A Critique of Capitalism

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Key Terms

1. Governments print currency and sell bonds. They create money without producing anything. Money is legal tender for all debts public and private. It is also the medium of exchange for goods and services.

2. Earned money is paid to workers who produce goods and services. Earned money is also paid to those who produce raw materials, transport, distribute, and sell merchandise and manage businesses.

3. Unearned money is money that nobody works to earn. It comes from interest, net profit, capital gains, and rent.

4. All money, whether earned or unearned, loaned or borrowed, profit or capital, has equal purchasing power.

5. Some capital buys necessities, luxuries, and supports a lavish way of life. But much capital is invested in businesses. They acquire more efficient equipment, patents, intelligent technology, and automation. Thus invested capital increases sales, production, and profits; it creates more capital.

6. Wealth is the accumulation of valuable products and services. Except for land and undeveloped natural resources, wealth regularly decreases through time. Food spoils. Clothes wear out. Houses need upkeep and repair. The fact that capitalist economies enable capital to create capital supports the claim that capitalism creates wealth. But the claim fails to recognize that unlike capital most wealth deteriorates through time.

7. Ponzi schemes take some or all of the money that investors put into a business and distribute it to prior investors. Factual data show that Ponzi schemes are successful business ventures as long as gullible investors keep investing more money in them. When investments cease, Ponzi schemes collapse and investors lose everything. Then Ponzi schemes become crimes.

Abstract

Capitalism is not a natural phenomenon. It is a human creation. It is a theory about the production and sale of goods and services. Part of the income from sales pays the workers. Another part pays the wages of those who produce raw materials, transport and market products, build manufacturing plants, repair and maintain equipment, and manage businesses. A third part is profit that becomes capital. Some capital is spent on necessities, luxuries, and a lavish way of life. But nature limits what the owners of capital buy. Capital does not buy more goods and services than the wealthy can use. Instead capital is invested to increase production and profits. Inevitably there is a mismatch between the products produced and sales. More merchandise is produced than is sold. A constant influx of unearned money that is generated out of nothing is needed to buy the unsold merchandise and keep the economy growing. A growing economy enables money to make more money and capital to generate more capital.

Banks are a major source of money that is generated out of nothing. They lend money that they do not have and then collect interest on the loans. The more money they lend, the more money they make. Banks are a profitable business. However, when loans are so great that interest cannot be paid, loans go into default. Loans become losses. Banks make fewer loans. Merchandise is not sold. Production declines. An economic downturn begins that ends in recession.

Governments are another major source of money that is generated out of nothing. Governments print legal tender. They guarantee the loans of banks that are too big to be allowed to fail. They issue bonds to pay trade deficits and the interest on debt. When bonds and loans are repaid with unearned money, the continuous influx of money that does not produce anything causes inflation. Prices increase faster than wages. Merchandise is not sold. Production declines. And an economic downturn begins that ends in recession.

The goal of this essay is to demonstrate that modern capitalism is incoherent. It is an unworkable economic system. It produces more goods and services than workers and the owners of capital buy. Both banks and governments come to the rescue. They generate the money needed to keep the economy growing. But both fail: it is impossible to create enough unearned money--money that does not produce anything--to sell all the goods and services that an ever growing economy produces.

Preface

This essay repeats many criticisms of capitalism. For example, capitalism concentrates wealth in the hands of a few and distributes what is left among everyone else. It causes continuous inflation. It has cycles of boom and bust. Capital invested in businesses enables them to increase production, expand profits, and create more capital. Capital is money; it is not wealth: most wealth deteriorates while capital increases. No economy can grow continuously. In a finite world, only a steady-state economy is possible that uses a renewable and sustainable quantity energy, land, and resources. In short, this essay supports critics of capitalism.

This essay is written to those who hold capitalism to be an economic ideal or who believe that capitalism can be made to be equitable. The goal of this essay is to demonstrate the internal incoherence of modern capitalism. It eventually causes its own collapse. Thus before a new and viable economic system is possible, the principles that cause the incoherence have to revised or discarded. In fact, the present capitalist economy may already be causing its own breakdown. It may already exceed the capacity of the earth's bio-system to support the present human population at the present rate of economic production. A new economic theory is needed to replace modern capitalism.

