

Eugenie Joseph

Why we should defend capitalism





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POLICY Paper 12

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Introduction

Capitalism has become a controversial idea in recent years, even though we in Australia — along with most of the developed world — rely on the market economy to supply us with jobs, incomes, and essential goods and services. It was the father of modern economics, Adam Smith, who wrote of capitalism:

It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.

Yet, many in capitalist economies — particularly Millennials and young people — have lost sight of this fundamental fact or simply associate capitalism with excessive consumption. In effect, capitalism is having an identity crisis. Prominent economists such as Joseph Stiglitz have become vocal critics, decrying the capitalist system as fundamentally flawed. American economist Jeffrey Sachs has declared capitalism to be unsustainable through its destruction of the natural environment. Pope Francis has labelled capitalism the “new tyranny” and condemned the “absolute autonomy of markets.”¹

Even the elected leaders of prosperous countries with market economies are quick to join the anti-capitalism

bandwagon. New Zealand Prime Minister Jacinda Ardern has proclaimed capitalism a “blatant failure”² while Conservative British Prime Minister Theresa May has spoken of unethical companies as the “unacceptable face of capitalism.”³ Even United States President, Donald Trump, is no fan of free trade — the vehicle for successful capitalism — which he blames for destroying local jobs and industries.

Disturbingly, these messages appear to be resonating with Australian Millennials — the majority of whom have a favourable view of socialism, according to recent polling by The Centre for Independent Studies. Yet, this is not surprising in some respects. How can Millennials defend our economic system, when they do not understand it?

Given the identity crisis of capitalism, it is timely to highlight once again the proven record of capitalism in destroying poverty and creating shared prosperity — which alternative systems such as socialism have repeatedly failed to achieve. Therefore, this paper outlines what every Millennial should know but are too afraid to ask about capitalism: its proven record in eliminating poverty and creating shared prosperity in Australia and around the world.

What is capitalism?

Capitalism is commonly defined as an economic system in which the means of production is privately owned (rather than government owned) and used to generate profits. However, a more intuitive definition is a system where individuals have the freedom to engage in private enterprise and trade.

Indeed, the self-interest motive inherent in capitalism (that is, the motive of earning reward for oneself and one's family) is essential to the proper functioning of markets so people can engage in the mutually beneficial exchange of goods and services. The pursuit of profit is fundamental to spurring good ideas, innovation and inventions.

A great strength of capitalism is also its ability to adapt to the rule of law. Unlike other systems, capitalism can successfully function within the democratic rule of law and is compatible with individual rights. In fact, that is why capitalism can still work within the constraints of regulation. Indeed, it is why Australia can have a market economy, regulated by corporate standards, anti-monopoly laws and consumer protection laws.

At the same time, capitalism cannot properly work without the rule of law and respect for private property rights. Law and order are essential to a market economy. There is a clear reason that extreme poverty is associated with war-torn countries: without stability, people cannot easily engage in trade and entrepreneurship.

It is also important to clarify what true capitalism is not. It is not so-called corporatism or crony capitalism, where private enterprises benefit from government protection and a lack of competition. In such cases, businesses are able to make profits by charging high prices or producing sub-optimal quality without the fear of market competition, rather than by satisfying consumers.

Benefits of global capitalism

Global capitalism can be defended on many fronts; but its most important impacts have been on reducing global poverty (thereby improving the quality of life for billions of people) and supporting the emancipation of women around the world. These effects are analysed in the following sections.

Fighting global poverty

Capitalism is defeating poverty

Undoubtedly, the greatest impact of capitalism is in reducing global poverty. The facts speak for themselves. Two centuries ago, 94% of people lived on less than the equivalent of \$2 (USD) per day.⁴ Now, less than 10% do.⁵ In fact, the United Nations reported that global poverty fell more in the second half of the 20th century than the preceding 500 years.⁶

