3

Economic History

A short history of the economy

In the early days of human civilization, the "economy" was a pretty simple affair. Our work consisted of hunting animals for meat, fur, and bones; gathering wild produce (like berries); and constructing simple shelters. These hunter-gatherer economies were often nomadic (moving in tune with the weather or animal migrations). They were cooperative, in that everyone in a family or clan grouping worked together (with some division of tasks across genders and ages). And they were mostly non-hierarchical: no-one "owned" anything or "hired" anyone. (While priests, chiefs, or other leaders had special authority, that authority did not derive from their economic position.) In general, these economies produced just enough to keep their members alive from one year to the next.

Eventually humans learned they could deliberately cultivate useful plants, and agriculture began. This caused corresponding social and economic changes. First, it allowed for permanent settlements (with the opportunity to build better homes and other structures). Second, the greater productivity of agriculture allowed society to generate an economic SURPLUS: production beyond what was required just to keep the producers alive. Third, with that surplus came the task of deciding how to use it. The existence of a surplus allowed some members of society, for the first time, not to work. This opened up a whole new can of worms. Who would avoid working on the farm? What would they do instead? And how would they keep the rest of society – those who had to continue working – in line?

With permanent settlements and a growing economic surplus, therefore, came the first CLASS divisions within society – in which different groups of people fulfilled fundamentally different economic roles, depending on their status and their relationship to work. Different economic systems handled this fundamental issue in different ways. For example, under monarchist systems, a powerful elite controlled the surplus and its allocation based on inherited birthright. The monarch needed the acceptance or at least acquiescence of his or her subjects, which generally needed to be imposed (from time to time, anyway) by brute force.

Many of these societies also relied on SLAVERY, where entire groups of people (often designated by race or caste) were simply forced to work, again through brute force. In case this sounds like ancient history, remember that the US economy (the most powerful capitalist country in the world) was based largely on slavery until fewer than 150 years ago, and human trafficking still forcibly enslaves millions of people around the world today. The resulting economic surplus was used in various ways: luxury consumption of the ruling elite; the construction of impressive buildings and monuments; the financing of exploration, war, and conquest; the work of non-agricultural artisans and scholars; and re-investment into new and improved economic techniques.

While slavery and direct authoritarian rule were certainly powerful and straightforward ways for elites to control the economy and the resulting surplus, they had their drawbacks, too. Slaves and subjects often revolted. Their work ethic was not always the best: slaves tend to be grudging and bitter (for obvious reasons), requiring "active supervision" (often with a whip!) to elicit their effort and productivity.

Eventually a more subtle and ultimately more effective economic system evolved, called FEUDALISM. In this case, a more complex web of mutual obligations and rights was used to organize work and manage the surplus. Peasants were allowed to live on land that was governed by a higher class (gentry, landlords, or royalty). They could support themselves and their families, but in return had to transfer most of their surplus production to the gentry (in the form of annual payments or tithes). The gentry used this surplus to finance their own (luxury) consumption, the construction of castles, the work of artisans and priests, maintenance of a simple state apparatus, wars, and other "fringe" activities. In return, they were supposed to protect the peasantry on their land (from attack by competing landlords), and ensure their security.

Agriculture became steadily more productive (with the invention of techniques such as crop rotation, the use of livestock, and plant breeding). The surplus became larger, allowing the development of more complex and ambitious non-agricultural activities – including the emergence of a more powerful and well-resourced central government, more ambitious non-agricultural production (including the emergence

