Funding the Future

Glossary entry: Capitalism

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On Saturday, I wrote a piece entitled [What is labour was not a cost?](#) It generated a lot of comments, including one noting that I had never written a glossary entry on capitalism, although I had one on neoliberalism. I have now made good on the deficit, with the following entry. This, however, is not a standard glossary entry. It also asks the question, why do we still tolerate capitalism? That builds on the previous article.

Capitalism is an economic system built on a simple but rarely questioned assumption, which is that capital has the ultimate claim on the financial rewards an enterprise generates.

That assumption is so deeply embedded in our economic thinking that we hardly notice it. A capitalist business employs people, buys goods and services, pays interest and meets its other costs. What remains is called profit, and that profit belongs to the owners of capital. Labour is treated as a cost to be deducted on the way to calculating that return.

There is, however, nothing natural about this arrangement. It is not an economic law. It is a choice about how businesses are organised, whose claims have priority, and ultimately who has power.

That is the issue I want to explore here, but doing so requires an important distinction. Capitalism is not the same thing as neoliberalism, which I have defined in a separate glossary entry. Capitalism existed long before neoliberalism, and understanding the difference between them matters if we are to decide whether capitalism can be reformed, or whether something more fundamental has to change.

In the decades after the Second World War, and particularly until about 1980, capitalism in countries such as the UK operated within significant democratic constraints. Governments maintained substantial public services. Significant parts of the economy were publicly owned. Trade unions had real power. Capital movements, most especially internationally, were regulated. Taxes on higher incomes and wealth were high by current standards. Full employment was an explicit policy objective. Capital remained powerful, but it did not have an unquestioned right to organise society around its own interests.

There was, in effect, a compromise between capital, labour and government. Capital expected a return. Labour received wages and had significant economic and political rights. Government mediated between the two, provided public services and social security, regulated markets, and sought economic stability.

That system was far from perfect. Women were denied equality. Racial discrimination was embedded in many institutions. Colonial and post-colonial relationships supported prosperity in ways whose costs were imposed elsewhere. There is no reason to romanticise the period, and I do not do so.

However, what that period did demonstrate was something important. It showed that capitalism could operate within limits imposed by democratic government. It could coexist with strong trade unions, public ownership, progressive taxation, regulated finance and substantial public services. It could also do so whilst delivering rising living standards and greater equality.

Neoliberalism shifted that balance of power across supposed Western democracies. From around 1980 onwards, policy increasingly prioritised capital over labour, markets over government, private provision over public provision, and financial wealth over productive activity. Trade union power was deliberately weakened. Capital controls were removed. Taxes on high incomes and wealth were cut. Privatisation created new opportunities for rent extraction, meaning returns from ownership rather than productive contribution were prioritised. Finance expanded until it came to dominate much economic decision-making. Capitalism became increasingly rentier in character.

But neoliberalism did not just happen. It won, and understanding why matters because there is a temptation to believe that all we need to do now is recreate the post-war settlement and its form of capitalism. I do not think that is enough.

That settlement depended upon particular circumstances. Cold War competition gave labour political leverage. American power structured international trade and finance. The memory of depression and war remained politically powerful. Reconstruction and subsequent economic development maintained employment and provided considerable opportunities for productive investment.

By the 1970s, those conditions were fraying. There was a profit squeeze. Commodity prices rose, partly because of war in Western Asia. The Bretton Woods international financial system broke down, including its system of fixed exchange rates. There was genuine economic instability, and neoliberalism offered capital an answer.

That answer was to weaken labour, remove constraints on capital, reduce taxation, expand financial markets and create new opportunities for private ownership and rent extraction. It worked, at least from the point of view of those who owned wealth.

None of this was inevitable. A substantial political and intellectual infrastructure was created to promote neoliberal thinking. Networks of think tanks, academics, politicians, businesses and wealthy funders spent decades making ideas that had once appeared extreme seem like economic common sense. They succeeded.

That matters now because rebuilding democratic constraint on capital will require more than nostalgia for the post-war settlement. New institutions, political alliances and ways of thinking will be required. But even that will not answer the more fundamental question with which I began.

Why should capital have the residual claim on the proceeds of economic activity?

The conventional answer is that shareholders deserve that claim because they provide risk capital. But workers take risks as well. They can lose their jobs, careers, pension expectations, accumulated knowledge and future earnings when businesses fail. Communities can lose their economic base. Governments can suffer lost tax revenues and incur substantial costs supporting those affected. Meanwhile, limited liability deliberately caps the losses shareholders can suffer.

There is another problem with the conventional argument. Most shareholders in large quoted companies did not provide capital to those companies. They bought shares from someone else. When one investor buys an existing share from another investor on a stock exchange, the company usually receives nothing. The investor has acquired an ownership claim, but has supplied no new finance to the business.

Why, then, should that claim automatically carry entitlement to the residual return from the company's activities?

Accounting makes the answer appear obvious because it reflects the institutional arrangements that capitalism has created. Wages are treated as a cost and deducted before profit is calculated. The return to capital is what remains. Company law, property rights, limited liability, corporate governance and accounting conventions reinforce each other to create a structure in which labour appears as a cost whilst capital enjoys the residual claim.

We could organise things differently. Instead of asking what labour costs, we could ask what return capital needs. Capital could receive an agreed return sufficient to attract the investment required by an enterprise, whilst the remaining surplus could belong primarily to those whose labour created it.

That apparently simple reversal would have profound consequences. It would change the relationship between capital and labour. It would change corporate governance. It would change the distribution of income and wealth. Most importantly, it would change who has power within the enterprise.

There are obvious questions to answer. Who would control the enterprise? Who would decide how much surplus should be reinvested? Who would bear losses? How would workers acquire and surrender rights as they joined and left? How would long-term investment be financed? These are important questions, but they are design questions rather than reasons why change is impossible.

After all, capitalism itself had to answer precisely these sorts of questions. The limited company was designed. Limited liability was designed. Shareholder rights were designed. Accounting rules were designed. The priority afforded to capital was designed. None of these things is a law of nature.

That is why the distinction between capitalism and neoliberalism matters, but it is also why that distinction can only take us so far. Neoliberalism changed capitalism by removing many of the democratic constraints imposed upon capital. We can, and should, restore those constraints. But doing that would still leave the fundamental structure of capitalism intact.

From a Funding the Future perspective, there are therefore two tasks. The first is to restore democratic control over capital so that markets serve people rather than people being required to serve markets. That means challenging neoliberalism and the political power that sustains it.

The second task goes much further. It requires us to ask why capital should have the residual claim on the rewards from human economic activity at all. If we are serious about changing the distribution of economic power, that question cannot be avoided.

Capital does not work, think, create, care or have needs. People do. Capital is a mechanism created by people to facilitate economic activity. It should therefore serve people and the work they do, rather than people and their work being organised to serve it.

That is the real challenge to capitalism. A politics of care and an economics of hope cannot simply ask how capitalism might be made more tolerable. They must ask how we design businesses and an economy around people, the work they do, and the needs they meet.

Labour is not simply a cost. It is how we serve each other. Capital should serve us too.