The Current Crisis of Capitalism

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Introduction

The ongoing crisis of capitalism that emerged in 2008 and continues in various degrees and manifestations has caught up the whole of the western economic landscape. Very recent shocks, or aftershocks for some, can be witnessed in Greece, Spain, Italy and Portugal, making it the most discussed issues in the present day discourse. While it is true that North America and Western Europe were the epicenter of this economic tumult, its multifaceted implications and consequences are felt in all parts of the world. Many divergent perspectives regarding the current crisis are floating among the intellectual circles, where some would call it a ‘financial and banking crisis’; some other would term it as ‘the crisis of economy’; several others would take it as the crisis of capitalism—the very paradigm on which the contemporary world economic system is founded; yet many would see it as the crisis of economics—the fundamental philosophy and science of modern economy.

It is very significant that in the last 40 years, the world has witnessed two major economic ideologies of modern times in shambles: the collapse of communism in Moscow after swaying over almost one fourth of the world, and crumbling of capitalism in New York, short after having been claimed as “a single sustainable model for national success.”[1] Without denying the positive aspects and lasting effects of capitalism, the weaknesses of the ideology on which the whole system was founded as a central guiding force have been exposed. When the South East Asian crisis emerged, it was looked upon as ‘the crisis of the other world’. Then the crisis shifted to the heart of capitalism, the United States of America, and shook the big economies to their core.

The way the science of economics failed to foresee, foretell, warn and, in the post-crisis scenario, could not provide a way out of the turmoil, a great many economic scholars and thinkers are reflecting upon the current crisis not merely in terms of crisis of economics but a crisis of civilization.

In this context, it becomes pertinent to delve deep into the fundamental philosophy of capitalism, the flaws in the empirical and applied dimensions that gave birth to the current crisis, possible alternatives to come out of it in the short and medium term, and long-term solution to the perennial economic and financial miseries of global world.

Zafar Iqbal[•]

[•] This write-up is based on the proceedings of the seminar organized by the Institute of Policy Studies, Islamabad on December 28, 2012. The event was first in the series that IPS has planned to deliberate upon various dimensions and implications of this recent most and ongoing crisis of capitalism. The first event, as the write-up suggests, focused primarily on diagnosing the issues involved and severity of the crisis, while in the coming events, IPS plans to bring forth the prescriptions, in detail, to cope with the crisis.

[1] US Department of State. “The National Security Strategy of the United States of America.”

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Scholars differ on the precise definition of capitalism. At one extreme are philosophers, such as Ayn Rand[2], who take capitalism as synonymous with libertarianism and consider it as a comprehensive social system consisting of a set of moral-political-economic principles embodied in a society's laws, institutions, and government, which guarantee each person freedom to forming aims, objectives, allegiances, commitments, relationships, and plans of action in accordance with some overall conception of good that he/she chooses to value rather than someone else opts on his/her behalf. As Sen[3] elaborates, as such the emphasis of libertarianism is on the process aspect rather than the opportunity aspect of freedom. The former in turn consists of two elements: autonomy of individual choices and immunity from interference by others.

The crucial issue in case of autonomy is whether choices are being made by the person concerned rather than by other individuals and institutions on his behalf. For immunity, the focus usually is on 'negative freedoms' i.e., the absence of obstacles external to a person—coercion and legal prohibitions—that prevent willful action. This libertarian stress on negative freedoms then translates into a number of rights to life, liberty, property (and that includes protection against theft, fraud, and breach of contract), the right to defend against violation of these rights, and the right to punish transgressors against these rights.[4] In a nutshell then, capitalism is a social system based on the recognition of individual rights, including property rights, in which all property is privately owned and all human relationships are voluntary and contractual in nature.[5]

The ethical theory underpinning the capitalist social system, according to Rand, is objective theory of values, which construes good neither inherent in certain things or actions, regardless of their context nor a matter of arbitrary, subjective, emotional states of mind (which respectively refer to the intrinsic and the subjectivist conceptions of good), but rather the good is an aspect of reality in relation to an individual, which must be discovered according to a rational standard of value, not invented.[6] Here, the capitalism's emphasis on individual rights is a case in point. It implies that the good is to be rationally conceived by an individual in relation to his/her living conditions and is not to be derived from some ineffable abstraction in a transcendental dimension divorcing the good from its beneficiary. Accordingly, concepts such as 'the common good' or 'the public interest' are considered as meaningless and untenable: individuals alone ought to be taken as a basic unit in the analysis of social phenomenon (methodological and normative individualism). In Rand's words, "Nothing can be good for the tribe as such; 'good' and 'value' pertain only to a living organism—to an individual living organism—not to disembodied aggregate of relationships."[7]

