful of ultra-rich individuals may have a higher average income than a more equal society. This is the case of, say, America compared to Sweden. Unsurprisingly, Hong Kong is a very unequal society and this inequality is growing (so his claim that Hong Kong is capitalist refutes his 1962 assertion that the more capitalist economies are more equal). *"Behind the impressive GDP figures,"* indicates Chan, *"is a widening income gap between the super-rich and the grassroots, with 650,000 people reportedly living below the poverty line."* [**Op. Cit.**, p. 576] As Bell points out, 13% lived below the poverty line in 1999, compared to 8% in 1971. This is partly explained by *"the rising proportion of elderly people and single-parent families."* However, economic integration with China has played a role as Hong Kong's manufacturing sector *"has been almost entirely transferred to the southern province of Guangdong (where labour is cheaper and workers' rights are practically non-existent), with the consequence that Hong Kong's industrial workers now find it much harder to find decent jobs in Hong Kong. Most end up working in low-paying service jobs without much hope of upward mobility."* [**Op. Cit.**, pp. 21–2]

As other experts note, while Hong Kong may have a GDP-per-capita of a developed nation, its distribution of household income was similar to that of Guatemala. Looking at the 1960s onwards, income distribution only improved between 1966 and 1971, after this period the share of the bottom 30% of the population went down continuously while the top 20% saw an increase in their share of total income. In fact, from the 1980s, *"the top 20% of households managed to account for over 50 per cent of the total income."* In fact, the bottom 60% of the population saw a decline in their share of income between 1971 and 1996. Overall, *"high-income households increased their wealth progressively faster than low-income households."* This polarisation, they argue, will continue as the economy de-industrialises: *"in the absence of proper social policies, it will generate a small, extremely wealthy class of the 'new rich' and simultaneously a large population of the 'working poor.'"* [Simon X. B. Zhao and L. Zhand, **Op. Cit.**, p. 85, p. 80, p. 82, p. 84 and p. 102]

Given that everywhere cannot be such a service provider, it does not provide much of an indication of how "free market" capitalism would work in, say, the United States. And as there is in fact extensive (if informal) economic management and that the state owns all the land and subsidies rent and health care, how can it be even considered an example of "free market" capitalism in action? Unless, of course, you consider that "economic freedom" best flourishes under a dictatorship which owns all the land, which has close links to business interests, provides a comprehensive, if basic, welfare state and is dependent on another country to provide its defence needs and the head of its executive. While most American's would be envious of Hong Kong's welfare state, it is doubtful that many would consider its other features as desirable. How many would be happy with being under a *"benevolent dictator"* (perhaps being turned into a colony of Britain again?) whose appointed government works closely with the local business elite? Having a political regime in which the wealthy can influence the government without the need for elections may be considered too a high price to pay just to get subsidised housing, health care and education. Given a choice between freedom and a high rate of growth, how many would pick the latter over the former?

It is no coincidence that like most examples of the wonders of the free market, Hong Kong was not a democracy. It was a relatively liberal colonial dictatorship run. But political liberty does not rate highly with many supporters of laissez-faire capitalism (such as right-"libertarians", for example). However, the two are linked. Which explains why we have spent so much time debunking the "free market" capitalism claims over Hong Kong. It is more than simply a concern over basic facts and correcting inaccurate assertions. Rather it is a concern over the meaning of freedom and the dubious assumption that freedom can be compartmentalised. While Hong Kong may be a more appealing example that Pinochet's Chile, it still rests on the assumption that the masses should be excluded from having a say over their communities (in their own interests, of course, and **never**, of course, in the interests of those who do the excluding) and that freedom is simply the ability to change bosses (or become one yourself). Ultimately, there is a big difference between "free" and "business-friendly." Hong Kong is the latter simply because it is not the former. Its success is testament that dictatorships can be more reliable defenders of class privilege than democracies.

This can be seen from the attitude of Hong Kong's business elite to the democratic reforms introduced in the 1990s and integration with China. Significantly, *"the nominally socialist Chinese government consistently opposed the introduction of further social welfare programs in Hong Kong."* This is because *"it has chosen to enter into a strategic alliance with Hong Kong's business class"* (*"To earn support of corporate bosses, the Chinese government organised timely interventions on behalf of Hong Kong companies"*). Unsurprisingly, the first Beijing-appointed executive was made up of successful business men and one of its first acts was to suspend pro-labour laws passed by the out-going legislature. [Bell, **Op. Cit.**, p. 17, p. 18 and pp. 19–20] The Chinese government opposed attempts to extend democracy, imposing a complex electoral system which, in the words of the **Asian Wall Street Journal**, was a *"means of reducing public participation in the political process while stacking the next legislature with people who depend on favours from the regime in Hong Kong or Beijing and answer to narrow special interests, particularly the business elite."* [quoted by Bell, **Op. Cit.**, pp. 18–9]

This reflects the fact that business tycoons are worried that democracy would led to increased welfare spending with one, for example, predicting that the *"under-educated, and those who did not pay tax would elect candidates who stood for more social spending, which would turn Hong Kong into a 'welfare state' … If we had a 100-per-cent directly elected LegCo, only social welfare-oriented candidates will be elected. Hong Kong is a business city and we [sic!] do not want to end up being a social welfare state."* [*"Tycoon warns on protests,"* **The Standard**, 29 April 2004] Such a government can ignore public opinion and the electorate more than in an independent democracy and, of course, can be more influenced by business (as the history of Hong Kong testifies).

Overall, it is fair to say that Friedman only saw what he wanted to see and contrasted his idealised vision with Britain and explained the divergent economic performances of both countries to a conflict between "socialism" and "capitalism." How he failed to notice that the reality of Hong Kong was one marked by collusion between big business and the state and that in key areas the regime was much more "socialist" than its British counterpart is difficult to understand given his willingness to use it as an example. It seems intellectually dishonest to fail to mention that the state owned all the land and was the biggest landlord with at least 50% of the population living in subsidised housing. Then there are the facts of almost free medical treatment at government clinics and hospitals and an education system almost entirely funded by the government. These are all massive interventions in the marketplace, interventions Friedman spent many decades fighting in the USA. He did, however, contribute to the myth that the British were benign imperialists and the "free market" they introduced into Hong Kong was in the interests of all rather than for those who exercised the dictatorship.

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