

# THE POLITICAL ECONOMY OF THE DEVELOPMENT OF ADVANCED CAPITALISM

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## Politická ekonómia vývoja rozvinutého kapitalizmu

**Abstract:** *In modern economics it is customary to leave out political considerations from economic models. This paper will try to dispense with this error. I will set up a simple dialectic of the development of capitalism as economic and political phenomena. The ultimate aim of the paper is to explain the reemergence of radical politics in the developed world by using a simple explanatory theory constructed from economic, political and historical considerations. Given that my analysis is correct, I will be able to render an assessment of the likely future development of western capitalism.*

**Keywords:** *political economy, development of capitalism, institutional crises*

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## 1 Introduction

In modern economics it is customary to leave out political considerations from economic models. This preference is justified by claiming that modern economics needs to be exact and scientific, which means that we should exclude uncertain or messy phenomena out of our models.

This exclusion of political considerations from economic discussions is more than academic. Quite to the contrary, it has become a mainstream doctrine that the execution of the most important macroeconomic policy tool (as understood by new Keynesian macro models, (Woodford, [9]) – the price of money – needs to be completely depoliticized. We have set up a system, where the institution responsible for setting the price of money is seen as an entity that needs to be independent from the elected representatives of the society. This is seen as rational and effective because politicians are beholden to the election cycle, which is not synchronized with the business cycle; therefore politicians have an institutional incentive to introduce unreasonable monetary measures.

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This sounds reasonable on its own and it reinforces the belief of economists to be the intellectual defenders against power hungry politicians who want nothing more than to intervene at any point into the market process. But even if the narrative about good willed economists bravely defending the market against the dangerous hand of the government was true, it does not at all follow that the central bank *is* an apolitical instrument or that it *can* become one.

We are living through the greatest crisis of common European institution since the establishment of the European community. Greece and other periphery states are forced into agreements that effectively mean that they are conceding their sovereignty. To whom? These states conceded their sovereignties to the institutions of the TROIKA, meaning the European Commission, the International Monetary Fund and the European Central Bank (ECB). So the decisions about fiscal policy and by extension the funding of every policy of these states is being controlled, evaluated, proposed, and approved partly by the central bank of the Eurozone. Is this apolitical? If we believe that, then we are lying to ourselves. *Could* it be apolitical? Well, considering that the interventions of the central bank have an effect on the market for money, which in turn has an effect on financial markets, on the market for state bonds and by extension on the whole macro economy, every decision of any central bank will have political repercussions. We are lying to ourselves if we believe that it *could* not be so.

Moreover, how do we think that the independence of central banking was established? Was not the establishment of a publicly funded institution which has appointees and tools that are publicly chosen a political event? Was the movement to make central banks more independent in the seventies not a political event?

Phillip Mirowski [5], a well-known and controversial historian of economic thought explains that the so called Nobel prize in economics (which is *not* a real Nobel prize) was pushed for by the Swedish central bank. Why? The Swedish central bank wanted to become independent because the economists appointed may have had a sincere belief that they will do a better job without being beholden to politicians. But monetary policy was rightly considered a political instrument, which means that in a free and democratic society it should be controlled by elected representatives. So, the Swedish central bank tried to establish economics as a possible recipient of the Nobel prize so as to strengthen the public image of economics as an exact scientific discipline so that it would seem reasonable to the public to give the central banks more independence and to leave the decisions about monetary policy to unelected technocrats. The economists played along because it was compatible with their narrative about bad politicians and good economists, the politicians played

along because it absolved them from the responsibility for the economic pain of disinflationary policies of the late seventies and early eighties and the financial markets played along because the new aim of the independent central banks was to be low and stable inflation which is a good environment for traders with financial assets.

So diverse groups, with different but compatible interests came together and by actively and purposefully changing the public's imagination pushed through a new institutional arrangement. This is a text-book case of a political movement.

My point here is that the division of economics and politics is completely illusory even when we are talking about the paradigm case of apolitical economic institutions – the modern independent central bank.