Market exchange then becomes the cardinal mechanism of governance in the libertarian conception of a social order since free market represents the social application of an objective theory of values. To wit, the market value of a product or service is neither an intrinsic value nor a

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[2] Rand, *Capitalism: The Unknown Ideal*.
[3] Sen, *Markets and Freedoms*.
[4] Haslett, *Capitalism with Morality*, 55.
[5] Rand, op.cit., 19.
[6] Ibid., 20-4.
[7] Ibid., 20.

subjective one but instead a socially objective value i.e. a value incorporating the individual judgments of all the persons involved in trade at a given time. Second, the market provides unfettered opportunity for people to translate their knowledge into a tradable product or service, indulge in a voluntary exchange of their products or services, and be responsible for the outcomes—be they good or bad. Third, a freely competitive economy requires minimal government intervention as it is regulated by the 'invisible hand' of the law of supply and demand. Sovereign consumers regulate a free market by selecting the goods and services offering the greatest value. Producers compete for consumers' business by providing the highest quality goods at the lowest possible prices. From the pursuit of profit—narrow self-interest—by individuals, comes the 'greatest good for the greatest number of people'.

The economic implications of the above social arrangements are worthy of note. First, distributional consequences of economic arrangements depend on existing allocation of property rights. Thus resource distribution as starting point has to be justified in some normative sense. Second, procedural rules for further entitlement have to be clarified in order to lower transaction costs, encourage investment, and mitigate socially wasteful effort. Third, the pursuit of certain economic goals has to be ruled out.[8] These requirements are catered by rules of entitlement.

John Locke (1632-1704 CE), for example, considers natural resources as the common property of mankind but grants rights of entitlement to those who mix their labor with these resources. First-occupancy is implied. However, spoilage and destruction are prohibited as enough good must be left for the rest. Above all, each person has a right to subsistence when others are living in plenty.[9] However, in the footsteps of Nozick,[10] contemporary capitalists are unwilling to concede the right to subsistence. Also, the rules of acquisition are re-interpreted to mean that an act of appropriation must not worsen the situation of others in terms of using (not owning) what they could previously do.

This opens up the way for concentration of resources in few hands on grounds of higher productivity. Rectification of past unjust acquisitions is limited to living generations. And, voluntary transfers through bequest, gift, and trade are freely permitted. Nevertheless, certain important issues remain unexplained. According to Musgrave, these are: why earnings from capital have an entitlement claim *pari passu* with earnings from labor.[11] Also, whether voluntary exchange of rights alone—and not through a competitive market—is a sufficient condition for legitimate entitlement? What about transfers at death which do not constitute the fruit of the recipient's labor? Finally, how should externalities be dealt with?

From a libertarian standpoint, given initial property rights and a procedure for further entitlements, protection cannot be left as everybody's business. A civic society/government must

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[8] **Hausman and McPherson, *Economic Analysis and Moral Philosophy*, 126-127.**
[9] **Sugden, *Social Justice*, 280.**
[10] **Nozick, *Anarchy, State and Utopia*.**
[11] **Musgrave, *Public Finance and Distributive Justice*.**

be established to protect property and prevent coercion, fraud, and deception in contractual arrangements that are primarily entered into on a voluntary basis. This creates scope for police and judiciary, which is extended to defense against external aggression, period. Persons join in, on their own accord, as free and equal. Financing of protection costs is on a *quid pro quo* basis. Such a 'night-watchman state' indulges neither in the provision of public goods nor in redistribution and any taxation for purposes other than 'minimal' state is condemned as 'forced labour'.[12] Here comes the challenge to the puritanical vision of the establishment of a capitalistic social system. Can negative freedoms be of any value to a person without the positive guarantee of the fulfillment of basic needs?

The Crisis of Capitalism

The most common critique of capitalism is that while free markets are important, they may not necessarily produce results that are compatible with liberty. This is because capitalism evades the opportunity aspect of freedom that refers to the real opportunities (means) that one has in order to achieve what one has reason to value. Accordingly, Sen objects to libertarianism on the grounds that its 'consequent-independent' stance provides too restricted an information base to encompass basic variables that human beings have a reason to value.[13] Thus, stark poverty and extreme hunger can exist precisely because people have libertarian rights—the negative freedoms—but no right to nourishment which is a pre-condition for appreciating freedom. This means libertarianism is ultimately indifferent to achieving substantive liberty as an end. He raises the question as to why should the status of economic needs, which can be a matter of life and death, be lower than that of personal liberties?

