Capitalism or the Market Process?

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Abstract

For academics and like-minded influencers, capitalism serves as a benchmark for success. As such, they critique historical and contemporary institutions for their lack of it. But as they define capitalism, it should not be used as a benchmark. Historical economics and comparative institutional analysis are hindered for the simple reason that capitalism is often equated to fixtures, such as property rights, capital markets, or equality of freedom. This paper aims to resolve said hindrance by advocating for banishment of the word (capitalism) from economic dialogue and removing capitalism as a benchmark for success altogether. In doing so, economists and academics alike may more accurately represent and explain past phenomena and contemporary institutional issues.

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1. Introduction

By most—if not all—standards for material prosperity, the past was awful. The further back, the worse the average person lived. That much of the world has become wildly rich is beyond much debate. But knowing how we got rich matters; not just for settling pedantic arguments, but so we may continue enriching. McCloskey and many like-minded theorists of the Smithian tradition have equated enrichment to liberalism and capitalism. But in doing so, they forego economics. While liberalism and capitalism are typically good heuristics for increasing material prosperity,[2] they are just that: heuristics, and ones that don't properly identify a causal relationship between enrichment and its progenitor—whatever that may be.

To encourage economic thinking and discourage erroneous critiques of the past, this paper posits a banishment of the word—capitalism—from economic dialogue and removing capitalism as a benchmark for success altogether. To this end, I provide multiple examples in which the aforementioned terms—and consequent thinking—have stunted development in economic literature. The main argument of this paper rests on whether any fixture—like property rights, capital markets, of equality of freedom—is universally wealth-generating. My conclusion is that they are not. This paper also rivals explanations of the great enrichment proposed by free-market and liberal economists and promotes more economic approaches to analyzing historical phenomena.

2. The Issue

When Leeson (2012) wrote about medieval ordeals, he used economics. He approached a phenomenon and asked, "why did this work?" While people would typically view a superstitious ordeal—one that involves hands in boiling water—as chaotically crazy, Leeson explained why this pattern of behavior persisted using rational choice theory. Ordeals effectively determined guilt in cases where evidence was slim to none. In approaching *any* situation, an economist should do the same as Leeson: identify a pattern and use economic logic to discover the underlying mechanism that produces benefit to decision-making actors. But economists often neglect this responsibility when looking at the past.

Richard Ebeling—former president of the Foundation for Economic Education (FEE)—argued that free fairs in Medieval Europe were examples of "capitalism" in a time of economic oppression (Ebeling 2016). Free fairs were rare opportunities in which merchants were allowed to trade without being subject to price controls and (sometimes) tariffs. Indeed, free fairs invoke an image of capitalism; they were markets in the simplest sense. But was Ebeling correct to critique feudalism on the grounds of free fairs' rarity? Ebeling wrote:

"Even with emerging appreciation and recognition of property rights and legal contract relationships for commerce and exchange in the towns, the economic system was one of strict

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[2] Jeffrey Sachs has made a career of telling governments to, essentially, privatize. Whether his reasons are correct is debatable, but he has enjoyed much success by employing this heuristic (Sachs and Lichtenfels 1992).

regulation of prices, production, and employment through the craft and professional guilds." (Ebeling 2016).

Descriptively, Ebeling is correct that prices and production were regulated. But his emphasis that appreciation for property rights was "emerging" is most troublesome. Ebeling's implication is that property rights were not appreciated before, but slowly discovered. He also proposes the state of the market at the time—rife with price controls and similar interventions—as a bane to the progress of "capitalism." These conclusions not only lack economic logic, but are antithetical to it. Though it seems like a value-free description of medieval political economy, Ebeling's article is actually a critique of feudalism for not being capitalism. In other words, he's not doing economics.