This paper will try to dispense of this illusion. I will set up a simple dialectic of the development of capitalism as an economic and a political phenomenon. The ultimate aim of the paper is to explain the reemergence of radical politics in the developed world by using a simple explanatory theory constructed from economic, political and historical considerations. Given that my analysis is correct, I will be able to give an assessment about the likely future of development of western capitalism.

In the next part I will explain the dialectic of the development of democratic capitalism, then I will use this dialectic to explain the development of 20<sup>th</sup> century capitalism in particular, and in the last part I will use this analysis to give some descriptions of the likely future course of western democratic capitalism and some prescription about what should be done.

## **2 Crises, ideas and change in democratic capitalist societies**

There exists a common dialectic that has captured the imagination of most economists. The economy is a fundamentally and historically free enterprise. There are times in history through which this fundamental freedom is challenged by oppressive forces which would want to take the fundamental economic freedoms away. This is almost completely ahistorical and it is the obvious intellectual outcome of far-right libertarian ideologies in the United States of America, where modern economics was canonized. The one incident in history where this narrative can hold is the revolution of 1917 in Russia and the spread of authoritarian communism in Eastern Europe. No such oppressive attack on economic freedoms by the state was ever made in any advanced capitalist country of the west. On the contrary, the governments of the west were historically speaking responsible for the creation of the *laissez-faire* economy in the first place.

Historically speaking, market societies emerged out of the ineffectiveness of feudal societies, where the gentry and the church were using their god given power to control most aspects of economic life. Given the emergence of production in manufactures a new class was formed – the merchants, or to use today’s language, the capitalists. This development represented a problem for the traditional economic order. The merchants were using their skills to get to economic power through competition in the market. The gentry and the church were old fashioned institutions which had economic power, not as a result of successfully competing in the market, but had economic power given to them as a birth right. An obvious political and economic battle of ideas ensued when the merchants won. Following this ideological win, this win of classical liberalism, the states of every western country instituted anachronistically called market-friendly reforms. They instituted the modern notion of private property; they institutionalized corporations; they enabled the peasants to sell themselves on the new creation – the labor market, and they ended the economic privileges of the gentry and the church and much more than I am able to cite here. To use the enlightening thought of one of the great economic historians Karl Polanyi [7]: “*laissez-faire* was planned”.

*Laissez-faire* policies for which the 19<sup>th</sup> century is known for were not some inevitable return to the true nature of the economy. This thought is just an echo of the “public relations” campaign of the merchants against the gentry that were trying to win the battle of ideas so that the state would institute the reforms that the merchants wanted. Again, none of this was apolitical. This was a conscious choice by some members of the society who wanted to reshape the economy into their image.

I am not saying that the merchants were not sincere in their belief, that the new economic order they were trying to achieve would be better than the old one. That is not the point. The point is that the merchants had a preferred model of the *right* economic order in mind that solved some of the economic problems of that epoch. Acting upon this belief, they campaigned for a change which did indeed happen, and the result was the construction of institutions that mimicked the economic order the merchants had in mind.

This is a concrete example of how the change in democratic capitalist economies takes place more generally. A problem with the underlying economic system emerges, which cannot be overcome by using, at that time, conventional means. This is an opportunity for the emergence of new ideas and for the reemergence of old ideas. A fight of different ideologies ensues, where every ideology tries to give its diagnosis of the underlying problems and of course offers solutions for these problems by the method of offering a new image of the *right* economy. When one ideology wins the battle of ideas, it imposes its version of the right economy on society, which has

tentatively accepted this new version, and the economic institutions of society are reshaped according to the new image. The new mainstream is accepted until another deep problem emerges which cannot be solved by conventional means of the given epoch and a new battle of ideologies ensues.