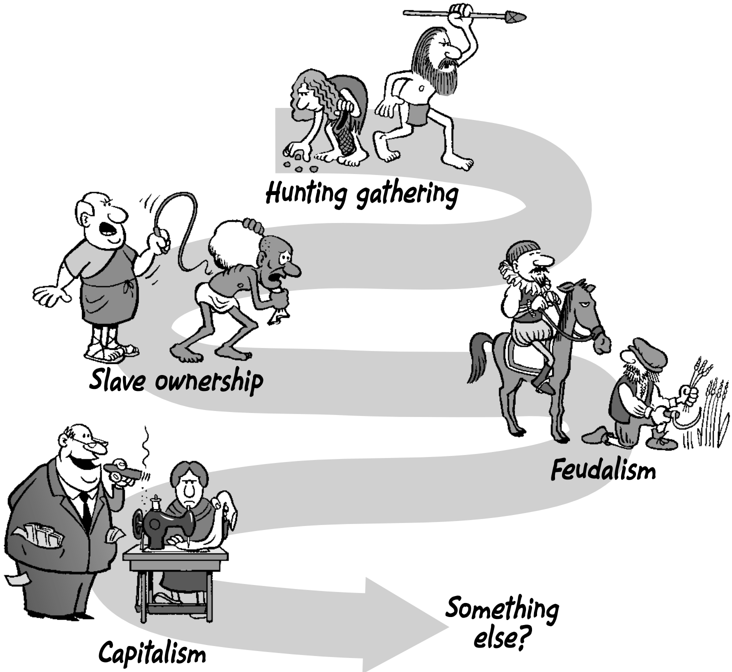

Figure 3.1 **Economic Evolution**

of early manufacturing workshops), and farther-reaching exploration and conquest. More effective transportation (like ocean-going ships) allowed the development of long-range trade (bringing in specialty goods from far-flung colonies and trading partners). Later in the Middle Ages, this trade sparked the emergence of a whole new class: merchants, who earned an often-lucrative slice of the surplus by facilitating this growing trade. These merchants would play an important transitional role in the subsequent development of capitalism.

This is a ridiculously short review of economic history. Yet it still conveys some crucial lessons that are relevant today:

- Human beings learn by doing. As they work at something for a while, they identify and implement ways to do it better. In economic terms, this leads to improvements in technology and productivity over time – sometimes very slowly, sometimes very quickly.

- These ongoing changes in productivity and technology tend to require corresponding changes in the way work is organized, and indeed in the way society is organized. The evolution of workplaces, class structure, markets, even politics has occurred hand-in-hand with the ongoing evolution of the economy.
- Economic systems come, and economic systems go. No economic system lasts forever. Capitalism is not likely to last forever, either.

Where did capitalism come from?

Capitalism first emerged in Western Europe, especially Britain, in the mid-1700s. It evolved from relatively advanced feudal monarchies, in which non-agricultural production and long-distance trade had become important economic activities, and in which central state power was relatively strong. Historians have spent a lot of time trying to determine the causes of this incredible economic and social transformation, and arguing about why it occurred in Europe instead of elsewhere in the world. (During the Middle Ages, China and India had been about as wealthy as Europe – but for various reasons, the social and technological changes which led to capitalism did not occur there.)

There is broad agreement on at least these key factors which contributed to the rise of capitalism:

- **New technology** The invention of steam power, semi-automated spinning and weaving machines, and other early industrial technologies dramatically increased productivity. Also, these technologies needed completely new ways of organizing work: in larger-scale factories which required more complex (and expensive) equipment. And they implied new structures of ownership: the machinery (and associated costs of raw materials and other necessary inputs) was too expensive for individuals or groups of workers to finance on their own. An owner was needed to finance the large up-front investments needed to get the factories working.
- **Empire** The fact that Britain (and, to a lesser extent, other European colonial powers) possessed the organizational and military ability to conquer and dominate far-off lands contributed

to the development of capitalism in many ways. It fostered the emergence of a class of merchants – which itself eventually evolved into a class of industrial capitalists. It provided raw materials and exotic goods, including the importation of cheap foodstuffs to feed the growing non-agricultural workforce. It extracted wealth from the colonies by brute force (including good old-fashioned slavery, in many instances) to support the growth of capitalism at home. It provided an inflow of precious metals to serve as money and lubricate commerce. And empire also provided captive markets for the impressive output of the new factories.

