The Liberal Defence of Capitalism*

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The Liberal defence of capitalism takes two distinct forms in economic theory. One states that the capitalist system operates in a manner that ensures full employment of all resources and produces the bundle of goods it does with *"efficiency"; "efficiency"* here is defined as a state where no more of any good within this bundle can be produced without having to produce less of some other good. This claim of full employment is so palpably false, as the entire history of capitalism, marked by the systematic coexistence of unemployed labour and idle equipment, shows, that Liberal economists who are more honest invoke a second strand of argumentation.

This second strand, while admitting that capitalism does not actually operate in the manner described by the first strand, and that on the contrary it is characterized systematically by the coexistence of unemployed workers and idle equipment, claims, however, that its operation can be rectified through State intervention to make this lacuna disappear. It sees the State as an external entity, standing outside of the system and intervening in its "spontaneous" operation to rid it of its ill-effects.

The Keynesian tradition obviously belongs to this second strand. It shares with Marxism the perception that the system left to itself is indeed beset with crises, and is incompatible with the demands of a humane society; but it differs from Marxism in its belief that the State, even in a capitalist society, can intervene effectively to rid the system of its basic ills. As Keynes had put it, there was no need for the social ownership of the means of production as the socialists wanted; "socialization of investment", by which he meant the use of a set of "central controls" to ensure that the level of investment was sufficiently high to prevent any dearth of aggregate demand at full employment output, was all that was necessary to overcome the basic lacuna of the capitalist system.

I shall not discuss here the Marxist criticism of this position. I shall instead look at the logic of this second strand on its own terms and at how far it conforms to the reality of contemporary capitalism. One obvious question that arises is: how can the State intervene to achieve full employment if the capitalists oppose such intervention? The answer to this question that Keynes had given was that the capitalists would not oppose such intervention since they would also stand to benefit from it, i.e. that State intervention to boost aggregate demand was a "non-zero-sum game", in the sense that everybody could be made better off through such intervention: the workers through larger employment and the capitalists through larger profits that would arise from better utilization of the productive capacity at their command. And even if the proponents of this second strand concede that "full employment" in the true sense of the term would be opposed by capitalists, because of the fear that any disappearance of the reserve army of labour would mean that the workers would "get out of hand", they would still hold that State intervention can push the level of employment much higher than where it would otherwise be on average in capitalist economies operating "spontaneously".

But then the question may be raised: if State intervention to maintain high levels of activity is a "non-zero-sum-game", i.e. works to the capitalists' benefit too, then why has it not been tried earlier? The answer Keynes gave to this question was that there was a lack of theoretical understanding among the capitalists, which is why they viewed State intervention with suspicion or hostility. Once they develop a correct understanding of what produces demand deficiency, which he thought his theory had provided, then hurdles against State intervention in "demand management" arising from capitalists' opposition, would disappear.

Of course, even if they were armed with such an understanding, the capitalists in their individual capacity could not overcome demand deficiency. They had to act in conformity with their "private rationality" (making as much profit as possible) because that is what the market forced them to do. Overcoming demand deficiency required therefore the effort of a supra-individual entity, the capitalist State. And capitalists, though unable to act against demand deficiency in their individual capacity, would not oppose such an effort by the State once they acquired a correct understanding. *Individual capitalists in short were necessarily trapped within the realm of "private rationality"; the only entity that could act in accordance with "social rationality" was the State.*

This however necessarily meant that the State had to act not in keeping with the dictates of the market, not in conformity with market criteria, not in imitation of the market participants, but wholly independent of the market. It had to be in short an "outsider" to the market. And appropriate institutions had to be put in place within the system to make this possible. For several years after the war capitalism did have such institutions in place, of which at least three deserve mention.

The first was State control over cross-border capital flows, which ensured that the State could act without fear of triggering capital outflows, i.e. unconcerned with of what "disgruntled" financiers, who might otherwise have taken their funds out, thought of its actions. The Bretton Woods system allowed countries to have capital controls and all of them did have such controls in place.

The second was that State borrowing to finance the fiscal deficit was not necessarily dependent on "market sentiments". The central bank of the country, in its capacity as the underwriter and manager of public debt, picked up whatever portion of the public debt was not subscribed to by the market. This meant that the government had a free hand in running fiscal deficits without worrying about what the "market" thought about the size of this deficit.

The third was that State expenditure was undertaken in many spheres without the same criteria being applied for judging the worthwhileness of such expenditure as would be applied in the case of private expenditure. Many of these spheres in any case, such as education and health, were primarily within the public domain, so that even the question of comparing the performances of public and private service providers did not arise. And the idea of public providers having to make profits, or raise their own resources, was never entertained. The freedom of the State to spend without being constrained by the "market" gave it a certain leeway to spend as it liked.

All these institutions are now gone. Globalization of finance now means that the State is constrained with regard to the policies it follows for fear of losing the "confidence" of "international investors"; and since such "investors", like finance capital traditionally, prefer "sound finance", i.e. balancing budgets, or at the most running a small fiscal deficit (typically 3 percent of the GDP), most countries now have "fiscal responsibility" legislation that limits the size of the fiscal deficit. Likewise, central bank "autonomy", not just de jure but de facto, means that public borrowing has to obey "market sentiments". Indeed, in groupings like the Eurozone, the fact that the central bank itself is completely outside the purview of the nation-State, has further re-inforced this dependence of the State on "market sentiments" for its borrowings. And with privatization of services, itself a result of the curbs on State spending, public service providers now have to fend for themselves, and are therefore in competition with private ones.

What all this means is that the State, far from being an "outsider" to the market, far from being an embodiment of "social rationality" that could intervene to rectify the functioning of the market which constituted the domain of "private rationality", as the Liberal economic theorists of the second strand had visualized, has itself become a prisoner of the market. It has become absorbed as a market participant to a point where Moody's had once even downgraded the credit rating of the U.S. State. In terms of the Liberal perspective in short, the State has got incorporated into the market, and is no longer an external entity that can enforce a different "rationality" upon the system.

If the first strand of Liberal economic theory was indeed correct, i.e. there was no need for State intervention, and that capitalism operated in a way that ensured full employment and efficiency, then this "incorporation of the State into the market", or an "annexation of the State by the market" (which, from a Marxist perspective, is nothing else but international finance capital pressurizing the State to act exclusively in accordance with its demands), would not matter. But this claim, which is actually put forward as ideological defence of the "annexation of the State by the market" is obviously an absurd one. The prolonged capitalist crisis which even today keeps at least 11 percent of the work-force unemployed in the U.S. (the position is worse in Eurozone and the third world) testifies to the absurdity of the claim.

Since the first strand of Liberal economic theory in defence of capitalism is wrong, and since the second strand of theory is infructuous, because State intervention to rectify the ills of the system, upon which it had pinned its hopes, cannot be resorted to owing to the "incorporation of the State into the market", it follows that there is no Liberal counter-argument against socialism today.

Socialism to be sure has to update its own theory; and the socialist movement is yet to pick up momentum. But the environment within which it has to address these tasks is one where there is no credible Liberal theoretical opposition to it.

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