*Crisis:* A new problem emerges which cannot be solved  
by conventional means



*Ideas:* A battle of competing images of the right economic order emerges



*Change:* One ideology wins, solves the problem and imposes its version  
of the right economic order

### **3 Crisis, ideas and change in 20<sup>th</sup> century democratic capitalism**

The crisis that we ought to begin with, when discussing the political economy of the 20<sup>th</sup> century, is naturally the great depression of the 1930s. It was an epoch of deflation, unemployment, inequality, poverty, and of the decline of the international order. Growth in the international flows of goods and capital was stagnant or declining. A battle of ideas ensued. Each new ideology, each new way of thinking was designed so as to give a diagnosis of the underlying economic problems of society and to offer solutions. With the historical hindsight some of these ideas proposed seem alien to us. But historically speaking, a wide range of ideas was discussed and experimented with: the social democratic model, the capitalist model, the new deal, the syndicalist model, anarchism, the royalist model, fascism, nazism, communism, and many less prominent ideologies. Each provided the societies with a victim that was to blame for the sorry state of affairs. The inequality was at fault, the working classes, the gold standard, the oppression by the powerful, the declining morals of society, the *status-quo* international order, a Jewish conspiracy, or the inevitable downfall of capitalism. The point is not to figure out what the right diagnosis was and what was not. As Mark Blyth [1] argues, the point is that every group is constructing an ideology under conditions of extreme uncertainty about the present, the future and even extreme uncertainty about the past. Each group is shocked about the crisis and each group is constructing simplifying accounts of events that may be locally true or untrue, but that are ultimately too crude, simple and wired in political interests to give an honest account of the situation. But such simplifying accounts are exactly what is needed when the goal is to persuade the public into agreeing with an institutional change whether we are speaking about free societies or autocratic ones (Chomsky, [2]).

Be that as it may, in each state an ideology won the battle of ideas and instituted its desired changes. Some societies chose better than others as can be the case even if all ideologies are very crude and simplifying.

The developed world chose, after the Second World War, to accept the so called “embedded liberalism” model (Ruggie, [8]). According to this model, the world should cooperate in economic matters (as well as in other matters) and should not be constrained by tendencies for nationalistic protectionism. However, the model also recognized that the domestic politics of each country should not be beholden to interests of international capital flows. That is why under this order, even when trade was being liberalized, restrictions on international capital flows were instituted, foreign currencies were given a fixed exchange rate and each country of this order instituted full domestic employment as the most important policy outcome, irrespective of mild inflation. It will not be possible to give a full account of such massive change in the western societies. But let it be said, that upon further reflection it would seem that this new order solved even some problems that were problems in countries that were autocratic in the 30s and from the 50s onwards. But they did it under a system that was internally free and democratic.

Ideas do matter, and it matters what ideologies are victorious, even if it is surely the case that they all are crude and simplifying. All are useful to someone, but some are at least more just than others.

This epoch passed in the 1970s when the underlying economic problem that provoked a crisis was the stagflation of the era. The ideological narrative that was victorious in persuading the public of its correctness was that the stagflation was caused by greedy and power hungry unions that were distorting the markets by pushing labor wages above the acceptable level (Hay, [4]). To give an assessment about what really happened looks to be too difficult. We are living too close to this period to give an unbiased assessment of the situation and are still living through the direct consequences of these changes today. For example, the narrative of power hungry unions is still present, which is shocking given that the movement of unions was pretty much decisively beaten during the last era. To say that unions were strong and influential in the 1970s is to give a true statement about political institutions of the west at that time. To say that unions are strong or even somewhat influential in policy discussions currently in the west is completely untrue and cannot be sustained. But the image of dangerous unions is still alive, which means that we are still in the grips of the ideology devised in the 70s.

The new economic order that emerged out of the turmoil of the 1970s is the order that is currently in the process of dying – called neoliberalism or globalism. During the last decades the political narrative accompanying economic institutions was that the world is becoming inevitably intertwined,

that domestic economic concerns have to be put aside when they conflict with international ones, that capitalists have to have to right to freely move goods, capital and machinery across liberalized global markets, and that any move by unions or other popular groups to somehow mitigate these movement cannot be economically sustained. It has been further argued that the state should not intervene in the market process, that even if it would be right on moral grounds, it would not function on economic grounds because the markets would respond and companies would inevitably leave the interventionist country for another which is more “market-friendly”. The power of the state was diminished during the neoliberal period, which means that everybody is freer (according to the true believers in neoliberalism), but it also means, of course, that the power of something else was increased during this period (transnational corporations – mainly financial conglomerates).