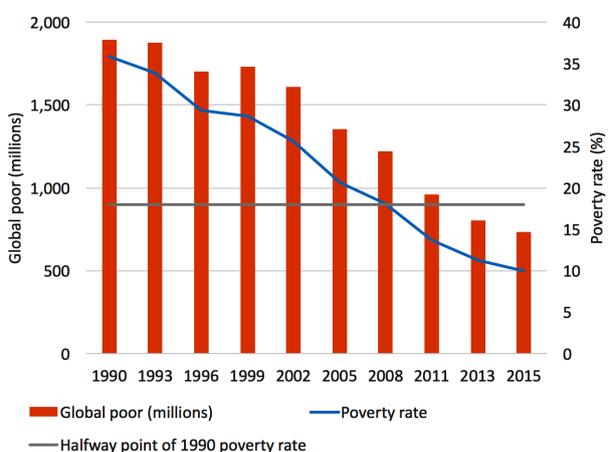
In developing regions, the proportion of people living in extreme poverty fell from 47% in 1990 to 14% in 2015. Since 1990, more than 1 billion people have been lifted out of extreme poverty.⁷ In fact, the UN's Millennium Development Goal to halve the world poverty rate by 2015 was reached five years ahead of schedule (Figure 1).⁸

According to the World Data Lab, more than 90,000 people are still escaping extreme poverty every day.⁹ This incredible phenomenon is visually and powerfully brought to life through the online World Poverty Clock.¹⁰

However, despite this positive story, there are still small pockets of the world — particularly Sub-Saharan

Africa — where extreme poverty is either stagnant or worsening. In such cases, sadly it is largely due to war, conflict or political authoritarianism; as they impede commercial activities, stable trade and economic development.¹¹ Similarly, extreme poverty in the Middle East — despite being relatively low compared to Sub-Saharan Africa — has worryingly increased from 2.6% to 5% since 2013, again due to regional conflict.¹² For economic markets to flourish, it is clear that a certain amount of political stability is essential.

Figure 1: Global poverty over time



Source: World Bank

The global middle class is also booming

The good news is not limited to the global rapid decline in extreme poverty. We should not fall into the trap of assuming most people experience income stagnation once their income reaches \$2 a day* — that is certainly not the case. According to the progressive think tank, the Brookings Institution, millions of the global poor are joining the middle class each year — with much of this growth occurring in India and China.¹³

In fact, for the first time in recorded history, over 50% of the global population (some 3.8 billion people) can now be classified as middle class or wealthier.¹⁴ Global inequality is falling on an unprecedented scale thanks to the booming global middle class. Of course, any definition of 'middle class' is subjective, but in this case, it is defined as households that spend between \$11 and \$110 daily per person, with sufficient income for some discretionary spending.

The growing global middle class does not have socialism to thank for all of this. It is the free exchange of goods and services through open trade and entrepreneurial capitalism. Only by allowing access to markets and international trade can countries lift their citizens out of abject poverty. Even modern China — nominally a communist regime — is a powerful example of what is possible when enterprise and markets are allowed to flourish.

Human wellbeing is also improving by other measures

The state of the world is improving by other indicators too. Around 2.6 billion people gained access to safe drinking water between 1990 and 2015.¹⁵ Consequently, over 90% of the world's population now has access to safe drinking water.¹⁶ The United Nations' goal to halve the proportion of the global population without access to safe drinking water by 2015 was achieved five years early.¹⁷

Thanks to improved health and nutrition, life expectancy for the average person has improved dramatically over the last 200 years. Before the 19th century, life expectancy in Britain stagnated between 30 and 40 years.¹⁸ However, by 1900, life expectancy in Britain (at the forefront of modern economic development) had reached nearly 50 years and grew exponentially throughout the 20th century.¹⁹ This trend was replicated across many other countries. Between 1960 and 2015, global life expectancy increased from 52 years to 72 years.²⁰

Living standards and quality of life

Capitalism has not just reduced extreme poverty; it has also improved the quality of life beyond recognition over the past 200 years. By countless measures — health, sanitation, life expectancy, education, literacy — life for the average person on earth has improved immensely.

For Australians, this truth is particularly salient. Life expectancy for Australians has surged from 49 years in 1890 to 82.5 years today,²¹ while the death rate from cancer has fallen by more than 24% in the last three decades.²² Australians are more educated than ever; nearly 29% of us have university degrees now, up from 7% just 30 years ago.²³

Thanks to the market economy, most Australians enjoy almost limitless choices today — choices that were once only available to the very richest or did not exist at all. These choices extend to entertainment on demand, global communications and information — a limitless repository of knowledge at our fingertips, all at the click of a keyboard.