Adam Smith created the early version of capitalism. It lets entrepreneurs start businesses that increase production, improve products, and invent new ones. Smith's capitalism has an invisible hand that benefits both consumers and workers. Consumers get better products at lower prices. Workers earn higher wages than they previously earned. However, capitalism has changed. It no longer is the benevolent capitalism of Adam Smith. Karl Marx saw a different kind of capitalism. He noted that workers are paid less than the value of the goods and services that they produce. The sales in excess of all expenses are profits that increase the wealth and power of the capitalists who create and own businesses. The governments use the police and the armed forces control labor and put down strikes. They enforce the property rights of the capitalist owners.

Modern capitalism has changed the nature of capitalism. It no longer is the benevolent capitalism of Adam Smith. And it also is no longer the capitalism of the robber-barons of the nineteenth century who used the power of the state to enforce the ownership and property rights of the capitalist owners. Instead modern capitalism now builds on economic principles that have the status of laws of nature. Economic principles are assumed to be universal, permanent, and self-enforcing. They determine modern corporate and business activity.

All around the world, mass production, new technology, and automation are used to increase production and to make more profit. Empirical evidence corroborates the fact that the executive officers of major corporations obey modern capitalist principles. They increase profits; raise stock prices; they increase the capital gains for stock holders. Those that fail to do so, either go into bankruptcy, are bought out, or merge with businesses that can promote economic growth.

Businesses and corporations everywhere promote global trade to lower costs and to increase profits. They give jobs to people in countries where desperate poverty makes workers accept low wages, long hours of work, dangerous working conditions. They move factories to countries where taxes are low, where there are few environmental constraints, few safety regulations, and no provisions for workers' health care or retirement. They develop real estate; they turn vacant land into streets and building lots. They buy up private farms and turn them into agricultural corporations that hire specialists to manage crop production. They buy out competing businesses and sell off their assets. They merge businesses to increase efficiency, reduce competition, and eliminate redundant employees. They buy the right to produce an established drug and then raise its price tenfold or more. They get a jump on inflation by reducing the size of packaging. They increase profits by buying or controlling petroleum reserves, mineral resources, precious metals, natural resources, and patents. They lobby governments to put higher taxes on wages and low taxes on capital gains. They fund research to get patents that increase profits. They use modern technology and automation to reduce the need for labor. They induce consumers to buy an item and get another free and throw away what they cannot use. Obsolescence engineering produces products that break, cannot be repaired, and have to be replaced. Plastic is an ideal capitalist product: it is light in weight, doesn't rust, and is cheap to make. It soon breaks and a new product is be bought to replace it. They fill the stores with shoddy merchandise at low prices. It becomes nearly impossible to buy durable, repairable, well-made products at any price. Furthermore, businesses and corporations devise all kinds of ploys to increase profits, expand market share, increase profits, and raise stock prices. They pay billions of dollars to lobbyists to induce legislatures to reduce taxes on major corporations and to provide subsidies to promote foreign trade. Indeed, capitalist principles rather than entrepreneurs now determine economic activity.

Indeed, as long as incoherent principles are allowed to define modern capitalism, unfortunate consequences are unavoidable. Wealth is concentrated in the hands of a few that produce nothing. Banks and governments have to generate money out of nothing to buy unsold merchandise and keep the economy growing. There are cycles of economic growth and depression. The constant influx of unearned, non-productive money causes a continuous inflation. Philanthropy and humanitarian aid are needed to assuage the hardship and environmental damage that capitalist economies cause.

The Failure of Modern Capitalist Economies is Logically Inevitable

This essay is essentially a logical proof. Its goal is to prove that two principles which now define capitalism entail the valid and logically necessary conclusion that modern capitalist economies are incoherent. They eventually cause an economic downturn that ends in recession or in a terminal depression.

However, proof of the incoherence of modern capitalism is overlooked. The reason is that its economic collapse is not an immediately observable event. Rather, the collapse is a prolonged and complex process that is still incomplete. Indeed, as unearned, non-productive money is created to buy the unsold merchandise, capitalist economies keep growing and making more profit. Capital is invested to create more capital. Wealth trickles down to improve the lot of the poor. Capitalist economies thrive for a deceptively long time before they eventually breakdown.

The constant influx of unearned money causes non-productive money to become an ever greater part of the money in circulation. In contrast, the money earned by those who produce goods and services becomes a ever smaller part of it. As unearned money dominates the economy, the wealthy who produce nothing acquire more and more wealth. Those who produce goods and services get less and less. Although the argument is complex, it justifies the conclusion valid and logically necessary conclusion that the modern capitalist economies eventually fail: they cease to produce the goods and services that society needs.

