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AN ECONOMIC VIEWPOINT ON CAPITALISM BASHING

BURNETE Sorin
Lucian Blaga University of Sibiu, Romania

Abstract:

In this paper I discuss two long disputed notions: that capitalism without crises is a fallacy respectively that capitalism bashing, however severe, will not endanger the system itself. Yet proving both is not an easy task since the capitalism issue has always been a cupellation of theory, ideology and political precepts, which are controversial and hard to disentangle. That capitalism detractors are numberless is a truism. Yet criticism against capitalism, however fierce, has always been clearly delineated. Not any more: globalization has rendered the picture dangerously fuzzy. It is now hard to ascertain whether someone who will harangue about the ostensible evils of globalization is also a declared anti-capitalist. The blend of capitalism and globalization seems to be pure dynamite.

Key words: *capitalism, business cycle, depression, crisis, banks, exchange rates*

1. Introduction

Recessions are unavoidable by the same token as wars are: while international policy is a ceaseless string of approaches and clashes among nations, the business cycle involves a recurring succession of booms and busts in economic activity. If the latter could be utterly controlled, entrepreneurship would be piece of cake: entrepreneurs would stay in business for keeps and businesses would work for ever, just like Rolex watches. Yet reality is far starker: markets may fail, governments may take wrong steps, entrepreneurs may miscalculate their chances or miss opportunities and so on. Gottfried Haberler concisely expressed this idea: “The development of our economic life is not an even and continuous growth; it is interrupted, not only by external disturbances like wars and similar catastrophes, but shows an inherent discontinuity; periods of rapid progress are followed by periods of stagnation.” (Haberler, 1996) In a nutshell, sooner or later everyone is doomed to make mistakes. Does it follow that capitalism is wrong in its entirety? That the whole system is doomed? Some tend to believe it is…others do not. Obviously the former only see the empty half of the glass and fail to see the other half, whereas the latter proceed the other way around. In this misty context, the question how seriously dented is people’s trust in capitalism as a system, is most surely legitimate.

The paper is structured as follows: in the 2nd part I discuss a number of theories underlying the genesis and ideology of capitalism, in antithesis with certain counter-theories that mostly focus on its shortcomings. In the 3rd part, I outline the knock-on reactions against capitalism in the aftermath of the Great Depression, which translated into an acute distrust in the markets' self-balancing power and the laissez-faire principle. In the 4th part, I try to emphasize the defects the Bretton Woods system and explain why the rigidity of the latter was the primary cause that paved the way for the big shift toward globalization. In the 5th part I try to describe the resurgence of capitalism beginning with the 1980s but at the same time, to point to the chief factors that led to the 2008 credit crunch. I also included a few theoretical considerations in respect of economic crises, in addition to what is discussed in the 2nd part. In the 6th part, I discuss the topical problem related to the ostensible necessity of reverting to the regulation of economic activity, especially the taming of the financial markets, which might nevertheless herald the end of globalization but not necessarily the demise of capitalism.

2. Fundamentals in a nutshell

In strict economic sense, the terms market economy and capitalism are synonymous, simply designating the same economic paradigm, namely the one in which the economic decision regarding resource allocation belongs to the private firm, not to the state. However, the capitalism term dates to more recent times than the ones that make up the market economy catchphrase. "The word capitalism in its modern sense is only 150 years old." (Kaletsky, 2010) The forefathers of economics did not use it. Adam Smith for example, brilliantly described the mechanisms of market economy, while making no reference to capitalism. The term is hardly found in the works of neoclassical economists either. When did the term emerge then and what was it that made it so popular ever since?