- **Government** In addition to the role of colonialism, the centralized state power that existed in Britain, France, and Holland was crucial to the emergence of capitalism. A strong government provided a reliable currency, standardization of commerce, and protection of the private property of the ambitious new capitalists. It could also help to keep peasants and workers in line, as they endured the painful shift from feudalism to capitalism. As we will discuss in Chapter 19, a strong central state was also crucial to the successful development of capitalism in subsequent countries, too (like America and Japan).
- **Resources** Conveniently, Britain had ample supplies of coal and iron needed for the new industries. Water-power in rural areas was also important in the early days of the Industrial Revolution. The availability of resources shouldn't be overemphasized, however: many countries with abundant resources failed to develop quickly, while some countries (like Japan) successfully developed with very few resources.

The birth of capitalism was not pretty. Wages and conditions in the early factories were hellish. How did the first capitalists recruit workers? They were former peasants, driven off their former lands (which they never formally owned) by a process called the ENCLOSURES. Lands which were once held in common and worked under feudal rules were fenced in and assigned as formal private property to landlords – whose status became legal rather than traditional in nature. This also facilitated the depopulation of rural areas – necessary in light of the tremendous increases in the productivity of agriculture (far fewer farmers were needed to produce all the food the whole country needed). In this way, capitalism produced two entirely new economic classes: a group of industrial capitalists who owned the new factories, and a group of workers who possessed nothing other than their ability to work in those factories.

The evolution of capitalism

The "birth" of capitalism, amidst the smoke and soot of the Industrial Revolution, was a painful and in many ways violent process. Workers were forced off their land and driven into cities, where they suffered horrendous exploitation and conditions that would be considered intolerable today: seven-day working weeks, twelve-hour working days, child labour, frequent injury, early death. Vast profits were earned by the new class of capitalists, most of which they ploughed back into new investment, technology, and growth – but some of which they used to finance their own luxurious consumption. The early capitalist societies were not at all democratic: the right to vote was limited to property owners, and basic rights to speak out and organize (including to organize unions) were routinely (and often violently) trampled.

Needless to say, this state of affairs was not socially sustainable. Working people and others fought hard for better conditions, a fairer share of the incredible wealth they were producing, and democratic rights. Under this pressure, capitalism evolved, unevenly, toward a more balanced and democratic system. Labour laws established minimum standards; unions won higher wages; governments became more active in regulating the economy and providing public services. But this progress was not "natural" or inevitable; it reflected decades of social struggle and conflict. And progress could be reversed if and when circumstances changed – such as during times of war or recession. Indeed, the history of capitalism has been dominated by a rollercoaster pattern of boom, followed by bust.

Perhaps the greatest bust of all, the Great Depression of the 1930s, spurred more changes. New banking regulations were aimed at preventing financial chaos. Government income-support and make-work projects tried to put people back to work. To some extent, these projects were influenced by the economic ideas of John Maynard Keynes (more on this in the next chapter). The greatest (and deadliest) make-work project was World War II. The war spurred massive military spending which suddenly kicked all the major economies back into high gear, and eliminated unemployment.

After World War II, a unique set of circumstances combined to create the most vibrant and in many ways most optimistic chapter in the history of capitalism – what is now often called the "Golden Age." This postwar boom lasted for about three decades, during which wages and living standards in the developed capitalist world more than doubled. Strong business investment (motivated in part by postwar recovery and rebuilding) was reinforced by a rapid expansion of government spending in most capitalist economies. Unemployment was low, productivity grew rapidly, yet profits (initially at least) were strong. This was also the era of the "Cold War" between capitalism (led by the US) and communism (led by the former Soviet Union). In this context, business leaders and Western governments felt all the more pressure to accept demands for greater equality and security, since they were forced by global geopolitics to defend the virtues of the capitalist system.

Neoliberalism

It is now clear that beginning in the late 1970s, global capitalism entered a distinct and more aggressive phase. The previous willingness of business owners and governments to tolerate taxes, social programs, unions, and regulations petered out. Businesses and financial investors rebelled against shrinking profits, high inflation, militant workers, and international "instability" (represented most frighteningly by the success of left-wing revolutions in several countries in Asia, Africa, and Latin America in the 1970s). They began to agitate for a new, harder-line approach – and eventually they got it.