Nearly 90% of Australians now own a smart phone; which was cutting edge technology just 10 years ago and unaffordable for many people.²⁴ Australians are travelling overseas more than ever, undertaking more than 10 million international trips in the last year, with the majority being holidays.²⁵

But we should be reminded why we have these choices. Governments do not supply us with our mobile phones; we buy them from private companies. Australians do not queue up at a charity kitchen for their weekly fix of sashimi or Thai curry. They go to private businesses and enter into a free market exchange. Indeed, this is how capitalism works in practice; and overall the system works remarkably well.

* Note the internationally-recognised poverty line of \$1.90 is expressed in terms of Purchasing Power Parity in US dollars. Thus it does not refer to \$1.90 USD spent in the United States (which can purchase relatively little), but \$1.90 USD converted to the local currency of very poor developing countries (which can purchase enough to avoid extreme poverty).

Emancipation of women

The impact and benefits of capitalism for women cannot be overstated. Firstly, capitalism produced household innovations which have unshackled women from housework, freeing them to pursue education and work outside the home.

Even the humble washing machine we now take for granted was a game-changer. Until the spread of the automated machine in the twentieth century, washing clothes represented hard, manual labour for women. A little more than a century ago, as many as 200,000 women in Britain washed clothes for a meagre living, compared to a minuscule number today²⁶ — a change that no one today would lament. In the United States, women have gone from spending almost a whole day each week washing clothes,²⁷ to less than 20 minutes a day now.²⁸

Secondly, private enterprise has been the means by which many women have gained economic opportunities and autonomy. Bangladeshi economist Muhammad Yunus recognised this when he established the Grameen Bank, pioneering the practice of providing micro loans to women in developing countries. The bank now lends to nearly nine million people — 97% of whom are women.²⁹

Thirdly, economic development is strongly associated with women gaining legal rights and equality with men. That is, economic autonomy for women is often a precursor to gaining equal rights. The United Nations' Human Development Index shows that gender equality and women's rights are strongly associated with higher income countries (Figure 2); that is, countries with lower GDP per capita tend to score higher on gender inequality.³⁰

In fact, it is often the least developed countries where women face barriers to employment, such as requiring spousal permission to work outside the home. Significantly, family law reforms in Ethiopia in the early 2000s — which lifted restrictions on

women working outside the home — were found to be effective. Women were more likely to be employed in paid jobs five years after the reforms.³¹ In short, economic development and women's rights tend to work hand in hand.

Even aid assistance provided by the United Nations now has a greater emphasis on creating economic opportunities for women — recognising the importance of private enterprise in fighting poverty. For example, under a UN development program, a mother in Bangladesh is provided with a loan that enables her to start a grocery business and invest in kid goats to raise and sell for a profit. Consequently, her family goes from eating just one meal a day to three meals a day.³²

Furthermore, it is clear that women have greater economic opportunities in market economies. During the twentieth century, female participation in the workforce grew significantly in most developed nations.³³ In Australia, the labour force participation rate of working aged women increased from around 44% in the late 1970s to a record 60.5% today.³⁴

Women now have more opportunities than ever to work in professional fields. From a negligible number a century ago, women now make up over 50% of lawyers³⁵ and over 40% of medical practitioners in Australia.³⁶ Women also account for more than a third of all Australian business owners and operators today.³⁷ It is clear, therefore, that women's participation in the market economy has been instrumental to gaining autonomy and independence.

Sustaining a growing population

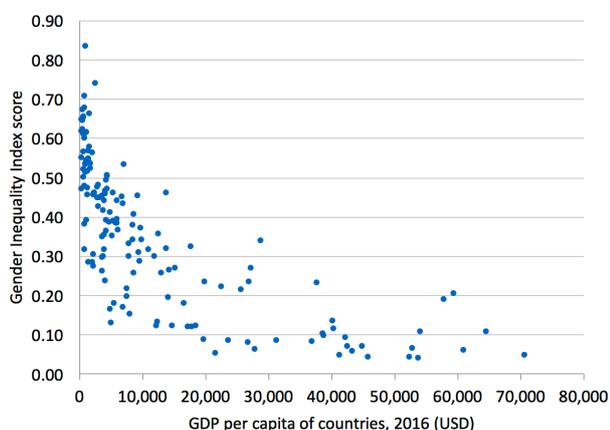
The other remarkable achievement of capitalism has been its ability to sustain a rapidly growing world population since the 19th century. It took hundreds of thousands of years for the world population to reach one billion around 1800. Then in just another 200 years or so, it grew to more than 7 billion.³⁸

Yet, global poverty and hunger rates have managed to decline dramatically in recent decades, despite rapid population growth. The Malthusian scenario has never eventuated. Why is this? The answer is technology and market-driven innovation in agriculture. Technology created the so-called 'green revolution' in agriculture, which consequently has been able to sustain billions of people.