An economist would approach free fairs and ask, "why doesn't this happen all the time?" Implicit to Ebeling's work (and the work of many contemporary economists) is the assumption that property rights were routinely infringed upon by feudal leaders. Acemoglu and Robinson (2012) describe feudal-like institutions as extractive and thus poverty-inducing. McCloskey (2006; 2010) attributes past poverty (and lord-peasant relationships) as a consequence of false and exploitative beliefs, like that of lords being "better" than peasants, which keeps lords relatively rich at the expense of peasants. Mises carries a similar critique to Ebeling, but extends it even to contemporary developmental issues:

"[L]iberalism and capitalism were even in their heyday limited to comparatively small areas of Western and Central Europe, South America, and Australia. In the rest of the world hundreds of millions still vegetate on the verge of starvation. They are poor or paupers in the old sense of the term, supernumerary and superfluous, a burden to themselves and a latent threat to the minority of their more lucky fellow citizens. The penury of these miserable masses of—in the main colored—people is not caused by capitalism, but by the absence of capitalism" (Mises 1949, 842).

While capitalism and liberalism serve as platonic ideals for Ebeling and McCloskey in critiquing the past, Mises—quote aforementioned—takes this implication further in trying to explain poverty in the modern world. Thus, the issue this paper addresses not only concerns conceptions of the past, but also our ability to help the contemporary world.

What these economists are propagating is a theory that ignores economics. Instead of assuming efficiency and trying to explain, they compare states of the world to ones that assume away transaction and information costs. They are committing the nirvana fallacy. A lack of capitalism and liberalism, whatever their adherents may claim the words to mean, is not an adequate explanation of market and non-market phenomena for the realm of economics.

3. The Solution, and an Appeal to Economics

Definitions of capitalism vary, equating it to capital markets, voluntary transactions, private property, equality of freedom, or any combination of the aforementioned. But none of these are helpful definitions for economic analysis because wealth-maximizing behavior can be explained without the presence of these items. Many societies have lacked capital markets; feudalism in Eastern Europe, for example.[3] But from this we cannot assume that Eastern Europe was

[3] In Eastern Europe it was common for peasants to not own land, or even the capital goods required to farm (plows, cattle, etc.).

operating out of efficiency; economics is about asking why Eastern Europe lacked capital markets, not saying it should have done better.

Private property and voluntary transactions are also not universally wealth-maximizing. Indeed, it can be possible to have wealth-reducing property rights (see Leeson and Harris 2018), and emergent orders utilizing force or coercion are still wealth-maximizing patterns (see Leeson 2014). While it is probably a useful heuristic to assert that stealing and murder are bad, we still can—from an economist's perspective—explain phenomena assuming these items are wealth-maximizing.

Friedman (1962) emphasizes the role of capitalism in individual (political) freedom; *many* economists similarly do so. But just as with the previous definitions of capitalism, there are organic orders which depend on a lack of political or economic freedom. None of this is to precisely say that capitalism has a bad definition (whatever that may be); in fact, these definitions sound perfectly descriptive of freer, contemporary markets. But with these definitions of capitalism, the word cannot be used to critique past or, in some instances (such as that of Leeson and Harris 2018), present institutions. The logical conclusion is to banish the word from economics.

If one's argument is that property rights incent decision-makers toward proper resource usage given relative scarcity (cf. Alchian 1965), or that property rights allow for efficient coordination a la price mechanisms (cf. Mises 1920), then one should make that specific argument. Invoking capitalism when one really means property rights is superfluous. Using the word capitalism as a catch-all for characteristics of a free market has damaged the science for the lack of accountability it affords its users.

The same is often true for liberalism, which so far this paper has treated synonymously with capitalism. Both are cop-outs to not use economics. McCloskey, by her own admission, is not using economics to explain the great enrichment; instead she argues that liberalism ideologically changed the modern world, but this appears equally fallacious as appealing to capitalism to explain poverty. McCloskey argues that economics *can't* explain the modern world. But as examples in the next section will show, there is reason to believe it can.