In retrospect, there were two clear "cannon shots" that signalled the beginning of this new chapter in the history of capitalism:

1. Paul Volcker became the head of the US Federal Reserve (the American CENTRAL BANK) in 1979. He implemented very strict MONETARY POLICY, heavily influenced by the ideas of Milton Friedman and the MONETARIST school (we'll discuss them more in Chapters 16 and 17). Interest rates rose dramatically, and economic growth slowed. Superficially, Volcker's high-interest-rate policy was motivated by a need to control and reduce inflation. But it quickly became clear that a deeper shift had occurred. Instead

of promoting full employment as their top priority (as during the Golden Age), central bankers would now focus on strictly controlling inflation, protecting financial assets, and keeping labour markets strictly in check.

2. Margaret Thatcher was elected as UK Prime Minister in 1979, followed by the election of Ronald Reagan as US President a year later. Both advocated an aggressive new approach to managing the economy (and all of society) in the interests of private business. They fully endorsed the hard-line taken by Volcker (and his counterparts in other countries). They were even tougher in attacking unions and undermining labour law and social policies (Reagan crushed the US air traffic controllers' union in 1981, while Thatcher defeated the strong British miners' union in 1985). Reagan and Thatcher shattered the broad Golden Age consensus, under which even conservative governments had accepted relatively generous social benefits and extensive government management of the economy. Despite forceful opposition in both countries, both leaders prevailed (supported by business interests), and became role models for hard-right conservatives in many other countries. Thatcher justified her initiatives with the now-classic (but false) slogan: "There is no alternative."

It gradually became clear that capitalism had fundamentally changed. The "kinder, gentler" improvements of the Golden Age era came under sustained attack, and would gradually (over the next quarter-century) be partially reversed – though not without a stubborn fightback by workers and communities. Some argued that capitalism could no longer afford those Golden Age programs; in my view, this is invalid, although there is no doubt that the Golden Age recipe began to encounter significant economic problems. Others argued that with the decline of communism and the weakening of left-wing parties, capitalism no longer *needed* to mollify its critics with compassionate policies (since it no longer faced a serious challenge to its continued existence).

This new era in capitalism has gone by several different names: neoconservativism, the "corporate agenda," and others. The most common term now used is **neoliberalism**. This term is confusing, since in some countries "liberal" refers to a centre or centre-left political ideology which still sees room for some Golden Age-style policies. In economics, however, "liberal" means something quite different: it means *an absence of government interference*. In this sense, "neoliberalism" implies going back to a more rough-and-tumble kind of capitalism, in which governments play a smaller role in regulating the economy and protecting social interests. But even this definition is not quite accurate: in fact, there are still many ways in which government and the state continue to wield real economic power under neoliberal capitalism (we will discuss these in later chapters). What has changed is *how*, and in *whose interests*, that power is now exercised.

Table 3.1 **Key Goals and Tools of Neoliberalism**

Key Goals:

- Reduce and control inflation; protect the value of financial wealth
- Restore insecurity and "discipline" to labour markets
- Eliminate "entitlements"; force families to fend for themselves
- Roll back and refocus government activities to meet business needs; cut taxes
- Generally restore the economic and social dominance of private business and wealth
- Claw back expectations; foster a sense of resignation to insecurity and hardship

Key Tools:

- Use interest rates aggressively to regulate inflation and control labour markets
- Privatize and deregulate more industries
- Scale back social security programs (especially for working-age adults)
- Deregulate labour markets (including attacks on unions)
- Use free-trade agreements to expand markets and constrain government interventions

The main goals of neoliberalism, and the tools used to achieve those goals, are listed in Table 3.1. They include controlling inflation; disciplining labour; downsizing and focusing government; and reinforcing business leadership. The broadest but perhaps most important goal is the last one listed in the first part of Table 3.1: ratcheting down popular expectations. There has been a deliberate and multidimensional effort since the early 1980s to construct a whole new cultural mindset, in which people stop demanding much from the economy, and accept insecurity and vulnerability as permanent, "natural" features of life. In the 1970s workers in most capitalist countries were uppity and feisty, ready to demand a better deal from their employers and their society. Today, after a quarter-century of neoliberalism, many are tempted to bow down in thanks that they at least have a job. Overturning this passive, defeatist mindset will be crucial for motivating people to challenge the inequality and imbalance that typify our economy today.