Farming productivity has boomed, leading to astronomical growth in the amount of food produced globally. The value of global agricultural output (all food and non-food crop and livestock commodities) has more than tripled since the early 1960s.³⁹

Land is also being farmed more efficiently now, with more food being produced per acre of land. For example, wheat and rice yields have nearly doubled

Figure 2: Economic development and gender equality



Source: United Nations

in Australia since 1961.⁴⁰ In fact, the world has become so efficient at farming that agricultural land use has actually been falling across Europe and North America—while only growing slowly in other regions.⁴¹

Due to agricultural productivity, the price of food declined significantly between the 1960s and early 2000s.⁴² With rising incomes, the poor can also afford more food and more nutrition. In the past three decades, calorie consumption has been rising in developing countries, while undernourishment rates have fallen across much of the developing world in the last 20 years.⁴³

It should also be acknowledged that rapid population growth over the past two centuries is actually *symptomatic* of improved prosperity—largely reflecting the proportion of people surviving to adulthood. The United Nations cites two factors in particular: advances in modern medicine and improvements in living standards.⁴⁴

Combined, these factors have reduced mortality rates of mothers and children; meaning more people are surviving to adulthood and old age. Longer life expectancy explains why the global population is still growing, despite a decline in fertility rates globally since the 1960s.⁴⁵

Capitalism in Australia

Capitalism has supported economic growth for the benefit of all Australians

In Australia too, the positive effect of capitalism is clear. Australia experienced remarkable economic growth over the twentieth century, which has supported the phenomenal rise in living standards for ordinary Australians.

Per capita GDP has grown on average by 1.9% annually since the 1970s, while national disposable income per capita (a better measure of Australians' economic wellbeing) has increased by an average rate of 1.8% (Figure 3).⁴⁶ As a result, Australia now has the tenth highest GDP per capita in the world.⁴⁷

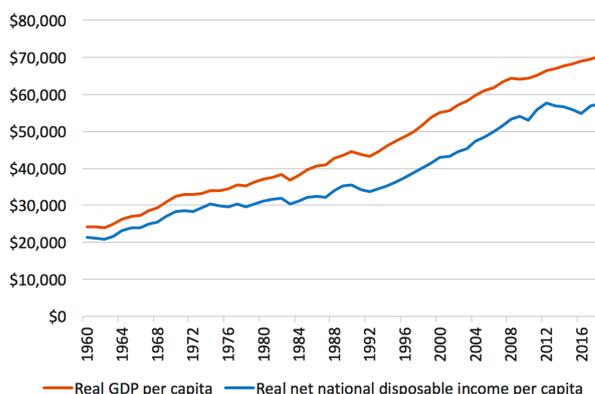
And generally, aside from recessions, unemployment rates have been low throughout the twentieth century—with more than enough jobs available for the rapidly growing Australian population. Over 80% of Australian workers are employed in the private sector, indicating the success of private enterprise in delivering jobs for Australians.⁴⁸

Furthermore, the creation of jobs in service sectors has more than offset the decline of employment in traditional industries such as agriculture and manufacturing. Over time, the quality of jobs has also improved immensely; becoming more interesting, highly skilled, less mundane—and safer.⁴⁹

Moreover, Australians across the income distribution, including the poor, have experienced real income growth over the past 30 years (Figure 4).⁵⁰

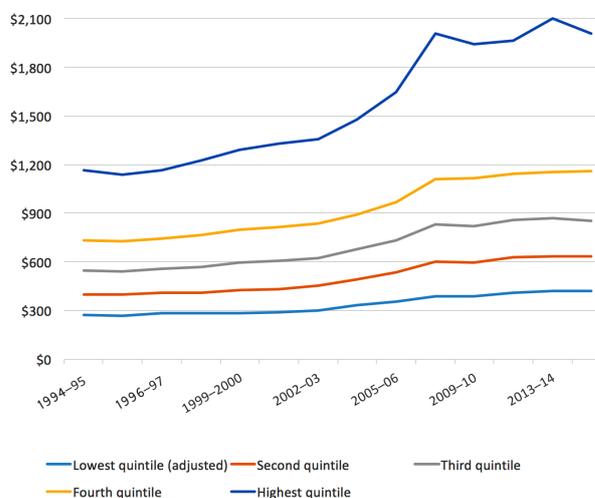
Furthermore, each new generation of Australians is earning more income than the last generation at their age, including Millennials.⁵¹