Ultimately, capitalism and liberalism are both used by economists as an excuse to not do economics. If doing economics—something economists should probably aspire to do—is "good," then the profession should stop appealing to these words altogether. As a matter of policy recommendations perhaps these terms are useful as heuristics, but that is methodologically divorced from economics. Economists should instead look for clues of *the market process*, even when no exchanges are occurring. This may seem contradictory, since the market process has traditionally been understood as one with exchanges, but there's no useful distinction between an emergent order with exchanges and one without. Perhaps it would be useful to call this the "non-market process," but that implies a difference with the market process—a difference that doesn't exist. Even without prices or exchanges, marginal benefit can equal marginal cost; there can be equilibrium, and in fact, there demonstrably is. The market process, whatever one defines it as, is merely an extension of the assumption that man maximizes benefits and minimizes costs. Man can maximize and minimize with or without exchanging. Thus, economists should look for the market process (maximization of benefits, minimization of costs) wherever humans act, not just where property rights and capital markets are prevalent.

The following subsection illuminates one example of a historical phenomenon better explained by employing economics, in lieu of appealing to capitalism or equated fixtures. With this example it is evident that economics *can* explain many historical phenomena that, due to an attachment to free-market tendencies, economists overlook.

3.1. The "Dark Ages" and the Rise of Castles

The fall of the Roman Empire is often referred to as a cataclysmic event in world history and is often cited as the impetus for the "Dark Ages." But an economist should be unconvinced; not only that this fall caused a dark age, but that a dark age even occurred. An assumption seems prevalent in literature that Rome enjoyed property rights and—consequently—trade, and that Rome's fall was responsible for a *lack* of those items. Haskell wrote of the Pax Romana:

"Property was protected and trade routes made safe. Both private and public exploitation of the provinces was limited by the organization of an efficient and honest imperial service that gradually spread throughout the world. Finally, Transportation was developed to a point that was not again reached in Europe until the advent of steam in the nineteenth century" (Haskell 1947, 20–21).

Haskell is descriptively correct that the Roman Empire protected property and trade routes, but that does not mean the world fell into peril and loss when these provisions faded. There may have been *some* losers—perhaps long-travelling traders depending on property rights to secure their living—but the loss of property rights could be indicative of something quite the opposite: that Rome's extension of property rights was untenable.

Much like the Austrians' defense of the "bust" in the boom-bust cycle (ABCT), a loss of property rights may reasonably be a correction of investments. In the Roman case, the malinvestment may be the long-term provision of property rights to places which would never spontaneously give way to the same enforcement. In other words, the cost of enforcing property claims in German forests (back then) would ridiculously high, but the Romans did this anyways.[4] Indeed, it promoted trade. But the traders were conferred rents at the expense of the Roman tax base. There is no evidence to suggest—nor does it seem intuitively likely—that this exchange was beneficial for Roman citizens (or whomever the tax burden laid on).

Coats and Pecquet (2013) have a wonderful paper explaining the decline of Roman conquests, but they don't expand into this point about property rights. They dutifully explain the individual incentives in *conquering* areas—essentially for loot—but they don't explain why anybody ever stayed there, and further provided so much defense. Why did Roman laws extend so far? After the fall of the Empire in the west, the beginnings of "feudalism" emerged as local elites hired armies to protect property and establish manors (Ganshof 1961); Vikings, oddly, did the same exact thing in Normandy—that is, they founded estates in which villagers lived and enjoyed a protection of property (Haskins 1966). This would suggest that Romans stayed in frontiers to bestow rents—property rights—upon those that resided there. Presumably some

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[4] It is odd that nobody has used Hadrian's Wall to make this point. The Romans built and staffed an eighty-mile defensive structure to protect the entirety of England when their interests resided only in a few settlements and fortifications. The rest of England free-rode on this (albeit partial) provision of property rights. I cannot imagine the Roman tax base profiting from this.