Curiously enough, the term's roots are ideological rather than economic. They can be tracked down in the standoff between socialists and proponents of economic liberalism, which kicked off in the second half of the 19th C and gained impetus in the 20th C. This detail is particularly significant because it provides an insight as to why the word has been more often than not used pejoratively. As Ludwig von Mises remarked, the term was coined by socialists, "not to extend knowledge, but to carp, to criticize, to condemn." (von Mises, 1951) Still, confrontation on the ground of economic theory has been no less fiery, Marxism being the main challenger. The Marxist theoretical scaffolding rests on two props: workers' exploitation by employers (aka capitalists) respectively overproduction that fatally leads to crises. Workers' exploitation to begin with, is achieved by virtue of the so-called surplus-value law, according to which workers' working day is divided into two parts: one, during which they work to earn their own salary; the other, during which, they produce extra value that is entirely appropriated by the capitalists. The surplus-value law underlies the Marxist thesis that capitalism was being increasingly eroded by a fundamental contradiction, namely between the ever more social character of production on the one hand, and the private-capitalist-type appropriation of its proceeds, on the other hand. Obviously, the Marxist view on exploitation is based upon the well-known classical labor theory of value, which nevertheless renders it vulnerable rather than sound. This soft spot was excellently "exploited" by other thinkers, Böhm-Bawerk in particular, who utterly rejected the labor theory of value, contending that Marxist theory proponents' chief mistake resided in their failure to differentiate between two separate concepts: present value and future value of products. Workers, Böhm-Bawerk argues, "*receive their whole product according to its valuation at the point of time in which they receive their wages*. Only in so far as the total wages differ from the final value of the product by more than the amount of interest customary in the country, can there be, under the circumstances, any real exploitation of the laborers." (Böhm-Bawerk, 2012) In brief, the time difference between the two measures of the value of a product helps explain the ostensible surplus value that is appropriated by capitalists, as Marxist thinkers advocate.

As regards overproduction, this concept underlies the Marxist theory of capitalism's crises. "For Marx, capitalist crises are caused by 'overproduction': too many commodities are produced than can be profitably sold, and too much capital has been invested in industry, in the attempt to claim a share of the available profits."[1] When expressed in these terms, the overproduction notion makes little economic sense: it suggests that demand for goods is much less than supply, which is false. In reality, as Keynes pointed out, it is not an extra supply of goods that triggers crises; it is the lack of money, more precisely an increased demand for money for both trade and speculative purposes. "…the dismay and uncertainty as to the future which accompanies a collapse in the marginal efficiency of capital naturally precipitates a sharp increase in liquidity-preference – and hence a rise in the rate of interest." (Keynes, 1997) It follows that the problem of the lack of "effective" demand could be resolved by the intervention of the state through deficit financing. On the other hand, overproduction is not the same thing as under-consumption: the latter is a more meaningful concept, which was explained by Jean Charles Sismondi. According to the great economist, increased competition among producers will generate a gap between total income and total production. "Through improvements from the production method, one part of the workers employed will become a surplus and become unemployed. At the same time, one part of the income of society will have to be reduced. And this lost social revenue will not be compensated for by the slight decease in the price of the newly produced commodities or the gains of the capitalist."[2] Although Sismondi's thesis has its merits for shedding some light upon the under-consumption phenomenon, the concept still remains a fuzzy one, with low explanatory power in respect of causes of economic crises, as emphasized by Murray Rothbard, who asks rhetorically: "…if insufficient spending is the culprit, then how is it that retail sales are the last and the least to fall in any depression, and that depression really hits such industries as machine tools, capital equipment, construction, and raw materials?...An adequate theory of the business cycle, then, must also explain the far greater intensity of booms and busts in the non-consumer goods, or ‘producer’s goods’ industries.” (Rothbard, 1996)

Obviously, the mechanisms of the business cycle, particularly the factors that lead to crises, are harder to grasp than it seems. It is “highly complex”, according to John Maynard Keynes: “In particular we shall find that fluctuations in the propensity to consume, in the state of liquidity-preference, and in the marginal efficiency of capital have all played a part.” (Keynes, 1997) It is hardly surprising then that the business cycles issue aroused heated argument among scholars ever since the early days of economic thought. But the advent of the Great Depression in the late 1920s brought the controversy to a climax. I expand on this matter in the 3rd part.