Kinds of capitalism

Even under neoliberalism, however, and despite the pressures for conformity that arise from globalization, there are still clear differences between capitalist economies – even those at similar levels of development. (There are even bigger differences, of course, between richer capitalist countries and poor ones.) So it would be a dangerous mistake to imply that all capitalist economies must now follow exactly the same set of policies. And those differences produce very different outcomes for the people who live and work in those economies.

Table 3.2 identifies four broad "types" of capitalism among the most developed countries in the world. They operate very differently in terms of how harshly workers are treated, how economically active government is, and the sectoral make-up of the economy. The "Anglo-Saxon" variant of capitalism is, by most indicators, the most unequal of all. It is characterized by a small role for government, an overdeveloped financial sector, and the largest inequalities in income. Other variants of capitalism – like the Nordic, the continental, or the Asian variants – offer generally better outcomes for working people.

Clearly, different societies still have considerable leeway to put their own stamp on the economy, even when the fundamental rules and structures of capitalism remain in place. Working for incremental improvements in capitalism, making it a little bit fairer and less degrading, is clearly important.

After capitalism?

At the same time as we fight for positive reforms in capitalism, we may also want to consider whether it's possible to move *beyond* the fundamental rules and structures of the system. After all, capitalism represents just one phase (and a relatively short phase, so far) in the evolution of human economic activity. That long process of evolution is not going to suddenly stop. We haven't arrived at some kind of economic "nirvana": a perfect system which can't possibly be improved. Collectively, we will continue developing new technologies, new goods and services, and new ways of organizing work. And it is

Table 3.2 Types of Capitalism (in the advanced countries)

Type of Capitalism	*Role of Government: Taxes as Share GDP*	*Role of Government: Economic Regulation*	*Financial Sector (Banks, Stock Market)*	*Income Distribution*	*Managing Income Distribution*	*Union Coverage as % Workforce*
Anglo-Saxon (US, UK, Canada, Australia)	30–35%	Weak	Very Large	Very Unequal	Market Power	10–30%
Continental (France, Germany, Italy)	35–45%	Moderate	Moderate	Somewhat Equal	Mild Corporatist†	20–50%
Asian (Japan, Korea, soon China)	25–35%	Strong	Relatively Small	Somewhat Equal	Paternalist Corporatist†	20–30%
Nordic (Sweden, Denmark, others*)	45–55%	Strong	Relatively Small	Very Equal	Strong Corporatist†	50–80%

* Some other European countries (like Austria and the Netherlands) have features similar to the Nordic type.

† **Corporatism** refers to a system of centralized negotiation between business, labour, and government.

almost certain that we will ultimately find new forms of ownership, and new forms of economic management, to make the most of those new tools – and, hopefully, to do a better job of meeting our human and environmental needs in the process. Sooner or later, I suspect we'll end up with something quite different from capitalism: some system in which most production is no longer undertaken by private, profit-seeking companies, and most work is no longer undertaken solely in return for a money wage.

The world has some experience with "life after capitalism," but that experience has been difficult and in most cases unsuccessful. Communist-led economies were built in Eastern Europe, China, and some developing countries in the mid-twentieth century; most of these failed in the face of economic stagnation and/or political breakdown. A few countries (like Cuba) have tried to preserve aspects of that system, and others (like Venezuela) are trying to build new forms of socialism. Successful smaller-scale experiments in non-capitalist economic development have taken place in parts of other countries – like the Basque region of Spain, or the Indian state of Kerala.

We will discuss the problems and prospects of post-capitalist society in the last part of this book. We don't know what will come after capitalism, or when or how it will happen. But it would be folly to expect capitalism to last forever.