Roman generals, governors, or politicians benefitted from this, otherwise it would not have occurred. This would be a wonderful research project.

After the Romans (or Byzantines depending on the time and place) ceased their provision of property rights, these frontiers gradually developed an alternative system: castles. From 700 AD to 1200 AD—give or take—castles and similarly-purposed fortifications sprung all around Europe, and the provision of which was not always the impetus of some lord or king. Consider the Hauteville brothers of the tenth century, who began as landless sons of a Norman knight and ended as counts in Italy by building castles. There are many similar stories from the Middle Ages. Castle construction settled Europe and provided property rights—and social mobility—to peasants. The logic was this: a wealthy lad—let's call him Adalberto—finds a forest and thinks "this would be a splendid farming community, if not for the bandits and raiders." Adalberto builds a fortification in the forest—let's call it Canossa Castle—and presumably hires some soldiers to staff it. Nearby peasants then face a decision: stay as a day laborer, or leave and establish their own farm around Canossa. Many peasants migrate and pay taxes (in-kind or otherwise) to Adalberto.[5] This isn't to say that the taxes were voluntary—they were certainly extorted by threat of force—but taxpayers' alternative was being taxed elsewhere but with lesser wealth. And so, in the vacuum of the property rights the Romans provided, the frontiers of Europe were settled by a kind of emergent order—castle construction.[6]

And so, the so-called "Dark Ages," loosely defined as a degradation of progress in Europe, was probably not so bad. But this can only be explained if one foregoes the critiques that Mises and others levy on historical institutions. Also notice that, while early feudalism notably lacked some private property rights or voluntary exchanges, the market process is still clearly evident in the emergence of castle construction; the incentives of involved parties led to an order that efficiently produced safe lands for farming, This system—feudalism—also allowed for a geographically narrow provision of property rights, which is undoubtedly more tenable and less costly than providing property rights to everybody in an entire landmass.

4. Conclusion: Capitalism or the Market Process?

This paper is a call to action. Economists should use economics to explain phenomena. Often it is easier to employ other means, but the optimistic economist—this author—believes that most human action can be explained by man's maximization of benefits and minimization of costs. Talk is cheap, to the dismay of political scientists and philosophers everywhere. Thus, explaining major historical events using political philosophy is unlikely to yield productive results. This may actually explain why capitalism is invoked so often; in fact, it seems charitable to treat it as an equation to property rights. It is regardless a futile method of explaining the world, and even some contemporary issues. Mises wrote that:

"All civilizations have up to now been based on private ownership of the means of production. In the past civilization and private property have been linked together. Those who maintain that economics is an experimental science and nevertheless recommend public control

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[5] This is a real example. Adalberto Atto constructed Canossa castle around 910 AD and became the "Count of Canossa." His direct descendent, Matilda of Canossa (Matilda of Tuscany) played an important role in the investiture controversy, and Canossa Castle was the site of Henry IV's famous "Walk to Canossa," where he sought absolution from the Pope after being excommunicated.

[6] This the premise of my working paper, tentatively entitled "Castlemania: How Europe Settled."

of the means of production, lamentably contradict themselves. If historical experience could teach us anything, it would be that private property is inextricably linked with civilization. There is no experience to the effect that socialism could provide a standard of living as high as that provided by capitalism." (Mises 1949, 264-265)

One can agree with Mises' points on socialism, but Mises is committing the sin this paper is hoping to discourage. Property rights are not inextricably linked to civilization. While property rights are certainly correlated with extremely advanced and prosperous civilizations, that does not mean a past—or even contemporary—civilization is poor specifically because of their lack of property rights. It seems that property rights—and capitalism, whatever that may be defined as—only develops when it is less costly (more beneficial) for it to do so. If true, this is a profound realization. But one that can only be discovered by accepting that capitalism is no benchmark of comparative success. In the question of "Capitalism or the Market Process?" the choice should always be "the market process."

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