3. Capitalism under opprobrium: the backlash after the Great Depression

The Great Depression of 1929-1933 was a shocking event due not only to the huge destruction it caused to western economies but also to the fact that its outbreak could not be foreseen. The Stock Market Crash on October 24th, 1929 (Black Thursday) was indeed an immense surprise. Even the most highly-reputed academics were astonished. The case of Irving Fisher, the great American economist, who proved unable to intuit the forthcoming Stock Market Crash, is notorious. On the eve of the crash he still exhibited a candid optimism, which cost him his personal fortune and ruined his academic reputation. However, Fisher redeemed himself soon afterwards by his subsequent contribution to the general theory of business cycles. According to him, “these can be explained by correlating historical events with various tendencies that might prevail at a certain point in time. Such an event may be a chain of business failures or a bank panic, or any other quake that might trigger a crash. Ensuing deflation will make debts more valuable in real terms; because the two phenomena will feed each other the economy will be pushed into a tailspin, after which there is no coming back to the original equilibrium.” (Fisher, 1933)

Clearly, humankind was hardly prepared to cope with a cataclysm the like of the Great Depression, which equally hurt companies, governments and the people at large, causing tremendous havoc to national economies. It is then no surprise that it seriously shook people’s confidence in capitalism. The predicament was the more acute as the system itself was in question. Concepts such as laissez-faire, free markets, free trade etc., were under assault by a wide range of militant movements: socialists, anarchists, ecologists, feminists, protectionists, nativists etc. Still, the number of economists who then took a firm stance in defense of the capitalist system was not negligible. The Austrian school representatives were among the firmest defenders. Basically, what they suggested was that if one wished to make an accurate judgment, one should proceed emotionlessly, that is abstracting from the woes caused by the Great Depression. “If we want a deeper insight into the inner mechanism of our capitalistic system which makes for its cyclical movements, we must try to explain the fundamental phenomenon, abstracting from these accidental events, which might be absent or present." (Haberler, 1996)

However, the Marxists could not miss the opportunity to lambaste the capitalist system for the scourge. In fact, as Rothbard noted, Marx himself had stated that "business cycles were an inherent feature of the capitalist market economy." Yet this was not the core of the dispute; after all, most economists agreed with the idea. Disagreement revolved around the question whether depressions might become severe enough so as to dismantle the system as a whole. Though pro-capitalism partisans never acquiesced in this daunting view, they nevertheless turned out to be divided as regards the way of exiting crises. One group, mostly those belonging to the Keynesian school, believed governments could save the day through interventions in the economy – either through increased spending on public investments in case of recessions or by raising taxes in case of inflation – without yet sacrificing freedom. More specifically, Keynes suggested that in times of slump, governments can prime the economic pump by stimulating consumption. "The state, he argues, will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest, partly perhaps, in other ways." (Keynes, 1997)

The other group, with evolutionist Joseph Schumpeter as most prominent figure, refuted the idea of exiting depressions by means of government spending. Recovery from depressions "is sound only if it does come on itself. For any revival which is merely due to artificial stimulus leaves part of the work of depressions undone and adds, to an undigested remnant of maladjustment, new maladjustment of its own, which has to be liquidated in turn, thus threatening business with another crisis ahead." (Schumpeter, 2009) The Austrian school representatives also rejected the idea that government spending would be a useful countercyclical tool on the account that, once budget deficits become the rule, market mechanisms will no longer work properly. "Government spending is not a method of improving the market's efficiency, nor is it a method of employing allegedly idle resources. The result of government spending is foregone opportunities." (Finegold Catalan, 2011) Moreover, According to von Mises, government interventions are bad regardless their purpose; they will "disturb and eventually destroy the market economy". (Mises, 1998) Briefly, the two types of recipe for possible cure of capitalism crisis, with respectively without government intervention, are visibly thoroughly opposed. "Beneath their diagrams, mathematics and inchoate jargon, the attitude of Keynesians toward booms and bust is simplicity, even naiveté, itself." (Rothbard, 1996)

After the 2nd World War the influence of Keynesianism waxed, which prompted governments to increase their involvement in the economic activity. Consequently, monetary and fiscal policies were increasingly used to stabilize prices, raise employment and accelerate economic growth. I discuss all these developments in the next part.

4. Capitalism in fetters: the constraints of the Bretton Woods system

The Great Depression left a lasting painful imprint in people's minds, due to its unprecedentedly devastating impact on economic life: scores of closed plants, huge joblessness, ruined households, people in deep distress etc. It is little surprise that the hate against capitalism reached record heights in its aftermath. Yet in truth, the system had always been despised, a fact Friedrich Hayek likened to a mythology. Capitalism is often looked upon with distrust and sometimes even with contempt due to "one supreme myth which more than any other has served to discredit the economic system to which we owe our present-day civilization…The widespread emotional aversion to 'capitalism' is closely connected with this belief that the undeniable growth of wealth which the competitive order has produced was purchased at the price of depressing the standard of life of the weakest elements of society."(Hayek, 2003)