Figure 3: Real net disposable income and GDP per capita - Australia



Source: Australian Bureau of Statistics

Figure 4: Average Australian household income over time



Source: Australian Bureau of Statistics

Inequality is not the problem we imagine it to be

Nevertheless, there is still a common perception that inequality is increasing in Australia. However, this pessimism is not supported by observable data. In fact, income inequality has actually declined slightly in the past 10 years. In recent years, there has been no consistent trend in the Gini coefficient—a common statistical measure of income inequality—over the past two decades (Figure 5).⁵²

A certain degree of income inequality is easily explained by lifecycle effects, ie, Australians earning more or less income at certain stages of their life. Economic mobility in Australia is also high—the rich do not always stay rich and the poor do not always stay poor.

Arguably, poverty should be a greater concern than inequality. But in terms of poverty, it is generally a positive story too. Policy makers tend to focus on relative poverty, but that is not always an accurate gauge of material deprivation—as it is defined as having income less than 50% of median household income. When Australian household incomes rise, the relative poverty rate can also rise—even if the poor are no worse off than previously.

Rather, it is more useful to compare poverty rates over time, based on a benchmark. For example, the Productivity Commission compared the poverty rate over time to the median income (in real terms) in 1988. By that measure, the poverty rate in Australia has fallen from 9% in 1988 to just 3% in 2015.⁵³ Furthermore, the majority of impoverished Australians do not remain poor for more than three years.⁵⁴

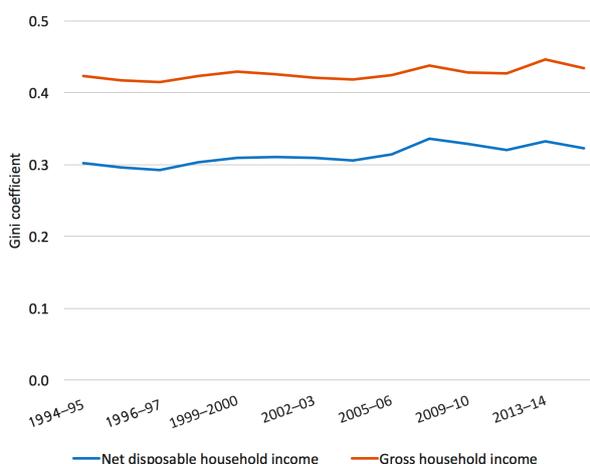
Free market reforms have been essential to Australia's continued prosperity

It is also important to remember why Australia has experienced prolonged prosperity. In part, it is thanks to market-oriented reforms introduced by successive governments—both Labor and Coalition—largely between the 1980s and early 2000s. Over that period, Australia became an open, free trading economy, which has supported productivity growth and the rise in living standards that Australians enjoy today.

Key reforms included the floating of the Australian dollar and lifting of capital controls. Deregulation of the financial system was also significant: opening up the banking sector to international competition and removing controls on bank loans and interest rates.⁵⁵

Labour market reform was also a critical part of this economic reform era, starting with the Accord agreement between the government and unions in the 1980s. Australia transitioned over time from a system of centralised wage fixing to enterprise wage bargaining. These reforms improved the flexibility of the labour market, supporting the efficient allocation of labour across industries.⁵⁶

Figure 5: Income inequality in Australia over time



Source: Australian Bureau of Statistics

Trade liberalisation—phasing out trade tariffs, import quotas and industry assistance—was also essential to driving productivity growth and reducing the price of consumer goods for Australian households. The Centre for International Economics (CIE) has estimated that the real income of an average Australian family was \$8,448 higher in 2016, due to the effects of trade liberalisation over the previous 30 years.⁵⁷

Successive Australian governments also pursued ambitious reforms of Australia's tax system, which included broad cuts to company and personal income taxes and introducing dividend imputation to prevent double taxation of profits.⁵⁸ In 2000, the Howard government introduced the Goods and Services Tax (GST) as a broad-based consumption tax to replace various inefficient state taxes.