Proof of the failure of modern capitalism begins with a statement of its essential principles. The principles give businesses and corporations legal status and that enable stock holders to own them. They also include private property, free enterprise, the free market, global trade, profit, interest, capital gains, and rent. Finally, there are two additional principles that define modern capitalism. One is the principle of continuous economic growth--the principle that businesses and corporations steadily increase production and profits. The other is the principle that money makes more money--that capital creates more capital. Although they are rarely if ever noted, these two defining principles have the status of laws of nature. Professional economists, politicians, and the chief executive officers of major corporations generally hold them to be universal, permanent, and self-enforcing. They now determine business practices all around the world.

The two principles that define modern capitalism work together to increase the efficiency of production, expand sales, reduce labor costs, make more profit, and create more capital. As more workers are hired. Profits grow. The GNP goes up. Despite ups and downs, real estate and the stock market expands over the long term. Money keeps making money; capital increases capital. The wealthy get more and more wealth. The expanding economy enables the poor to lift themselves out of poverty. The incoming tide of economic growth increases the wealth and well-being of everyone. As long as there is a steady influx of unearned, non-productive money, modern capitalist economies fulfill humanitarian ideals. But their success is limited. Their two defining principles make it logically necessary that economic production and profits keep expanding. More and more money is needed to buy the ever increasing economic output of goods and services.

In every economy, however, production and sales have to be in dynamic equilibrium. That is, the cost of production minus the cost of discarding both what spoils and what cannot be sold has to equal the total income from sales. However, neither wages nor capital buy all the goods and services that are produced. For example, only part of the income from sales pays the wages of those who produce, merchandise, transport and market products, maintain equipment, and manage businesses. Indeed, wages often decrease as mass production, technology, and automation increase production and reduce the need for labor. Capital also buys some of what the economy produces. Indeed, the owners of capital buy necessities, luxuries, and support for a lavish way of life. But biology limits what they buy. They cannot eat a hundred meals a day; they cannot call hundreds of mansions home. Instead, they invest much capital to increase production, profits, and make more capital. In short, both workers and wealthy owners of capital leave merchandise that the economy produces unsold.

In order to maintain a dynamic equilibrium between production and sales, money has to be created to buy all unsold merchandise and keep the economy growing. Obviously it is not earned money that is created. It also is not the capital that owners spend on necessities and luxuries. The source of the money that buys the unsold merchandise and that keep capitalist economies growing is money that is created out of nothing, It is money that banks and governments create out without producing anything.

Banks are a major source of money created out of nothing. In the U.S., only 10% of the money that banks lend is secured by Treasury bonds and Treasury bills. Thus 90% of the money that banks lend is money that they do not have--money that does not exist before they lend it. As long as loans do not exceed the 10% limit, the more money banks lend, the more money they make. Indeed, banking is a profitable business. By continually increasing the money supply, they enable consumers to borrow the money that buys all that is produced. Banks create the borrowed money that keeps the economy growing.

Governments are the other major source of money created out of nothing. They governments create legal tender and increase the money supply. They guarantee the faulty loans of banks whose failure would cause economy to break down. They sell bonds to pay trade deficits, to pay the interest on government bonds, to repair highways and bridges, to rush relief to victims of disaster. They lower taxes and increase the deficit lest higher taxes reduce purchases and prolong the recession. Indeed, they steadily increase the money supply in order to keep the economy growing.

But there are limits: the creation of money out of nothing cannot go on forever. Banks, for example, lend money until the loans are so great that borrowers cannot pay the interest. Then loans go into default. Banks stop making loans. Merchandise is not sold. Production decreases and workers are laid off. And recession begins.

Similarly, governments cannot print more and more currency and sell more and more bonds forever. Sooner or later the constant influx of money that does not produces anything causes inflation. As inflated money buys less and less, sales decline. Production decreases and workers are laid off. Indeed, finite world makes it inevitable that modern capitalist economies eventually brings about their own demise: eventually they end in recession or in a permanent depression[1].

The temporary success of modern capitalism supports the deeply ingrained conviction that modern capitalism is an ideal economic system. It supports the prevailing confidence that capitalism creates wealth and enables people to pull themselves out of poverty. But the two principles that define modern capitalism give modern capitalist economies the unique properties of a Ponzi scheme. Indeed, as long as newly invested money keep them growing, factual evidence confirms the temporary success of both. And although there are differences in the character of their collapse, both break down when the supply of new money cannot keep them growing.