After the end of the war, general disappointment in capitalism caused by the Great Depression, made everyone crave order and discipline. The mess left in the wake of the crisis had to be done away with rapidly and, above all, measures had to be taken so that such events to be averted in the future. In fact, such measures implied an overhaul of the whole system. At the time, this meant putting an end to unfettered capitalism, which entailed two radical steps: preventing capital from moving freely across borders respectively freezing exchange rates. Still, how effective the system would be if exchange rates were to be fixed and international capital movement was to become thwarted nobody knew. Despite uncertainty, optimism prevailed. After all, all that mattered was restoring order in trade and financial relations. Eventually order materialized in the implementation of the Bretton Woods system.

The post-2nd WW system enacted at Bretton Woods and enforced by the newly born International Monetary Fund was designed to restore confidence in the international monetary system after the havoc brought about by the Great Depression. This purpose was to be reached through a "set of monetary arrangements that would combine the advantage of the classical gold standard (i.e., exchange rate stability) with the advantage of floating rates (i.e., independence to pursue national full employment policies)." (Bordo, Eichengreen; 1993) Obviously, the solution was a compromise: Bretton Woods negotiations finally led to the adoption of an adjustable peg system, namely a system with fixed but adjustable exchange rates. Since the US was "the center region with essentially uncontrolled capital and goods markets", the US dollar was the center of gravity. Actually, the system was conceived to work on straightforward principles: whereas the US pledged to fuel the system with liquidity by spending massively abroad and lending long term to the rest of the world, its partner countries i.e. the periphery acquiesced to the rules and accepted the dollar as international currency. Moreover, the periphery "chose a development strategy of undervalued currencies, controls on capital flows and trade, reserve accumulation, and the use of the center region as a financial intermediary that lent credibility to their own financial systems." (Dooley et al., 2003) Thus, the marriage of fixed exchange rates and capital immobility was rightfully considered, at the time as the best solution to do away with currency morass that prevailed in the aftermath of the Great Depression and reinstate order in international monetary relations.

As it was expected, neo-liberalism schools expressed little enthusiasm in the Bretton Woods system, which imposed tough restraints on economic liberty. Nor did they believe in the system's overall efficiency. According to Milton Friedman for instance, pegging exchange rates "is not by itself a guarantee of future monetary stability as it happened under the Gold Standard." (Friedman, 1968) Theoretically, central banks could supplant the price-specie mechanism by handling the money supply so as to offset changes in the balance of payments provided they refrain from "'sterilizing' surpluses or deficits and without resorting to open or concealed exchange control or to changes in tariffs and quotas." (Friedman, 1968) Or, as Jacques Rueff put it, monetary authorities of periphery nations had to "effect the contractions in the purchasing power that the free play of the gold standard would have brought about." (Rueff, 1972)

In spite of criticism, the first post-war decades were eminently Keynesian, government intervention in the economy prevailing in both theory and policy. Stimulated by the mighty influence of the Keynesian school, governments widely pursued Keynesian-inspired policies, striving to reach a trade-off between cutting unemployment and containing inflation, with no-negligible success in certain instances. Until the early 1970s, most national economies scored growth and prosperity. In particular, countries that had been all but torn apart by the war like Germany and Japan achieved spectacular recovery. Yet after less than two decades, the system's built-in rigidity took its toll, leading to its abandonment.

Though short lived the Bretton Woods system did secure, at least for a short period, stability in international trade and monetary relations. This was due to the fact that its rules were in compliance with core monetary principles, not least, the incompatible trinity rule, which holds that national economies cannot simultaneously have a fixed exchange rate regime, mobility of foreign capital and an independent monetary policy. (Burnete, 2015) But the system had its flaws, among which, its biased nature was the most serious. For one thing, the United States had been bestowed disproportionately high privileges, for example "seigniorage", that is the right to issue the key-currency. This enabled them to finance their balance of payments deficits by simply printing extra-money. For another, the privilege of the dollar of being redeemable to gold looked fine in theory but in practice it was subject to the United States' ability to cope with increasing conversion demands from abroad. When the Fed got swamped with conversion demands from other central banks, the system crumbled. The core contradictions of the system were suggestively emphasized by Jacques Rueff: "the United States did not have to settle that part of their balance-of-payments deficit with other countries. Everything took place on the monetary plane just as if the deficit had not existed. In this way, the gold-exchange standard brought about an immense revolution and produced the secret of a deficit without tears. It allowed the countries in possession of a currency benefiting from international prestige to give without taking, to lend without borrowing, and to acquire without paying." (Rueff, 1972)

About the accumulated tensions that led to the fall of the Bretton Woods system and the rise of globalized capitalism, in the next part.