A further key reform was the privatisation of government assets in the 1990s to encourage market competition and productivity growth. Major privatisations included the national airline Qantas; Australia's largest bank, the Commonwealth Bank of Australia, and telecommunications provider Telstra. The National Competition Policy, a suite of microeconomic reforms in the 1990s, were estimated to have boosted Australian GDP by 2.5% and contributed to the productivity surge of the 1990s.⁵⁹

Reforms of monetary and fiscal policy also occurred at the tail end of Australia's economic reform era. In 1996, the Howard-Costello government formalised the independence of the Reserve Bank of Australia in setting monetary policy. The government also established the Australian Prudential Regulation Authority (APRA) in 1998 to promote the stability of the financial system. Successive governments also developed principles for responsible fiscal management, including the need to restrain government spending and promote national savings.⁶⁰

Common criticisms of capitalism

Failure of capitalism or government?

However, despite its proven benefits, capitalism remains a popular target of blame for the problems we face in Australia.

The Royal Commission into financial services unveiled problems of excessive greed and unethical or even illegal practices within the sector. Many Australians, even on good wages, struggle to gain a foothold in the housing market—a problem commonly blamed on speculative housing investors. At the same time, not everybody enjoys the benefits of our economic prosperity, with around 700,000 Australians experiencing entrenched socio-economic disadvantage.

But do these problems reflect a failure of capitalism? Or is it the failure of governments, regulators and communities? For example, government planning policies have restricted the supply of new housing and hence contributed to rising house prices. According to the Reserve Bank of Australia, as much as 42% of the price for a home in Australia can be attributed to zoning restrictions.⁶¹

The banking Royal Commission has also exposed persistent failures by financial regulators to enforce the law, with financial firms getting off with light penalties for breaking the law. At the same time, well-meaning but ineffectual social policies to support disadvantaged families can ultimately keep them trapped in an intergenerational cycle of poverty. In short, capitalism is used as a scapegoat for the moral failings of governments, regulators and individuals.

The environment

Another persistent criticism of capitalism is that it destroys the natural environment and represents unsustainable depletion of the world's natural resources.

However, this ignores the observed patterns in the economic development of countries around the world. It is certainly true that the least developed countries have the lowest emissions, but that is nothing to applaud when their citizens are most likely to experience extreme poverty.

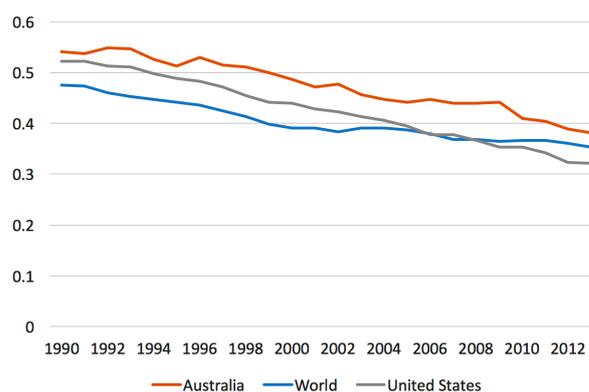
As developing economies grow, they tend to reach a 'tipping point' in the development cycle, beyond which they start to become more energy-efficient and less carbon-intensive.

This is borne out by the evidence. The carbon intensity of advanced economies has been steadily falling since 1990 (Figure 6).⁶² This is mainly due to improved energy efficiency and the growing use of natural gas and renewable energy sources.

In fact, carbon dioxide emissions have stabilised in many advanced nations—and in some cases, even decreased in recent decades. The United States is a surprising example of this—total carbon dioxide emissions have dropped by 14% since 2005, due to the transition towards shale gas.⁶³

Figure 6: CO₂ intensity of economies

Carbon dioxide (CO₂) intensity of economies measured in kilograms of CO₂ per unit GDP (2011 international-\$).



Source: Our World in Data and World Bank

Other environmental indicators show the same phenomenon. For example, deforestation trends are reversing in advanced economies. The annual rate of global deforestation has slowed from 0.18% in the 1990s to 0.08% since 2010.⁶⁴ The United Kingdom now has more forest than it did prior to industrialisation.⁶⁵

Advanced economies also have more effective waste management systems, designed to minimise the impact of plastics and other materials on the natural environment.⁶⁶ These trends are clear—as economies become more prosperous, they also become more effective at protecting the natural environment.

At the same time, we tend to forget the natural environment has always posed dangers for human beings. In fact, it is only economic development that has dramatically reduced these risks to humans.

