

## A History of Capitalism by Charles Drace

The concept of capitalism that the market will dictate the terms of supply and demand and thus will determine the terms of trade have probably been with us since caveman times. Many commentators will date the codification of modern capitalism with the publication of Adam Smith's *Wealth of Nations* in 1776 although Voltaire had written of it in earlier years.

It must be remembered that *The Wealth of Nations* celebrated the relatively recent escape of England and Northern Europe, especially what was to become Germany, from the command economies dictated by Kings and the lords of the land as well as the restrictions of the Medieval guild systems. This escape evolved slowly from the Renaissance, though mainly limited to Northern Europe and England, and by 1776 had proved to be successful in expanding the economy and facilitating the involvement in the economy of a significantly greater portion of the population.

When economists and politicians quote *The Wealth of Nations* as justification for laissez faire capitalism they ignore the fact that the *Wealth of Nations* described a period of time and a particular set of circumstances that bear little relation to our modern day world and its systems.

They also ignore the fact that Adam Smith's next two books take quite a different tack. As he had time to reflect and study the workings of capitalism Smith became aware of the problems inherent in unlimited capitalism, particularly how those with money and/or power could take advantage of the system to the great detriment of the poorer or less enfranchised.

This is a problem seen during the Industrial Revolution and again today..... as the gap between the rich and poor widen due to the more powerful gaming the system to take advantage of the less powerful, fewer earners can fully participate in the economy through earning enough to keep the levels of consumption up, and therefore the levels of production. This leads to a weaker economy and eventually an attempt to repair the economy through either a revolution, a change to a socialist system, a war, a depression, or all of the above.

This is also evident in the degradation of the world's environment as laissez faire capitalism invites and encourages companies to use limited and life sustaining resources without heed to the long term consequences of such use.

Smith's answer was that government regulation was necessary to prevent individuals and companies from gaming the system. An example of such regulation which has proven to be successful is the anti-monopoly laws in most Western countries.

My examination of economic cycles suggests that since the publication of *The Wealth of Nations*, political system cycles have matched economic cycles.

When an economy is in its growth phase, like in the 1830's, 1860's, 1900's, 1920's, 1950-60's, 1980-90's etc. companies grow stronger and become greedy... they want to take more and more advantage of this growth. So they do two things: they pressure governments or encourage [through funding] the election of more laissez faire political parties and they take on more debt. Both are seen as desirable to increase profits and take maximum advantage of the growth phase.

They demand and receive further relaxation of government regulation which has the result of widening the gap between rich and poor which has the result of disenfranchising a bigger and bigger segment of the population. This, along with the increased debt and the increasing interest burden associated with that debt, causes a recession or, every second cycle, a depression [1840's, 1870's, 1930's].

Recessions and depressions are the way capitalism cleans out its systems and are necessary to its functioning. Governments that lower interest rates and/or increase debt and the money supply in order to keep the growth phase continuing only make the eventual recession much worse - increasing the causes of the recession, mainly debt, increases the severity of the necessary correction. A good analogy is you do not solve the problems of paying off your first mortgage by taking out second and third mortgages.

There are two preconditions for a recovery: one, the debt must be removed so savings can grow and become directed towards increasing production and consumption and, two, the removal of the politicians and corporate leaders who encouraged the debt which eventually broke the back of the economy requiring the recessionary clean-out.

Populaces bear the brunt of recessions and subsequently switch their allegiances to political parties representing Socialist systems to provide solace from the pain of the recession and protection from same. During the recession they require more protection through social services and social policies. Therefore we find right wing capitalism growing during the growth phase of an economic cycle and left wing socialism growing during the recessionary phase of the cycle. And thus, we find pressure on politicians to relax regulation during the growth phase and to increase regulation during the recessionary phase.

What we're seeing in the world at the moment [June 2009] is, politically, the last gasp of right wing political parties applying [futilely] more of the laissez faire medicine that caused the current recession in the first place. They're also trying to use [again futilely] more debt and newly printed money to recreate the good times. As noted above, this only serves to make the problem worse, to prolong the agony, and to force the economy into a situation where it takes a much longer period of time to begin the recovery. It's a truism that the bigger the debt when the bubble breaks the deeper the recession and the longer it takes to clean out the system and set the stage for a recovery.

When the recession deepens and encompasses a greater percentage of society, we can expect the populace to elect more socialist leaning governments.