5. Capitalism rejuvenated: the deregulation fever of the 1980s

There were two main developments that put further strain on the monetary system after the demise of the Bretton Woods arrangement: the oil shocks respectively the unprecedented indebtedness of the developing world. The two phenomena are intertwined. For one thing, the oil shocks sparked a petrodollars glut, resulting from an upsurge in oil prices. As a consequence, huge amounts of dollars were deposited in western banks, which would loan them to developing countries that were in dire financial straits. Eventually, the build-up of loans ended up in a severe debt crisis in the early 1980s.

The oil shocks affected the supply side of the world economy, with far reaching implications, well described by Gregory Mankiw. Aggregate production slumped due to increased costs of imported oil: manufacturing firms that used oil as primary input (oil refineries, producers of tires etc.) found that their goods had become less profitable whatever the price level. Aggregate supply shrank as a result. In such conditions, regardless of what governments do – intervene or not – prices will go up. (Mankiw, 2008) The resulting combination of production sluggishness and inflation was indeed a sui-generis phenomenon, suggestively dubbed stagflation, which clearly could not be combatted with Keynesian-type policies. Clearly enough, markets could not adjust to the supply side shift unless they were freed from constraints. Therefore, liberty of capital to move across borders was imperatively necessary for production costs to drop sufficiently enough so as to meet aggregate demand. On the other hand, freedom of capital was probably the only solution to the debt crisis that finally exploded after 1980. Developing countries' debt service had piled up to such a high level that it virtually annulled their export earnings. In such conditions, what debtor countries needed was by no means extra-loans to prolong the predicament they were undergoing but foreign investments to rekindle their economies. In summary, with money circuits clogged up, the world economy was choking. Governments' hands were tied because Keynesian-type policies would no longer bear fruit. Globalization seemed to be the only way out.

Globalization ushered in a different kind of international division of labor, based less on specialization in products and more on specialization inside value chains, namely in various stages of the production process. Globalization-induced production sharing was suggestively depicted by Krugman et al. (1995): "a good is produced in a number of stages in a number of locations, adding a little bit of value at each stage". Industries became much more mobile due to increased possibilities of offshoring, i.e. the subcontracting of intermediate or final goods by western firms to enterprises in less developed countries. (Feenstra and Hanson, 1996) Production processes can be broken down into "separate parts that can be located in countries in which factor prices are well matched to the factor intensity of the particular fragments" (Jones, Marjit, 2001). Offshoring has two contradictory effects: on the one hand, it allows firms to cut back on labor costs by employing lower wage workers; on the other hand, it is a major reason of discontent for low skilled workers, mostly in developed countries.

In principle, the changes induced by globalization were made possible by a radical shift in both economic policy and economic thought. On the policy side, governments were showing increasing propensity toward deregulation, implying the removal of barriers against capital circulation in parallel with the opening of national economies to international competition. On the theoretical plan, while the Keynesian doctrine was on the wane, the neo-liberalism current was gaining ground only to become preponderant in the early1980s. This overarching shift is embodied in a set of principles, or rather prescriptions, known under the name of Washington Consensus (coined by British economist John Williamson), that are meant to prime the economic pump and secure macroeconomic stability. The new “gospel” has been the most influential view regarding the types of policies that are conducive to economic growth and prosperity for the last three decades.

