



## Capitalism

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## **Capitalism**

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CAPITALISM is an economic system dedicated to production for profit and to the accumulation of value by private business firms. In the fully developed form of industrial capitalism, firms advance money to hire wage laborers and to buy means of production such as machinery and raw materials. If the firm can sell its products for a greater sum of value than that originally advanced, the firm grows and can advance more money for a new round of accumulation. Historically, the emergence of industrial capitalism depends upon the creation of three requirements for accumulation: initial sums of money (or credit), wage labor and means of production available for purchase, and markets in which products can be sold.

Industrial capitalism entails dramatic technical change and constant revolution in methods of production. Prior to the British Industrial Revolution of the eighteenth and early nineteenth centuries, earlier forms of capital in Europe—interest-bearing and merchant capital—operated mainly in the sphere of exchange. Lending money at interest or “buying cheap and selling dear” allowed for accumulation of value but did not greatly increase the productive capabilities of the economic system. In the United States, however, merchant capitalists evolved into industrial capitalists, establishing textile factories in New England that displaced handicraft methods of production.

Capitalism is not identical with markets, money, or greed as a motivation for human action, all of which predated industrial capitalism. Similarly, the turn toward market forces and the price mechanism in China, Russia, and Eastern Europe does not in itself mean that these economies are becoming capitalist or that all industrial economies are converging toward a single form of economic organization. Private ownership of the means of production is an important criterion. Max Weber stressed the rational and systematic pursuit of profit and the development of capital accounting by firms as key aspects of modern capitalism.

In the United States the three requirements for capitalist accumulation were successfully created, and by the 1880s it surpassed Britain as the world's leading industrial economy. Prior to the Civil War, local personal sources of capital and retained earnings (the plowing back of past profits) were key sources of funds for industry. Naomi Lamoreaux has described how banks, many of them kinship-based, provided short-term credit and lent heavily to their own directors, operating as investment clubs for savers who purchased bank stock to diversify their portfolios. Firms' suppliers also provided credit. Capital from abroad helped finance the transport system of canals and railroads.

During the Civil War, the federal government's borrowing demands stimulated development of new techniques of advertising and selling government bonds. After the war, industry benefited from the public's greater willingness to acquire financial securities, and government debt retirement made funds available to the capital market. In the last decades of the century, as capital requirements increased, investment banks emerged, and financial capitalists such as J. P. Morgan and Kuhn, Loeb and Company organized finance for railroads, mining companies, and large-scale manufacturers. However, U.S. firms relied less on bank finance than did German and Japanese firms, and, in many cases, banks financed mergers rather than new investment.

Equity markets for common stock grew rapidly after World War I as a wider public purchased shares. Financial market reforms after the crash of 1929 encouraged further participation. However, internal finance remained a major source of funds. Jonathan Baskin and Paul Miranti noted (p. 242) that between 1946 and 1970 about 65 percent of funds acquired by nonfinancial corporate businesses was generated internally. This figure included retained earnings and capital consumption allowances (for depreciation). Firms' external finance included

debt as well as equity; their proportions varied over time. For example, corporate debt rose dramatically in the late 1980s with leveraged buyouts, but in the 1990s net equity issuance resumed.

Labor for U.S. factories in the nineteenth century came first from local sources. In textiles, whole families were employed under the Rhode Island system; daughters of farm households lived in dormitories under the Waltham system. Immigration soared in the 1840s. Initially, most immigrants came from northern and western Europe; after 1880, the majority were from southern and eastern Europe. After reaching a peak in the decade before World War I, immigration dropped off sharply in the 1920s–1930s. It rose again in the 1940s and continued to climb in subsequent decades. The origins of immigrants shifted toward Latin America, the Caribbean, and Asia. Undocumented as well as legal immigration increased. For those lacking legal status, union or political activity was especially risky. Many were employed in the unregulated informal economy, earning low incomes and facing poor working conditions.

Thus, although an industrial wage labor force was successfully constituted in the United States, its origins did not lie primarily in a transfer of workers from domestic agriculture to industry. Gavin Wright (1988, p. 201) noted that in 1910 the foreign born and sons of the foreign born made up more than two-thirds of the laborers in mining and manufacturing. Sons of U.S. family farmers migrated to urban areas that flourished as capitalism developed, but many moved quickly into skilled and supervisory positions in services as well as industry, in a range of occupations including teachers, merchants, clerks, physicians, lawyers, bookkeepers, and skilled crafts such as carpentry. Black and white sharecroppers, tenant farmers, and wage laborers left southern agriculture and found industrial jobs in northern cities, particularly during World War II. But by the 1950s, job opportunities were less abundant, especially for blacks.

