

## Chapter 2



# Historical Conceptions of Capitalism

Historians, most notably Fernand Braudel with his three-volume *Civilization and Capitalism*<sup>1</sup>, have traced the origins of the term capitalism to the mid-1800s. However, its notoriety came a few decades later, from socialists who used it as a term to describe what they disliked about the workings of liberal markets. Karl Marx, arguably one of the most prominent socialists of the time, used it as a way to refer to a system of markets that in his view favored capitalists at the expense of society.<sup>2</sup> His notion was, of course, conditioned by historical experience up to his own time as well as his own perspective on that history; when he was writing, markets appeared to inevitably pit capitalists versus the proletariat, without much regard for the fact that a democratically elected government, or even a limited monarchy, might intervene to protect the interests of the middle classes let alone the poor. In his era in both the United States and Europe, capital was achieving extraordinary power for newly emergent industrialists. For example, the largest firms in the US grew from perhaps 100 employees in 1800 to more than 100,000 a century later, and they grew still more in terms of the financial and physical resources at their

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<sup>1</sup> Fernand Braudel, *Civilization and Capitalism, 15<sup>th</sup>-18<sup>th</sup> Century, Vol. II* (Berkeley: University of California Press, 1992), 237.

<sup>2</sup> Michael Merrill, "Putting 'Capitalism' in its Place: A Review of Recent Literature." *The William and Mary Quarterly*, 3rd Ser., Vol. 52, No. 2. (April, 1995), 315-326: 322. Footnote 21 gives a very lucid description of some of the history, though mostly in a US context.

command.<sup>3</sup> This extraordinary accumulation of private power called for a new conception of capitalism; Adam Smith's conception of atomistic capitalism, where firms had little or no economic power, was hardly an adequate framework for such analyses. At the same time, there were virtually no large-scale democratic states until almost the end of the 19<sup>th</sup> century; Britain enlarged its electorate from about 1.5% of its population to 2.5% in 1832, and then only by the late 19<sup>th</sup> century began to add wealthy merchants and manufacturers to its class of wealthy aristocrats. The US was the outstanding exception, as Alexis de Tocqueville recognized during his first hand study of the US in 1830.<sup>4</sup> But the fact that governments had not mounted much by way of any of successful attempts to embed markets in regulatory frameworks to protect labor, a critique brought up by Karl Polanyi, did not mean that they could not do so, as Marx implied, but only that it had not yet done so.

Despite its grounding in a particular historical context, Marx's critique became an influential understanding of capitalism during the mid- 19<sup>th</sup> century, and his ideas served as a sort of handbook for revolutionary activities. Notably, they provided a covering ideology for those who wanted to establish totalitarian regimes to suppress the power of the capitalists in a perverted recipe that allowed a few to govern in the name of the proletariat, while in reality they were not held accountable to anyone. In such a context, capitalism was hardly a term of approbation. Indeed this competition for ideas and for power was clouded by the fact that capitalism had been defined by its adversaries more than by its proponents; proponents

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<sup>3</sup> Alfred Chandler, *The Visible Hand* (Cambridge: Belknap Press of Harvard University Press, 1977), 50-65, 204. Alfred Chandler reports that prior to 1840, few firms employed over 50 workers, but that by 1891, the Pennsylvania Railroad Company alone employed over 110,000 and, indeed, it was not even the largest US railroad in terms of mileage at the time.

<sup>4</sup> Alexis de Tocqueville, *Democracy in America* (New York: Alfred A. Knopf, Inc., 1945).

were preoccupied with resolving differences between utopian views, such as those of Robert Owen, with the near opposite view of laissez faire capitalism, a view that assumed market outcomes were based upon a system that predated government and were therefore not to be disturbed by government, with rare exceptions. The democratic alternative to both sets of views had yet to show much either in theory or practice that it could form market frameworks meeting Polanyi's challenge.

This very brief introduction to the history of capitalism in the 19<sup>th</sup> century is only intended to suggest that, by the late 19<sup>th</sup> century, it was a rather imperfect alternative to feudalism, in fact creating a new order that was open to huge concentrations of power that simply replaced those of the earlier order. Thus, ironically, capitalism came to be defined by some of its critics as the rationale for creating a centrally planned, coercive state that would monopolize power even more than its feudal predecessor. Although the democratic capitalism that we tend to take for granted today already existed in a few places, such as the United States, its existence was pushed into the shadows by the obvious presence of the new industrial giants, even in the United States, in the mid 19<sup>th</sup> century. Democratic capitalism has been challenged almost since its inception by oligarchic capitalism, though in the US case this challenge was delayed for some 200 years or more.

Over the last century and a half, the prevailing conception of capitalism has undergone a rather remarkable evolution, in terms of both its inherent structure and its impact on societal outcomes, both of which are of very direct import for this discussion. A century or more ago, the notion that markets were political as well as economic constructs was obvious; indeed, economics was then called political economy. At the same time, capitalism was a little used term, except as an epithet by its critics. Since then, economics has gradually narrowed its focus from political economy to economic relationships. From there, the focus has narrowed further to economic relationships that can be mathematically modeled, as though

economics were a science devoted to the discovery and exposition of a system of natural laws. From this narrowed perspective, microeconomics has become the study of how markets – traditionally, the essential institution of capitalism – coordinate decentralized decision-making through a price mechanism to bring supply and demand into equilibrium without any explicit human agency or planning. Economic actors are presumed to interact on the basis of rational self-interest in a largely self-regulating economic system controlled by the laws of supply and demand. Rational self-interest is presumed to be universal and context-free (not to mention bubble-free), as are the laws of supply and demand. And capitalism, though based upon property rights created by human agency, is presumed to be able to achieve optimal outcomes for society without the benefit of explicit human agency, as though markets were controlled by natural forces akin to those of a gravitational field, a claim that might have been plausible in Smith's era, but surely is not in our own. In the terms to be used in this monograph, microeconomics and the prevailing conception of capitalism are now largely focused on markets alone. As this market-based conception of capitalism is one with which my definition most strongly contrasts, I find it appropriate to describe and then critique it here, before introducing my own view.



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