Bernard Madoff's is a typical example of a Ponzi scheme that flourishes for a deceptively long time. As long as gullible investors keep investing money in it, it makes a lot of unearned money for the initial investors who get high returns even when stock market is down. His financial acumen was widely acclaimed for almost twenty years.

Similarly, factual evidence shows that modern capitalist economies also flourish as long as they keep growing. Indeed, they succeed as long as banks and

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[1] A interesting anomaly arises when a recession begins. Workers work part time or are unemployed. They buy less. Consumer prices fall as workers buy less. For wealthy investors, it is pointless to invest in businesses that increase the production of products that cannot be sold. It is also pointless to buy mines and petroleum reserves that operate at a loss. A wealthy few have a surfeit of money that they that do not spend on what they cannot use. In short, the fact that both workers and the wealthy owners of capital fail to buy the merchandise on sale causes consumer prices fall. At the same time, the value of investments falls because wealthy capitalists are awash in unearned money that invest in businesses that cannot sell what they produce.

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Again both Ponzi schemes and modern capitalist economies fail when they run out of money that keeps them growing. Madoff's scheme collapsed when the source of the income was revealed. Investors lost their investments and Madoff is spending time in jail. Similarly, modern capitalist economies go into recession when the supply money generated out of nothing fails to buy all merchandise that the economy produces. Production declines. Workers are laid off. Profits cease. Invested capital generates loses. Workers cannot find employment. The economy ceases to produce the goods and services that people need.

Although similarities are essential, there are notable differences. One is that individuals create Ponzi schemes who are responsible for creating the business scheme. When investors stop investing in them, they crash and become crimes. The people who devise them are punished. By contrast, no individuals create modern capitalism. Capitalism is a theory that society invented. Capitalism is just assumed to have the status of natural laws. Factual data enforce its laws. Thus if modern capitalist economies concentrate wealth, if workers are laid off and poverty increases, there is no crime. There is no one to punish. It is up to humanitarian ideals and philanthropic aid to relieve the hardship and need that capitalism makes inevitable.

Another difference is that Ponzi schemes fail completely whereas modern capitalist economies may only go into a temporary recession. As human needs accumulate and as a sound currency is established, another cycle of economic expansion can begin. Banks and governments can create money that does not produce anything. Non-productive money again dominates the money supply. A new cycle of inflation begins. More and more unearned money has to be generated to buy the unsold merchandise. When the supply stops, a downturn begins that ends in recession or depression.

In short, both modern global capitalist economies and Ponzi schemes are essentially alike. Both prosper as long as a steady influx of money maintains economic growth. Their success supports the self-destructive principles that define them. Indeed, it is difficult to reject mistaken principles while they are successful. And both eventually fail. Ponzi schemes fail when they run out of gullible investors. Modern capitalist economies fail when the influx of unearned, non-productive money dominates the economy. Then sales decrease. Decreased sales reduce production. Workers are laid off. The economy goes into recession or depression.

Before modern capitalism can be assessed, the nature of economic theories and of the data confirm them it must be understood. Scientific theories are confirmed by objective, factual data. By contrast, economic theories are confirmed only by the data of human needs and interests; they are even confirmed by such human foibles as tattoos and dyed hair. The difference in the confirming data enable human preferences to refute economic theories and concepts. The only way to overcome the failure of modern capitalism is to discard or revise the two principles that cause economic breakdown. After all, the principle of continual economic growth and the principle of the steady increase in capital and wealth are only human conventions. Society can discard them. Society can invent different economic laws and principles. It can play a different economic game.

The new and viable economy cannot let the owners of capital who produce nothing constantly acquire more capital and increase their wealth. It cannot let workers who produce goods and services get lower wages and have less opportunity for employment. The new economy cannot run on borrowed money. Money that does not produce anything cannot dominate the economy.

The new economy can better fulfill human needs and interests. Technology and automation that increase production and efficiency can raise wages rather than create more capital. Labor-saving devices can save labor rather than make more profit and steadily increase capital. Durable and repairable products can minimize the use of energy and resources and reduce the amount of trash that has to be discarded or recycled. It can be a steady-state economy that avoids cycles of boom and bust. It can minimize repetitive and boring work. It can promote a simple way of life that has a minimal impact on the environment. It can maximize health and freedom rather than wealth and luxury. In short a new economy can improve the social fabric and make life more worth living. ♦