Family farms using family labor, supplemented by some wage labor, were dominant in most areas outside the South throughout the nineteenth century. But in the West and Southwest, large-scale capitalist agriculture based on wage labor emerged in the late nineteenth century. Mechanization of the harvest was more difficult for fruits, vegetables, and cotton than for wheat, and a migrant labor system developed, employing both legal and undocumented workers. In California a succession of groups was employed, including Chinese, Japanese, Mexican, and Filipino workers. Labor shortages during World War I led to federal encouragement of Mexican immigration, and Mexicans remained predominant in the 1920s. They were joined in the 1930s by migrants from Oklahoma and other Plains and southern states. Federal intervention during World War II and the 1950s established bracero programs to recruit Mexican nationals for temporary agricultural work.

An extraordinary home market enabled U.S. capitalists to sell their products and enter new rounds of accumulation. Supported by the Constitution's ban on interstate tariffs, preserved by Union victory in the Civil War, and served by an extensive transportation and communication network, the U.S. market by the 1870s and 1880s was the largest and fastest-growing in the world. Territorial acquisitions included the Louisiana Purchase of 1803, which nearly doubled the national territory, and the Mexican cession, taken by conquest in 1848 and including the area that became California. Although some acquisitions were peaceful, others illustrate the fact that capitalist development entailed violence and nonmarket coercion as well as the operation of market forces. Growth in government spending, particularly during and after World War II, helped ensure that markets and demand were adequate to sustain accumulation.

According to Alfred Chandler, the size and rate of growth of the U.S. market opened up by the railroads and telegraph, together with technological changes that greatly increased output,

helped spawn the creation from the 1880s of the modern industrial enterprise, a distinctive institutional feature of managerial capitalism. Using the “visible hand” of salaried managers, large firms coordinated vast quantities of throughput in a sequence of stages of mass production and distribution. Chandler thought these firms were more efficient than their competitors, but other scholars argued their dominance rested at least partly on the deliberate creation of barriers to entry for other firms. These included efforts to monopolize raw materials and other practices restricting competition, such as rebates, exclusive dealing, tariffs, patents, and product differentiation.

Technological changes included the replacement of handicraft methods using tools and human or animal power by factories with specialized machinery and centralized power sources. Nineteenth-century U.S. capitalism was notable for two industrial processes: the American System of interchangeable parts, which eliminated the need for skilled workers to file parts (of firearms, for example) to fit together as they did in Britain; and continuous-process manufacture in flour mills and, later, factories with moving assemblies such as automobile factories. Public sector institutions played an important role in some technological developments. The Springfield armory promoted interchangeable parts in the early nineteenth century. Government funding of research and development for industry and agriculture assisted private accumulation by capitalist firms in the twentieth.

Organizational and technological changes meant that the labor process changed as well. In the last decades of the nineteenth century, firms employed semiskilled and unskilled workers whose tasks had been reduced to more homogenized activity. Work was closely supervised by foremen or machine paced under the drive system that many firms employed until the 1930s. “Scientific management,” involving detailed analysis of individual movements, optimum size

and weight of tools, and incentive systems, was introduced, and an engineering profession emerged.

In the early twentieth century, “welfare capitalism” spread as some firms provided leisure activities and benefits, including profit sharing, to their workers, partly to discourage unionization and reduce labor turnover. As Sanford Jacoby documented, higher worker morale and productivity were sought through new personnel management policies such as job promotion ladders internal to firms. Adoption of bureaucratic employment practices was concentrated in times of crisis for the older drive system—World War I and the Great Depression. In the 1930s, union membership also expanded beyond traditional craft unions, as strike tactics and the rise of industrial unions brought in less skilled workers. During and after World War II, union recognition, grievance procedures, and seniority rules became even more widespread. Capitalism rewarded relatively well those in primary jobs (with good wages, benefits, opportunities for promotion, and greater stability). But segmented labor markets left many workers holding secondary jobs that lacked those qualities.

### Capitalism, the State, and Speculation

Capitalism involves a combination of market forces, nonmarket forces such as actions by the state, and what can be termed hypermarket forces, which include speculative activities motivated by opportunities for large, one-time gains rather than profits made from the repeated production of the same item. In some cases state actions created opportunities for capital gains by private individuals or corporations. In the United States, federal land grants to railroad companies spurred settlement and economic development in the West in the nineteenth century. Profits often were anticipated to come from increases in land values along railroad routes, particularly at



terminal points or junctions where towns might grow, rather than from operating the railroads.