It must be remembered that what we now refer to as laissez faire economic theory is really the reincarnation of the liberal economic theory developed and promoted during the latter part of the 19th century. Liberal theory was developed as a response to the growing influence and disruption of the trade unions and the movements to enfranchise workers. The Industrial Revolution had massively widened the gap between rich and poor, essentially creating a very substantial class of virtual slaves. As it's human nature to attempt to break the bonds of slavery and unjust servitude, after 100 years or so of accepting their fate the workers began rebelling. In order to protect their privileged positions of power and profits, industrialists developed liberal economic theory to support their control over the economy and the workers.

As *The Wealth of Nations* described a time and set of circumstances that bear little relation to today's world, so late 19th Century liberal theory bears little relation to the time and set of circumstances of today's world.

It became obvious during the recessionary period following the First World War, as well as during the Depression, and as well, to a lesser extent, during the recessionary 1970's, that liberal theory eventually led to the destruction of the growth cycle and that to overcome some of the many problems created a more caring and inclusional system needed to replace it. We saw this most vividly with the US's New Deal in the 1930's.

After the war, during the growth phase of the 50's and 60's, industrialists again wanted to maximise their profits and control of the economy during that growth phase and found their champion in Milton Friedman of the Chicago School of Economics. Friedman and his acolytes exported their reincarnated late 19th Century liberal theory to many nations around the world, encouraging, in most cases, the violent takeover of governments by strongmen who could force their respective countries into liberal capitalism. The book to read on this is *Shock Doctrine* by Naomi Klein.

It was also this out of date doctrine that Roger Douglas forced on New Zealand helped by Friedman acolyte Michael Porter of Harvard. As a result infrastructure was decimated, production went offshore requiring the enormous increase of the trade deficit in order to buy needed goods, and the gap between rich and poor widened. However, in our case and as also seen in South America, parts of Asia, Eastern Europe and parts of Africa and the Middle East, the rich who benefited were mostly overseas companies, thereby depriving local economies of the profits which would normally have recirculated within the local economy.

It must be noted that the champion of overseas investment and unrestricted growth unfettered by government policy was the so-called New Zealand Business Roundtable. Two thirds of its members are overseas corporations or corporations controlled by overseas interests and the policies it promotes and has had great success getting successive governments to adopt have mainly benefited overseas based companies.

The current Key government is trying to recreate the growth phase by reintroducing the

same failed late 19th Century liberal theory. As this will only make the recession deeper and longer we can expect the population to lose patience with them in time and elect a more socially inclusive government. This may not be Labour as Labour has largely adopted these same Friedmanesque policies.

As this recession is a worldwide recession, unlike any recession since the 1930's Depression, we will not have the benefit of any strong economies able to buy the produce of the recessional economies. This will likely result in a worldwide depression like we saw in the 1930's. Only this time the level of debt is much higher [and growing at an alarming rate] so the depression is likely to be deeper and longer lasting.

The debt in the US and the UK is shared by the government, banks, industry and individuals. They will likely suffer the most. The same with Eastern Europe and Italy. The debt in Germany [the world's leading exporter] is mostly in the banking system. In New Zealand it's the consumer who is most indebted, as well as the banks. In fact, only two countries lead New Zealand in consumer indebtedness: bankrupt Iceland and Hungary. As our economy has become quite consumer focused this eliminates a consumer led recovery.

On the plus side Michael Cullen was one of the few Ministers of Finance in the world to save part of our surplus during the growth phase. On the negative side, the four major Australian owned banks collectively owe \$130 billion to offshore lenders, most of it short term, in an environment where overseas lenders have tightened up or stopped lending.

Also on the negative side New Zealanders have probably the highest allocation of investments into property in the world and 60% of that is supported by borrowing. This puts the consumer and the banks under extreme pressure when the recession deepens into the redundancy cycle which will result in a major bout of foreclosures. This will lead to substantial falls in property values wiping out the investment assets of a large sector of the population.

Because of the very high level of debt going into the recession, and the current policies of increasing debt, as well as the fact that this recession is a worldwide recession unlike any since the Depression, this recession will likely develop into a worldwide depression which will likely last for twenty years. The 1930's Depression didn't start to recover until 1949 so it lasted 20 years. The recession in Japan which started at the end of 1989 has also lasted 20 years and was also preceded by large levels of debt.