In spite of the ostensible “consensus”, the Washington Consensus sparked a great deal of controversy among scholars. According to the initiator, mentioned earlier, the term was not meant to be a synonym for neoliberalism; it was intended to describe a technocratic policy agenda, not an ideology. Technically, the term designates a set of policy reforms that reduce the role of government, “such as privatization and the liberalization of trade, finance, FDI, and entry and exit.” The said principles, Williamson contends, do not “imply a swing to the opposite extreme of market fundamentalism, and a minimalist role for government but that is what seems to have been assumed in the rather simplistic way in which such ideological issues are debated, or at least in the way which came to be assumed as a result of the ideological debates of the 1990s.”(Williamson, 1999) Yet contrary to the author’s stated intents about the meaning of the Washington Consensus terms, it was widely perceived as an elitist ideology underlying the globalization process. “In the view of many skeptics, this broad ‘neo-liberal’ agenda has been deliberately designed to serve the needs of the rich at the expense of the poor.” (Crook, 2006) Still, the most blamable aspect about the Washington Consensus was that its principles were included on the agenda of important international agencies like the World Bank and the International Monetary Fund, which used them as strings attached to loans offered to a host of developing countries. “In the longer term, this kind of development – in effect, on terms dictated by the rich countries – saddles the developing countries with crippling debts.” (Crook, 2006) The reasons for discontentment were admirably dealt with by Nobel laureate Joseph Stiglitz: “the Washington Consensus policies were designed to respond to the very real problems in Latin America and made considerable sense…The problem was that many of these policies became ends in themselves, rather than means to more equitable and sustainable growth. In doing so, these policies were pushed too far, too fast, and to the exclusion of other policies that were needed.” (Stiglitz, 2002)

Beyond ideological arguments, one fact cannot be denied: under globalization, capitalism rejuvenated. During the last two decades of the 20th C the world economy witnessed a number of neo-liberal changes e.g. resurrection of free markets, soaring foreign investment etc., which yielded compelling growth and prosperity, especially to western nations. The US economy grew most spectacularly, "…during the 1990s productivity took off; by decade's end it was rising faster than ever before in American history, and wages had ended their long stagnation." (Krugman, 2004) It is quite understandable then, that the glorious 1980s and 1990s are widely considered a triumph, not of capitalism in general but of American capitalism, which became hegemonic on a world scale, as stressed by Nobel laureate Joseph Stiglitz: "With globalization came the spread of American-style capitalism to all the reaches of the world". (Stiglitz, 2003)

As I emphasized earlier, according to the business cycle theory, triumphs are usually short lived. During prosperity spells, seeds of self-destruction will be sowed and there is only a question of time until bust will strike. This is precisely what happened in the first decade of the 20th C, when capitalism again underwent an extremely tough crisis. I deal with it in the next part.

6. Capitalism again in straits: the 2008 meltdown and the banks' sin

Since the 1930s, many a crises discontinued at intervals the smooth functioning of the world economy, but none of them equaled the Great Depression in terms of either geographical reaches or damage. Yet by mid-2007, the specter of a new economic earthquake became apparent. As 2008 Nobel laureate Paul Krugman remarked in one of his recent books, "while depression itself has not returned, depression economics – the kinds of problems that characterized much of the world economy in the 1930s but have not been seen since – has staged a stunning comeback." (Krugman, 2009) Admitting the essence of financial crises resides in the interrelation between over-indebtedness and deflation, then the credit system and monetary policies are most certainly, at their origin. However obvious this might appear nowadays, economic thought had to come a long way before attributing a critical role to such forces, which had been regarded as dependent variables of economic activity. (Rothermund, 1996)

Almost hundred years ago Irwin Fisher argued that debt-deflation spirals are unavoidable. Their most likely cause resides in speculative manias, which "gather speed through expansion of money and credit." (Kindleberger, 2005) But why does an expansion of money and credit occur in the first place? Financial disequilibria, according to Keynes, "usually occur because the monetary authority is unable to size the quantity of money created, through the handling of the interest rate, due to its propensity to deal only in short-term debts." Alternatively, the Austrian School representatives point out that on a free and unhampered market, the interest rate is determined purely by the 'time-preferences' of all the individuals that make up the market economy…"People's time-preferences, argues Murray Rothbard, also determine the extent to which people will save and invest as compared to how much they will consume…Since money market equilibrium is set by the market forces, central bank interventions – aimed at stimulating credit expansion by increasing the central bank's liabilities and implicitly, the commercial banks' reserves – artificially lowers the rate of interest in the economy below its free market level." (Rothbard, 1996) "The implication, according to von Mises, is that investment projects, especially those initiated in the production of capital goods will look more valuable, more attractive than they would be under normal conditions. (Mises, 1996)