Similarly, from the mid-twentieth century, federal highway and dam construction and defense spending underpinned city building and capitalist development in the southern and western areas known as the U.S. Sunbelt. In the 1980s, real estate speculation, particularly by savings and loan institutions, became excessive and a threat to the stability of the system rather than a positive force. The corporate merger and takeover wave of the 1980s also showed U.S. capitalism tilting toward a focus on speculative gains rather than on increases in productive efficiency.

In the judicial sphere, the evolution of legal doctrines and conceptions of property in the United States during the nineteenth century promoted capitalist development. As Morton Horwitz explained, in earlier agrarian conceptions, an owner was entitled to absolute dominion and undisturbed enjoyment of a property; this could block economically productive uses of neighboring properties. At the end of the eighteenth century and beginning of the nineteenth century, the construction of mills and dams led to legal controversies over water rights that ultimately resulted in acceptance of the view that property owners had the right to develop properties for business uses. The taking of land by eminent domain facilitated the building of roads, canals, and railroads. Legal doctrines pertaining to liability for damages and public nuisance produced greater predictability, allowing entrepreneurs to more accurately estimate costs of economic improvements. Other changes affected competition, contracts, and commercial law. Horwitz concluded that by around 1850 the legal system had become much more favorable to commercial and industrial groups.

Actions by the state sometimes benefited industrial capitalism as an unintended consequence of other aims. Gavin Wright argued that New Deal farm policies of the 1930s,

designed to limit cotton production, undermined the sharecropping system in the U.S. South by creating incentives for landowners to switch to wage labor. Along with minimum wage legislation, the demise of sharecropping led the South to join a national labor market, which fostered the region's development. Elsewhere, capitalist development was an explicit goal. Alice Amsden showed that beginning in the 1960s, the South Korean state successfully forged a reciprocal relation with firms, disciplining them by withdrawing subsidies if export targets were not met. It set priorities for investment and pursued macroeconomic stabilization policies to support industrialization.

State action also affected the relationship between capital and labor. In the United States, federal and state governments fiercely resisted unions during the late nineteenth century with injunctions and armed interventions against strikes. Federal legislation of the 1930s and government practices during World War II assisted unions in achieving greater recognition and bargaining power. But right-to-work laws spread in southern and western states in the 1940s and 1950s, the 1947 Taft-Hartley Act was a major setback for labor, and the federal government turned sharply against unions in the 1980s.

Varying combinations of ordinary market forces, state action, and speculative activity generated industrial capitalism by the late twentieth century in an increasing but still limited group of countries. Western Europe, which had seen a protracted transition from feudalism to capitalism, was joined in the nineteenth and early twentieth centuries by white settler colonies known as "regions of recent settlement," such as the United States, Canada, Australia, and New Zealand. Argentina and South Africa shared some features with this group. Capitalism in regions of recent settlement was less a transformation of existing economic structures than an elimination of native populations and transfer of capital, labor, and institutions from Europe to

work land that was abundantly available within these regions.

However, capitalism was not simply imported and imposed as a preexisting system. Scholars have debated whether farmers in New England and the Middle Atlantic region in the seventeenth to nineteenth centuries welcomed or resisted the spread of markets and the extent to which accumulation of wealth motivated their actions. In their ownership of land and dependence on family labor they clearly differed from capitalist farms in England whose proprietors rented land and hired wage labor. Holding the independence of the farm household as a primary goal, these U.S. farmers also were determined to avoid recreating a European feudal social structure in which large landowners held disproportionate economic and political power.

A final group of late industrializers—Japan from the late nineteenth century and, after World War II, Korea, Taiwan, Brazil, India, Turkey, and possibly Mexico—took a path to capitalism based on what Amsden called “industrialization through learning.” Like European latecomers such as Germany, Italy, and Russia, these countries took advantage of their relatively backward status. Generally, they borrowed technology rather than inventing or innovating, although Germany did innovate and Japan became capable of innovation in some areas.

Some late industrializers relied heavily on exports and benefited from participation in the international economy. But home markets were also important, and among the most successful Asian countries were those with land reforms and relatively equal income distributions. In this respect they resembled regions of recent settlement that were not dominated by concentrated landownership. For countries in the periphery, moreover, industrial capitalism could be fostered by delinking from the international economy. Some Latin American countries and Egypt saw their manufacturing sectors strengthen when the crises of the 1920s–1930s weakened their ties with the center. Delinking allowed them to follow more expansionary monetary and fiscal

policies during the Great Depression than did the United States.