We must stop talking about the ridiculous idea of 'green shoots' and start to become serious about dealing with the recession. This means firstly to stop pretending that it's going to get better. History clearly shows us that bear market bounces in the share market and temporarily improving statistics in the general economy are false shoots that only lead to the unsuspecting [suckers] being led more deeply into debt or setting themselves up for even greater losses. Individuals and companies will be better able to cope if they understand the reality and can make plans accordingly.

We must also stop taking on any more debt at any level and instead pay down debt. It's a truism that those in debt, whether individuals or companies, suffer most in a recession or depression. Those with little or no debt have the great opportunities to buy assets or companies at fire sale prices which they can benefit from when the recovery begins. The wise will put off those purchases until the very end to the recession. You will know when it's due to end: the news will be universally bad and there will be absolutely no interest in buying shares or property. That extreme level of pessimism will herald the time to buy.

History is also very clear on the best way to deal with a recession. First, we must get rid of the debt and those that made the decisions to get into deep debt. That means letting the weak companies and the less judicious property owners go bankrupt. That also means letting the over-indebted banks which lent so unwisely go under. A precondition for a recovery is the dramatic reduction of interest costs so that money currently going to pay interest can be saved and thus made available for investment into employment enhancing production.

Secondly, and finally, the only way to reduce the effects of the recession and to set the stage for recovery is to increase employment and to also focus on preventing unemployment. As the government is usually the only entity in a recession that can afford to increase employment, the last thing they should be doing is making people redundant in the name of so-called increased efficiency or increased productivity. Increasing the measurement of productivity by reducing the payroll is false accounting and just prolongs the recession.

Maintaining employment levels is vital as without them an economy does not have enough earning and buying consumers to maintain demand for goods and services and therefore the demand for the manufacture or provision of same. The object should be to achieve the highest level of employment possible so there are enough participants in the economy to keep it's light aflame.

Employment will have to be created, a lot of it by government. Work schemes should concentrate on infrastructure projects that will produce long lasting benefits to both the economy and the culture. Good examples of this would be renewable energy, public transport, education and preventative health. Bad example would be more oil consuming roads, bank and finance company bailouts and short term stimulating tax cuts.

As recessions are characterised by falling share markets, New Zealand has an ideal opportunity to utilise the surpluses of the Cullen years. We should refocus the Cullen Superfund away from falling share markets towards New Zealand based infrastructure.

Imagine a situation where billions were poured into employment creating renewable energy infrastructure during the depression. By the time the growth phase started again much of the investment would be paid for. We could then offer our populace cheaper and less harmful energy so they could be healthier as well as be able to save more of their income, savings which could be invested in production.

Imagine also a situation where New Zealand was able to offer its industry cheaper energy thus making it more competitive on the world trade scene.

This is the type of investment we need, investment which would create new employment. It would also reduce our carbon costs.

It should be bleedingly obvious that we should not encourage, maybe not even allow, more foreign investment into New Zealand. Overseas companies will only invest in New Zealand if they expect to make profits which they can repatriate back offshore, thus depriving the New Zealand economy of those profits which would otherwise be recirculating within our economy, thus continuing to create employment and raising the standard of living, or, during the depression, keep many off the bread lines and able to participate in the economy.

It has been argued that one of the ways New Zealand recovered from the last Depression in 1949 was through the treasury printing money which was then lent out at very low rates for people to buy houses [Housing Corporation and State Housing] - raising the standard of living as well as providing employment to builders and sales to the building supply industry.

It probably makes more sense for governments to print employment enhancing infrastructure stimulus money rather than borrow it offshore for many reasons. One, it would create inflation which would debase the currency which in turn would create more export opportunities. Two, it would shorten rather than prolong the depression as increasing debt tends to do. Third, there's no interest bill hanging around our necks for decades.

However, in 1949 there was an extreme shortage of residential housing and a low level of participation of property in the economy. Also, property was not overpriced. We've recently seen in Australia how government subsidies to first home buyers have increased their burdensome debt levels while driving the price of first homes up dramatically. This will result in a lot more foreclosures and bankruptcies as the recession drives property values down.

We currently have enough houses and commercial properties, our houses are amongst the most over-priced in the world, and any focus on property would only produce short term benefits while creating the situation where more people would be at risk of losing their savings, their homes, and any short term employment gains.

Far better to use current savings to invest in renewable energy, public transport, education and preventative health infrastructure - all yielding long term benefits as well as ameliorating the effects of the depression while following the most pro-actively positive depression fighting strategy available. A further benefit would be that New Zealand would finally fulfill its obligations towards reducing global warming.