CHAPTER ONE

Introduction

The economic crisis that almost all industrial capitalist nations experienced at the end of the first decade of the twenty-first century has given rise to questions about the nature of capitalism that are seldom asked when times are good: What is capitalism? How does it usually perform? Where are we going? Do we need to totally change our economic system to avoid another economic meltdown in the future?

When I converse with others about our economic system, I often feel we are talking past each other. They seem to consider only one arrangement of institutions and policies as “capitalism” and everything else as some other economic system, such as “socialism” or “fascism.” On the contrary, I believe that capitalist economic systems appear in many forms and that a broader view is important, an approach necessary so that trade-offs before us regarding institutions and policies can be more clearly
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evaluated. Although we live in a capitalist economy system, it is often difficult to gain a perspective on how its important institutions work together as a system.

The purpose of this short book, aimed at a general audience, is to provide a broad view of the economics of capitalism – its origins, the different ways in which its institutions can be structured, its performance in recent years, and the directions of its institutional development in the coming years. I carry out the discussion by defining, comparing, and contrasting four different types of capitalist economic systems. I then show that these groupings of capitalist systems parallel the four types of pattern of cultural values of the population. These four economic systems differ significantly, however, in their economic and social performance. Nevertheless, the countries with economic systems that score higher for one set of performance indicators tend to score lower than countries with other economic systems for a different set of indicators, so that there appears to be a trade-off. Nevertheless, we could not find any evidence that any of these economic systems produced happier people.

This institutional approach means, however, that I neglect particular policies by the governments (or by industries) that vary among countries with the same set of institutions. And, in order to focus on more narrowly economic issues, I leave it to others to make moral
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judgments about various institutions and other aspects of capitalism.

This book differs from many other recent studies on capitalism in that it contains an empirical analysis of the similarities and differences between various types of capitalist economies, and the impact of these organizational arrangements on the performance of their economies. Many other books on the economic systems are highly abstract, so that it is difficult to apply their descriptions to the real world around us. Still others are highly ideological, drawing arguments from selected anecdotes that suit the author’s economic or political predilections. Finally, others focus primarily on a single country and, with a bit of hand-waving, proclaim other capitalist countries to be “similar.” In contrast, I have tried to keep the discussion as concrete as possible, drawing empirical evidence from the experience of the twenty-one industrial nations that belong to the Organisation for Economic Co-operation and Development (OECD).

Such a comparative approach allows us to see the similarities and differences between the various capitalist nations under consideration. Moreover, I have also taken pains to avoid most ideological arguments, although I do test several against actual data, for instance, to determine whether people in countries with particular capitalist systems are happier than those living in other capitalist systems.
The reassessment of capitalism in this book does not provide solutions to our present economic difficulties, since its focus is primarily on the structure of the economy and its institutions. It does, however, provide a point of view about the essential aspects of the system so that the implications of proposed institutional changes can be evaluated in a broader context than the immediate problems at hand.

The discussion in the following pages takes a straightforward route. The next chapter is a short clarification of what “capitalism” means, and it is then followed in Chapter 3 by an exploration of the historical origins of capitalism. In Chapter 4 I look at the institutional configuration of industrialized OECD nations and distinguish four different types of capitalist economic systems. In the following Chapter 5, I examine the particular types of cultural values that influence how these four economic systems are structured. Chapter 6 analyzes the performance of the four different types of capitalist systems in recent years, as measured by a variety of economic and social indicators. Chapter 7 briefly explores whether the degree of happiness in these nations, as reported in various public opinion polls, is related to the economic system. The book ends with a discussion of how capitalism is changing and what possibilities lie ahead for it.
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Of course, there are many issues concerning capitalism that I do not discuss in this short book, for instance, capitalist ideology, changes in capitalist institutions over the last few centuries, or many social and moral aspects of capitalism, such as what this economic system does to people’s characters.

Nevertheless, I try to provide new insights into the nature of capitalism so that we have a compass with which to steer our economic system in a direction to avoid the shoals of fruitless debate about our institutions that have marred our efforts to solve our present economic difficulties.
Capitalism is a protean concept with a variety of definitions. To avoid confusion and to allow for a straightforward analysis, it is first necessary to define my subject matter. I bear in mind, however, a serious warning: “The surest way to fail as an author is to start by sounding pedantic, and the surest way to sound pedantic is to start with an unexhilarating search for definitions.”¹ I plead guilty.