### Capitalist and Noncapitalist Forms of Organization

The development of capitalism and free wage labor was intimately bound up with unfree labor forms and political subordination. Coexistence of capitalist forms with noncapitalist forms has continued into the twentieth century. Immanuel Wallerstein argued that during 1450–1640, a capitalist world-economy emerged that included very different labor forms: free labor (including yeoman farmers) in the core, slavery and coerced cash-crop labor in the periphery, and sharecropping in the semiperiphery. From the sixteenth to the nineteenth centuries, the Baltic grain trade provided food for western European cities while intensifying serfdom in eastern Europe. Eighteenth-century sugar plantations in the Caribbean using African slaves bought manufactured exports from Britain and food from the New England and Middle Atlantic colonies, which also then could import British manufactures.

In the United States, slavery, sharecropping, and petty production were noncapitalist forms that interacted with capitalist forms. Petty production is small-scale production that can be market-oriented but is not capitalist. It relies primarily on individual or family labor rather than wage labor, and producers own their means of production. Slavery, sharecropping, and petty production were especially important in agriculture, although some slaves were used in industry and the factory system did not universally eliminate artisan producers in manufacturing. In some sectors, specialty production by petty producers in industrial districts coexisted with mass production of more standardized products. Slaves and, after the Civil War, sharecroppers in the U.S. South produced the cotton that helped make textiles a leading industrial sector in both Britain and the United States. Slave owners purchased manufactured products produced by

northern firms. Capitalist production and free wage labor thus depended on noncapitalist production for a key input and for some of its markets.

Petty producers in U.S. agriculture participated in markets and accumulated wealth, but unlike capitalist firms, accumulation was not their primary motivation. According to Daniel Vickers, U.S. farm families from initial settlement to the beginnings of industrialization held an ideal of “competency”—a degree of comfortable independence. They did not seek self-sufficiency, although they engaged in considerable production for their own use. They sold some of their produce in markets and could be quite interested in dealing for profit but sought to avoid the dependence on the market implied by a lifetime of wage labor.

As David Weiman explained, over the life cycle of a successful farm family more family labor became available and farm capital increased, allowing the household to increase its income and purchase more manufactured commodities. Farm households existed within rural communities that had a mix of private and communal social relations, some of which tended to limit market production and private accumulation of wealth. But over time the activities of petty producers contributed to a process of primitive accumulation—accumulation based on pre- or noncapitalist social relations, in which capital does not yet create the conditions for its own reproduction—which ultimately undermined the system of petty production in rural communities.

Noncapitalist forms of organization also include household production by nonfarm families and production by the state. These spheres have been variously conceived as supporting capitalism (for example, by rearing and educating the labor force), financially draining and undermining capitalism (in the case of the state), or providing an alternative to capitalism. Household production shrank over the nineteenth and twentieth centuries as goods and services

formerly provided within households were supplied by capitalist firms. Production by the state expanded with defense spending, the rise of the welfare state, and nationalization in Western Europe and Latin America. Some of these trends contributed to the shift from manufacturing to services that was an important feature of capitalist economies in the twentieth century.

In addition to depending on noncapitalist economic forms, capitalism involved political subordination both domestically and internationally. In some countries, labor unions were suppressed. Political subordination of India within the British Empire was central to the smooth operation of the multilateral trade and payments network underlying the “golden age” of world capitalism that lasted from the last third of the nineteenth century to the outbreak of World War I in 1914. India’s purchases of cheap manufactures and invisibles such as government services led to a trade deficit with Britain. Its trade surplus with India gave Britain the means to buy from other European countries such as Germany and France, stimulating their industrialization. On the monetary side, control of India’s official financial reserves gave Britain added flexibility in its role as the world’s financial center.

### Uneven Capitalist Development

Both on a world scale and within individual countries, capitalist development is uneven: spatially, temporally, and socially. Some countries grew rapidly while others remained poor. Industrial leadership shifted from Britain to Germany and the United States at the end of the nineteenth century; they in turn faced new challengers in the twentieth. Within countries, industrial regions boomed, then often declined as growth areas sprang up elsewhere.

The textile industry in New England saw widespread plant closings beginning in the 1920s, and employment plummeted between 1947 and 1957. Production grew in southeastern

states and was an important source of growth in the 1960s–1970s. But in the 1980s, textile production began shifting to even lower-cost locations overseas. Deindustrialization in the Midwest became a national political issue in the 1970s, as firms in the steel, automobile, and other manufacturing industries experienced competition from late industrializers and other U.S. regions. Growth in Sunbelt states was due to new industries and services as well as the relocation of existing industries.