An important point the argument between Keynesians and Austrians highlights is the ambiguity of the role played by central banks. On the one hand, their independence from governments allows them to guard price-stability thereby acting as a bulwark against inflation. On the other hand, they often assume the additional task of banking-system supervisor. It is this second role of central banks that is controversial: are they just overseeing the functioning of market mechanisms or, by virtue of their authority, actually hampering it? Empirical evidence suggests that central banks that are not directly responsible for banking supervision have scored better results in terms of price stability maintenance. (Siklos, 2002) The explanation is straightforward: banking supervision impedes central banks from properly performing their basic task of lenders of last resort, which is to offer loans at high interest rates.

If central banks' role is ambiguous, commercial banks had almost certainly a contribution to the cooking of the crisis. As Joseph Stiglitz recently remarked, banks have shown that they can't manage their own risk, and the consequences for others have been disastrous.[3] Many people may find this idea astounding because it points to the fragility of a system deemed sound enough to be trusted. Yet it is not an overstatement; it simply reflects the manner in which the banking industry works. Banks operating on a free, deregulated market will be faced with the risk-shifting problem, deriving from the nature of competition. The banking market is an imperfectly competitive one, due to the existence of various types of frictions such as switching costs, network effects and asymmetric information, prevailing in both deposit and loan sectors. (Thakor, Boot; 2008) Banks' behavior is influenced not only by the nature of competition but also by its intensity. Most of the studies so far have shown that the increase in the number of banks operating on the same market will produce perverse effects with regard to risk taking: as profits decline the bank's preference for risk increases. (Allen, Gale; 2004) Faced with more intense competition, banks will see their rents dwindling (because of every loan is valuing less) and this fact will render them more willing to finance riskier projects. Furthermore, the propensity toward risk-taking will be even stronger when deposits are hedged against risk through insurance schemes. (Thakor, Boot; 2008)

In brief, increased inter-bank competition will negatively influence bank's profits thereby prompting them to take more risks. However, it would be wrong to consider competition as the primary cause for banks' fragility and implicitly, for banking crises. On the contrary, a monopoly bank can more easily become subject to a run (as compared to a competitive one) because of its lower capability and higher opportunity costs associated with the turning of storage assets (reserves, securities etc.) into liquid ones. (Thakor, Boot; 2008) Consequently, monopolistic banking systems tend to be associated with a higher probability of a crisis than the competitive ones. (Boyd, 2004) It must nevertheless be noted that, under normal conditions, storage assets liquidation will not occur; it only becomes a generalized, contagious phenomenon under panic conditions, when banks are overwhelmed by excessive withdrawal demands. A number of contemporary studies have shed more light upon the implications of this phenomenon, generally called “asset bubbles” (Allen, Gale; 2003), characterized by a swelling of asset prices. Since banks accept various types of assets (including stocks) as collateral for the loans they offer to their customers, they get involved into a risk gap: their assets carry ever more risk while their liabilities are fixed. When bubbles burst, the system as a whole is in jeopardy.

The harshest lesson one can draw from the past is that banks should not be let to fall for they will most likely drag the entire economy in debacle. Prompt authority intervention by pumping liquidity into the system won’t solve the problem but it might contain the losses. As Milton Friedman pointed out, the chain of bankruptcies that struck the US banking system in the early 1930s could have been contained had the newly-created Federal System decided to buy large amounts of government bonds…Unfortunately, the Fed’s actions were hesitant and small. In the main, it stood idly by and let the crisis take its course – a pattern of behavior that was to be repeated again and again during the next two years. (Friedman and Friedman, 1990)

Why must banks not fall? The explanation is related to the circulation and handling of information, which, as Hayek has pointed out, is critical in the functioning of the free market; handling information in a decentralized manner is the only way markets can work optimally. (Hayek, 1945) Banks play an essential role in financial markets for this precise reason: they can collect necessary information about business prospects and can anticipate fairly well good loans from bad loans. “When banks cut back on their lending, no one else can step in to collect this information and make these loans.” (Mishkin, 2007) In brief, with the banks still working, governments don’t have to face the impossible task of centralizing and analyzing all the information about the financial system. Banks’ activity is thus “a bulwark against uncertainty about the current state of the economy, which is a chronic problem for policymakers.”[4]

In summary, globalization has rejuvenated capitalism only to bring theoretical confrontation about capitalism to an apex. On the right side of the spectrum, the neo-liberal prescriptions enshrined in the Washington Consensus have been “forcing the replacement of the traditional varieties of capitalism with a one-size-fits-all neo-liberal version of market capitalism.” (Schmidt, 2002) For neo-liberalists, globalization has long been equivalent to the end of history. On the left side, the sense of grievance against capitalism is now at its height. Still, the latter’s anger seem to be pointed toward global capitalism rather than capitalism itself, which means that globalization is to blame for most of today’s hardships.