It seems now that this narrative too is becoming null and void. Less and less people are willing to believe in neoliberal ideas. The results came in and they are not what was expected. Neoliberalism was supposed to create prosperity to all. That was its promise. It failed to do so. Inequality in the western world has reached historical levels (Piketty, [6]). Wages were stagnant during the last few decades (which is completely natural given the shift of political and therefore economic power from unions to corporations in the 70s). The level of private debt has reached historical highs as well (generally speaking the level of public debt started to rise only after the great recession, namely after the financial corporations were bailed out by public money – the levels of private debt are rising continuously from the 70s onwards). The average household is going into debt to pay for its home, its education, its healthcare, its car and its basic consumption. Meanwhile, private compensation of the highest wage earners in the economy is increasing even during the crisis. The holders of financial assets have positive and rising returns. The effective tax share of corporations is decreasing. States have instituted tax policies that are shifting the tax burden from corporate and income taxes to consumption and value-added taxes. Corporations are using the liberalized global economy to evade paying taxes – to “economize the tax burden” as it is euphemistically called. The developed states are therefore in a race to the bottom against each other. The willingness to intervene against tax heavens is low, when the growth of tax heavens is historically unprecedented.

These developments have been unfolding now for several decades. The response of the public was to stop caring about politics in general. Voter turnouts are decreasing, given that “it is pointless to vote”, and “nothing will change”. The average citizen does not trust institutions. They do not trust in politicians, in the traditional media or in the corporate marketing machine.

There is a decline of faith in traditional institutions, as the phenomena was named by academics.

Against this backdrop, the biggest financial and economic crisis in three generations happened. Nobody went to jail for obvious financial fraud. Compensations for the super-rich were unaffected. The financial markets did not fundamentally change. And the response of the status-quo establishment was to quote neoliberal scripture. We cannot intervene, except on the behalf of transnational financial corporations which were the immediate cause of the crisis. The public has to suffer austerity by reducing the welfare state, because we “had to” bail out fraudulent financial corporations. Germany “had to” save its banking system, therefore it pretended to help the Greek government by forcing them to go through a crisis deeper than the great depression of the 30s.

The public is just done with the neoliberal narrative. It is over. It cannot be sustained because the fundamental economic reality against which neoliberalism was devised has completely changed. The narrative about the brave entrepreneur fighting against power hungry unions made sense in the 70s. It is completely laughable now. The question therefore is “what is to be done?”.

#### 4 Conclusion

There are some obvious lessons from history. First, nobody really understands what is going on, least the economists. They have been always building *ad-hoc* models to explain past events to be repeatedly shocked by future events, causing them to build new models. The economy is too complicated and too affected by uncertainties.

Second, ideologies are important, because they capture the public imagination, which can then lead to substantial institutional changes in the domestic and international political and economic order. These changes can be for the better, or for the worse. But they do happen, even if the goal of every ideology is to be seen as “inevitable” and “the last one” (Fukuyama, [3]). This was the case for fascism, communism, and it is the case for neoliberalism as well.

Third, the establishment elite of every society is the most indoctrinated into the mainstream ideology (because it is the most educated one), which is why elites are always the last ones to abandon the old ideology. The public is not as concerned with societal questions, so the public is less indoctrinated into the prevailing ideologies of each epoch. Which is why the public can be the force for change, if it feels that some interests were being neglected.

The last conclusion I would want to draw is that historically speaking, the political economy has always worked in a cycle of changing ideologies,



or narratives about the “right” economic order. These are always crude and simplifying and always claim to be inevitable. Once they can no longer solve some “big” problem of its era, they all end. We should be aware of that, and we should participate in the debate, because there are ideologies that truly are worse than others. We should not be closed to change. We should not simply state that the public has gone mad or state that the world has become dumber because of Twitter and Facebook. That is just too intellectually convenient.

Neoliberalism is dying. Let us devise something that will replace it. Let us devise something reasonable that will change some aspects of the economic order, but that will preserve other aspects certainly worth preserving. We can try, although we should retain the historical humility that we will, most likely, fail.

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