Similarly, capitalism has been punctuated over time by financial crashes and by depressions with large drops in real output and employment. Epochs of growth and relative stability alternated with periods of stagnation and disorder. U.S. capitalism saw panics in 1819, 1837, 1857, 1873, 1907, and other years; particularly severe depressions occurred in the 1870s, 1890s, and 1930s. The post–World War II boom unraveled after 1973. Productivity growth was less rapid, and growth in median family income slowed markedly. Within periods of depression or prosperity, the experience of different industries is highly uneven. As Michael Bernstein emphasized, even during the 1930s the U.S. petroleum and tobacco industries saw strong output growth, while the iron and steel, automobile, and rubber industries remained depressed.

Finally, capitalism has been associated with shifts in the position of social classes, and its effects on different groups of people have been enormously varied. The broad-brush picture for Europe includes the decline of a landed aristocracy whose wealth and status were land-based and inherited; the rise of a bourgeoisie or middle class of merchants, manufacturers, and professionals with earnings from trade and industry; and the creation of a working class of wage earners. The fate of the peasantry varied—it was eliminated in some countries (England) but persisted in others (France, Russia), with lasting implications for economic and political development.

This simple story requires qualification even for Britain, where scholars question whether the industrial bourgeoisie ever truly dominated and suggest that landed interests maintained their political presence in the late nineteenth and early twentieth centuries by allying with internationally oriented financial capital. In the United States and other regions of recent settlement, the class configuration included the sector of family farmers discussed above. One result was that debtor-creditor relationships were particularly important in generating social conflict and social movements in the United States.

Although one might expect the capital-labor relationship to be the main locus of conflict in capitalist economies, this was not always the case. The United States did have a long and at many times violent history of capital-labor conflict. Its labor movement succeeded in the twentieth century in achieving considerable material gains for unionized workers; it did not seriously limit capital's control over the production process. Although groups such as the Wobblies (Industrial Workers of the World) sought to overthrow capitalism in the years prior to World War I, the United States did not have a strong socialist movement that included labor, as did some European countries. Other groups, particularly farmers, were important in the United States in alliance with labor or on their own in opposing what they saw as negative effects of financial capital or monopoly.

Farmers typically incur debts to purchase inputs, machinery, or land. During times of deflation or economic downturn those debts become particularly difficult to service. In addition to opposing debt and tax collection and foreclosures, farmers supported monetary policies that would increase the amount of currency and generate inflation (which would erode the real value of their debts) rather than deflation. Armed resistance to debt collection occurred in 1786–1787 in Massachusetts (Shays's Rebellion) and other states. After the Civil War, a long period of



deflation lasting until about 1896 led farmers to join farmers' alliances and the Populist Party, which united with silver producers and greenbackers in calling for increases in the money supply. Although there were some concessions to these forces, the defeat of William Jennings Bryan by William McKinley in the presidential election of 1896 signaled the triumph of "sound money" advocates.

The Populists, like other third-party movements in the United States, did not succeed in becoming a governing party, but they were an important source of agitation, education, and new ideas. Many Populist proposals eventually became law, including railroad regulation, the income tax, an expanded currency and credit structure, postal savings banks, and political reforms. While some criticize Populist efforts to redistribute income and wealth, others celebrate the alternative vision of a more democratic capitalism that these farmers and laborers sought to realize.

## Conclusion

Capitalism has had a two-sided character from its inception. Free wage labor coincided with unfreedom. Although capitalism eventually delivered greatly improved standards of living, its impact on people's lives as producers rather than consumers often was less positive. Jobs were deskilled, working conditions could be dangerous, and independence and decision-making were transferred to the employer. With changes in technology and industrial location, new workers were drawn in but old workers were permanently displaced. Rapid economic growth produced harmful environmental effects. Large-scale firms contributed to rising productivity but created potentially dangerous concentrations of economic and political power. Evolution of banking and financial institutions both aided growth and added a source of potential instability to the

economic system.

Eliminating negative features of capitalism while preserving positive ones is not a simple or straightforward matter. As Robert Heilbroner observed, a medical metaphor is inappropriate. It is not possible to “cure” capitalism of its diseases and restore it to full health. Moreover, measures that eliminate one problem can help produce the next. For example, if government spending and transfers provide a “floor” to soften depressions, inflationary tendencies can result. But a historical perspective helps underscore the fact that capitalism is not an immutable system; it has changed in the past and can continue to do so in the future.

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*See also* **American System; Banking; Financial Panics; Industrial Revolution; Industrial Workers of the World; Labor; Populism; Right-to-Work Laws; Trade Unions; Welfare Capitalism.**