The 2008 meltdown has brought economic theory of capitalism to a turning point. I briefly deal with this matter in the last part.

7. Capitalism reinvented: back to overregulation?

When economic troubles surface everybody's attention turns to the public authority. Never will people's expectations be more tightly linked to political leaders than in times of crisis. Between "governments should do nothing" and "governments should do everything", the range of dos and don'ts recommended by pundits is incredibly broad. But even if one admits – in the light of history's lessons – that governments must grapple with crises, policy makers will still be faced with a double dilemma: how to design an intervention without falling in the trap of utopia, on the one hand; how to regulate the financial system after the crisis has ended without falling in the error of overregulation, which might impede the market's smooth functioning, on the other hand.

The first dilemma can be explained through the so-called "nirvana fallacy": when comparing the real world's fallible markets either with utopian self-sufficient markets or with no less utopian, ostensibly omnipotent governments and bureaucracies, one makes a logical error. (Demsetz, 1969) In the first case, the unhampered market vision, searching for solutions that completely exclude the government is erroneous because it fails to distinguish between an ideal and the real world. On the other side, those who call for immediate government action, claiming that no one else could save the day are equally mistaken. Bureaucracies are no less fallible than private entrepreneurs; both will pay a toll for human errors and have imperfect knowledge.

The second dilemma becomes conspicuous when regulation (an old buzzword) begins to race up the political agendas. Governments are expected not only to solve ongoing crises but to find means so as this sort of economic mess should never happen again. In other words, people will ask for a more efficient regulation of the financial system. In fact, what we are witnessing today is a reversal of the re-regulation trend that prevailed in the 1980s and 1990s: people at large wish that banks and financial institution be under stiff monitoring. "The collapse of Enron in 2001 arguably marked the end of the age of deregulation, which began in the late 1970s, and the beginning of re-regulation. The financial crisis of 2008 served to reinforce that trend."[5] Yet how far the re-regulation trend will push, or to put it another way, how long the re-regulation fashion will endure, is hard to predict.

8. Conclusions

Capitalism hides a paradox: it is the best performing yet the most harshly slammed economic system ever. Popular catchphrases like "rotten capitalism" or "wicked capitalists" belong to a popular mythology, which is deeply rooted in people's mind-set all over the world, including western countries. Interestingly, both the high economic performance and the fierce criticism have been caused by the business cycle, an inherent trait of the system. In times of boom, economies thrive, jobs are in plenty, incomes increase and people are happy. By contrast, during depressions, the opposite occurs: economies stagnate or slump, jobs become scarce and people get in the throes of falling incomes and shortages of all sorts. It is natural then that capitalism to be equally praised and detested.

Globalization has rendered the gap between booms and busts even wider. It is understandable then, why in theory, anti-globalists are also capitalism detractors, while in in terms of policy, the pendulum has long swung between overregulation and deregulation. Such divergences will be likely to drag on…

Notes

1. Socialist voice nr.19 (Summer 1983), https://www.marxists.org/history/etol/newspape/socialistvoice/marx19.html
2. S. Kuruma, An Introduction to the Study of Crisis, first published in *Journal of the Ohara Institute for Social Research* (vol.VI, nr.1), https://www.marxists.org/archive/kuruma/crisis-intro.ht
3. J. Stiglitz, "Markets can't rule themselves", *Newsweek*, special edition issue 2009, pp.52
4. B. Bernanke, "Monetary Policy under Uncertainty", *Panel Discussion* sponsored by the University of Missouri Columbia, July 31st 2007, pp.411-412
5. The rise of the corporate colossus threatens both competition and the legitimacy of business, *The Economist*, Sept. 17th, 2016

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