This chapter starts with general definitions of the terms “economic system” and “capitalism.” I then explore some of the important implications of the definition of capitalism to specify the dimensions along which it can be quantified, so that in later chapters I can quantify the degree of capitalism in each of about ninety nations. The

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footnotes present references and additional explanations, while the technical appendices to the book appear on my Web site.\(^2\)

A. Definitions and Some Implications

1. Some Definitions

The word “capitalism” began to appear in various Western languages less than three centuries ago (see Appendix 2–1 for a discussion of its etymology), and over the succeeding centuries the concept has acquired various meanings. Some writers have used the term “capitalism” simply to designate ordinary trade in which credit and financial instruments play a large role, which is carried out in order to accumulate more wealth (commercial capitalism), an approach also followed in a broader manner by many of the classical economists. Others have placed primary emphasis on the presence of institutions of private property and enforcement of contract. Still others have linked capitalism to particular methods of industrial production involving hired labor or to special attitudes toward commercial activities (the “spirit of capitalism”). Marxist-oriented commentators

\(^2\) http://www.swarthmore.edu/SocSci/Economics/fpryor1/. The third link on this Web page leads to the appendices to this book.
define capitalism as a “mode of production” in which the market dominates distribution; ownership of the means of production is private; labor does not receive the full value of its output; and wealth is concentrated in ever-fewer hands. In contrast, liberal economists focus primarily on free individual producers selling goods and services and consumers buying them in a market economy.

Let’s start at the beginning. An economic system is usually defined in a very general manner, for instance, as the totality of institutions and organizations that specify property relations and have an important influence in channeling the production and distribution of goods and services. The economic policies or performance arising from decisions made by the functionaries of these institutions and organizations are not included in the definition of the system; instead, they are viewed as a result of it. Such an abstract approach is, of course, far removed from the world around us, but it allows us to define specific economic systems in many different ways.

In general, capitalism is an economic system in which goods, labor, land, and financial services are transferred through relatively competitive markets and in which the means of production are primarily owned privately or by groups of individuals, rather than by governments. A “relatively competitive market” is one in which most prices
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fluctuate according to the strength of supply and demand forces; most markets are not dominated by monopolies or guilds regulating the entry of new producers into the market or the prices at which goods and services are sold; and government regulations and other policies do not play a commanding role in the actions of the market but act to protect property and enforce contracts.

This very broad definition, however, tells us nothing about government-fixed prices and wages, pervasive technical regulations and standards, oligopolistic or monopolistic markets, or the variety of ways in which an actual economic system allocates goods and services. Nevertheless, it does have one critical advantage: it implies that there are degrees to which an economic system can be considered capitalist.³ Let us consider that on one end of the spectrum is an economy in which all goods and services are allocated in perfectly competitive markets, with just enough government regulation for the system to maintain itself and not self-destruct. Then we can set

³ Some believe that, just as a woman cannot be “a little bit pregnant,” an economy cannot have lower or higher degrees of capitalism. Underlying this belief is the false assumption that all the institutions that make up a capitalist economy are unchangeable once they reach a particular level and, moreover, that this level is reached at the same time for all of the criteria used to define capitalism.
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up scales rating the degree to which economic systems approach this standard; we can also define cut-off points at which to exclude from the capitalist camp economies that do not meet certain minimum criteria, even though they may have some capitalistic elements. Such an approach departs from the practice of some political conservatives of defining capitalism in terms of a strict laissez-faire government and perfect competition.

In Chapter 4, I show that in various capitalist economies different institutions can carry out particular economic functions; for instance, pensions can be distributed through insurance funds or through a government fund. And such institutions can distinguish different types of capitalist economies. Moreover, as I argue in Chapter 8, the financial institutions of an economic system are critically important in capitalism. To make this general definition more precise so that the degree of capitalism can be measured, it is important to consider several measurable elements of capitalism, namely, the level of economic development, the conditions facing the producers of goods and services, and the conditions facing consumers.

a. Level of Economic Development. At all levels of economic development almost all economies, including foraging and primitive agricultural societies have had