For example, the global death rate from natural disasters has fallen in recent decades from as many as three million deaths annually to as few as 20,000 in recent years, thanks to development that has made housing safer and human survival easier during times of natural drought.⁶⁷

Another example is indoor air pollution—caused by unsafe cooking fuels—which contributed to the deaths of more than two million people in 2016.⁶⁸ Only access to safe and affordable energy can mitigate this risk for the poor. In other words, economic development is necessary to protect humans from environmental dangers.

Socialism vs capitalism

With the fall of communism in Russia and Eastern Europe and the economic rise of China, the market economy has emerged as a dominant system in the modern world. However, capitalism has distinctly fallen out of favour with younger generations in many western countries. A recent survey by The Centre for Independent Studies found that 58% of Australian Millennials had a favourable view of socialism.⁶⁹ Similar views have been reported in the United Kingdom and United States.

This is the challenge facing societies in advanced economies: how to retain faith in the market economy. For Australians, one possible approach is to simply compare the system we have to non-capitalist alternatives, such as Venezuela, North Korea, Zimbabwe and Cuba—all countries we would clearly not wish to emulate.

In Venezuela, the mass nationalisation of industries and utilities under President Hugo Chavez between 1999 and 2013 has proven catastrophic. The result? A developing humanitarian crisis, hyperinflation and the mass exodus of Venezuelan refugees. In fact, three million Venezuelan refugees have fled the country's socialist regime – an incredible 9% of Venezuela's entire population.⁷⁰

There is also a common misconception that the Nordic countries are socialist economies. But this is far from the truth. In fact, according to the World Bank's Ease of Doing Business Index, it is harder for a private enterprise to operate in Australia than in Norway, Sweden or Denmark.⁷¹ It is also easier to start a business in a Nordic country than the United States.⁷²

Some of the most globally recognised private enterprises have originated in the Nordic region—including Ikea, Maersk, Lego, Skype, Ericsson, H&M and Volvo. Notably too, Nordic countries have lower corporate tax rates than Australia. The corporate tax rate is 23% in Norway, 20% in Finland and 22% in both Denmark and Sweden.⁷³ Even the Prime Minister of Denmark has felt the need to clarify that his country is indeed a capitalist economy:

I know that some people in the US associate the Nordic model with some sort of socialism. Therefore I would like to make one thing clear. Denmark is far from a socialist planned economy. Denmark is a market economy.⁷⁴

Of course, the Nordic countries show it is possible to have a market economy combined with a system of generous social benefits. The two are not mutually exclusive, but the point is that social expenditure programs are only possible because of revenue collected from businesses and workers employed in the market economy. In other words, a social welfare system is not possible without capitalism.

Conclusions

Capitalism—that is, economic markets and free enterprise—has been the bedrock of prosperity around the world, not least in Australia. It is only through innovation, ideas and technology—generated and spread through capitalism—that populations have been able to lift themselves out of abject poverty and improve their quality of life.

However, it has become all too easy for Australians to take this economic system for granted. Even worse, it is easy to forget or remain ignorant of the prosperity created through capitalism, and start dreaming of a socialist utopia that only exists on paper. Given the sympathetic views of socialism among Millennials, a timely reminder is needed about the proven benefits of capitalism—and the human misery caused by socialism in countries such as Venezuela.

Under capitalism, life for the average person on earth has improved by so many measures—health, life expectancy, education, personal choices and employment. Economic development through

capitalism has lifted billions out of poverty and into the global middle class. Women, too, have been the major winners of capitalism—providing them with economic freedom, often as a precursor to gaining equal rights and personal autonomy.

Capitalism also plays an important role in managing climate change—with market-led innovations in energy use and renewable energy sources. As advanced economies continue to evolve, they become more energy-efficient and environmentally responsible. In short, capitalism has proven adaptive in finding solutions to human problems.

At the same time, crony capitalism and rent-seeking should be condemned unreservedly; governments should be pro-markets—not pro-business. True capitalism, on the other hand, is worth defending, now more than ever—especially if we are truly committed to ending global poverty and safeguarding Australia's prosperity for the future.

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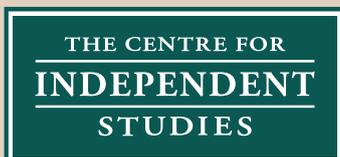
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