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Externalities of capitalism

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EXTERNALITIES OF CAPITALISM

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Capitalism produces consequences – both good and bad – that are not intended. Strong states are needed to manage them

When the annual haze blanketed and choked southeast Asia from August to November in 2015, fingers were once again pointed at companies that were accused of starting forest fires on the Indonesian islands of Sumatra and Kalimantan. Indonesia took the rare measure of arresting executives from seven companies accused of setting peat lands ablaze, while Singapore contacted four Indonesian firms on whose lands fires had been observed.

Frustrations stemming from the annual occurrence – the phenomenon became a regular affair in 1997 – revived allegations of corporate avarice.

“This is a classic externality of capitalism,” explains **Craig Calhoun**, Director of the London School of Economics and Political Science. “It’s not their goal to produce haze – their profits don’t go up by producing haze. It is entirely a byproduct of something that they are doing to secure their profit for which they are not paying the costs.”

He adds, “The costs can be imposed on governments through the need for some compensatory investments, and the cleaning up…could become a governmental problem. This business activity imposes costs externally for which businesses don’t fully pay.”

Double Movement

Speaking at the recent SMU Presidential Distinguised Lecture Series event “*Capitalism, Externalities and Social Institutions*”, Calhoun explained the concept of “externalities” first articulated by British economist Henry Sidgwick and subsequently formalised by fellow Brit A.C. Pigou. He describes how capitalism depends on externalising some of its costs.

“Businesses often locate where there are educated workers for obvious reasons,” he says, “but businesses don’t pay for all the costs of educating the worker. In fact, it is wildly impossible to imagine a system in which they would. The same thing goes for transportation and infrastructure.

“This is why governments invest in things such as improved airports and roads to create an attractive environment for businesses.”

Calhoun highlights economist Karl Polanyi's Double Movement concept which states that economies are embedded in societies, and are therefore interdependent and inextricably linked. As global capitalism evolves, bringing with it increasing financialisation and ever more rapid capital mobility, the resulting externality is spiking inequality and social tension. This weakens societies and, in turn, capitalism.

"This becomes an externality to capitalism," Calhoun says. "It becomes one of the things that make some people not like the economic system they live under.

"It poses costs, above all, on states. Capitalism has never been just an economic system – it has always been a political economic system. It has always relied on states to do significant work to organise and pay for significant costs in the system. If you want to start a business and make money, you need a context that works."

While capitalism produces negative externalities there are also positive externalities in the form of public goods, Calhoun elaborates. New shops revitalise urban business districts, and thereby create more foot traffic to feed other shops.

Still, a common by-product of capital success has been the undermining of state capacity, Calhoun laments, especially in Western liberal capitalist societies. While proponents of small government – notably those on the extreme right of American political spectrum – clamour for the state to get out of the way, Calhoun is of the opposite persuasion.

"Undermining state capacity should not be seen as liberation for capitalism even though some capitalists think that way," he warns. "States still matter. States are the primary means for dealing with the problems of externalities, and capitalism depends on externalising some costs.

"I repeat: We get this wrong if we moralise and say, 'The solution is for capitalists to stop imposing externalities.' Of course, some of them should be stopped, such as toxic waste-dumping, and some of them should be mitigated. But there is no version of capitalism that doesn't depend in part on externalising some of its costs."

Strong states needed

Citing the U.S.'s New Deal that came on the back of the Great Depression – brought on by capitalist excess – Calhoun explains that there has always been major state intervention in economic activity. America's current fiscal crises and debt profile make it difficult to be effective.

"Recent global growth has been led disproportionately by capitalist countries with more or less state management systems," Calhoun highlights. "State-led development has been relatively successful. It is able to stabilse the context, provide the conditions and manage externalities to a considerable extent. We don't know to what extent greater democratisation will inhibit that. Maybe greater democratisation is entirely compatible with these benefits but there are questions to be raised."

In the globalised age, it is imperative for states to work together. However, states cannot be expected to solve every problem.

"It takes states to create inter-state solutions," Calhoun says. "It's not that states can do all of this although they are important in solving the problems. States can only be effective if they give up the idea that they can do it all on their own.

"There is a tendency to imagine effective state power as autonomous state power. In the world of global capitalism and financially-linked capitalism, effective state power is the power to manage non-autonomy well. This relates to international cooperation on institutions that address the systemic risks of international finance or the capacity to manage issues of migration."