Although the above critique is philosophically potent, the crisis of Capitalism is much deeper than it appears on the surface, and to explore such crisis full fathom, one needs to go back to the roots of capitalism and vet its key tenets one by one. Take, for instance, the apparently neutral objective function of profit maximization for a person, business firm or a financial institution. From both the ethical and economic perspectives, theoreticians and practitioners alike have yet to justify that unequivocal pursuit of profits is good for humanity as a whole.

A top-down consequential appraisal could possibly lead to the conclusion that just three centuries of industrialization with this aim has polluted the planet earth to the extent that probably for the first time in the history of mankind, the human species is at the risk of becoming extinct by the consequences of its own handiworks. The divide between self-interest and social interest has clearly widened at least along the important dimension of environmental protection as companies continue to de-forest and pollute through mining and manufacturing practices incompatible with sustainability. In terms of making any difference to the lives of hundreds of millions of world's hungry and poor, the most profit maximization can achieve under ideal conditions is Pareto

[12] **Nozick, op.cit.**

[13] **Sen, *Development as Freedom*, 64-67.**

optimality, which is consistent with status quo and inequality. Not surprisingly, wider wealth circulation and poverty alleviation remain distant goals.

As an exclusive mandate for managers of business firms, profit maximization has frequently let down the world financial markets and national economies by introducing systemic shocks inspired at roots by corporate greed unchecked by decades of 'deregulation', another important policy tool flowing from the philosophy of 'laissez faire'. As a result, corporate governance has been in shambles; the state 'enthusiasm' for deregulation has been dented worldwide; and Acts like Sarbanese-Oxley in the US, make provisions for having auditors upon external auditors to keep the latter on a straight and narrow path of integrity, while maximizing profits. The trickle down of deregulation and privatization has been in terms of increasing concentration of wealth as well as industry ownership more and more into a fewer hands in the society and undermining the very principle that exalted markets i.e. that a large number of players would promote competition and welfare of the ordinary.

In this context, the Marxian critique of paying subsistence wages to labor also appears lively and relevant especially in terms of those companies shifting manufacturing to loosely regulated developing economies. In brief, the divide between self-interest and social interest has been widening, and fair distribution and poverty alleviation remain distant goals. Monopolies in many industries across the world are on the increase including media—an important tool in the ongoing struggle among alternative ideologies for winning the hearts and minds of people.

Finally, when national tax codes shun wealth taxation, there are no limits to capital accumulation, and there are political/strategic compulsions on capital to be invested in certain national or geographical boundaries alone, then over time the rate of profit on the real sector is suppressed unless innovation is kept at a very high pace. Alternatively, in pursuit of quick profits, wealth has to be channeled to highly speculative means. Here comes the passion of contemporary wealth with financial markets and the resulting financialization of economies over time. The large amount of capital that has been accumulated in the private sector, when partially diverted into the financial sector rather than the real sector of the economy, creates a gulf between the underlying trend growth of the real productive sector vis-à-vis growth rate in the pricing of the financial claims—bonds and equities—on the values and returns from the real sector.

This is the area where the crisis of capitalism has emerged in its most devastating form. The unconventional perspectives on the recent booms and busts in the Western economies such as those put forward by Hyman Minsky or Kindleberger attribute such crises to greed, leverage and speculation—the factors loudly condemned in dissenting strains of economics, including Islamic Economics, but completely legitimized within capitalism. Even worse are the tactics of the celebrated 'invisible hand' to drive itself out of the economic recessions. Notable are the confessions of the celebrated lady economist, Joan Robinson:

> **'It has not been proved that recessions can be avoided, except by armament expenditures, and, since to justify armaments, international tension has to be kept up, it appears that the cure is a good deal worse than the disease.'[14]**

And

> **'The requirements of the warfare state and the welfare state meet in the export of armaments, which keep industry in ex-imperialist countries prosperous and permit enmities in the ex-colonial countries, which were frozen at the level of bows and arrows or flintlocks, to breakout with bombs and tanks.'[15]**

One last but by no means least critique of the capitalism deals with its undermining the popular franchise in terms of lobbying and corrupting influence in the political domain. While voting works on 'one person, one vote' basis, markets work in a different way—more dollars, more power to purchase, and more power to purchase means more power to lobby, intervene, and influence political decision making process. Here, the rise in the resources under the influence of a modern corporation and its association with and capacity to influence policy makers even in a democratic set up has been phenomenal as has been alluded by Robinson in the case of interests of the military-industrial complex.

To conclude, Rousseau (1712-78 CE) rightly anticipated the direction of things to come under laissez faire when he pronounced the egalitarian ideal that 'No one should have either so little as to have to sell himself or so much as to be able to buy someone else'. It is high time that the academicians and practitioners get together to stitch this ideology in time to save nine.

Syed Nawab Haider Naqvi[•]

Many an economic problem that the world faces today, particularly Occupy Wall Street movement and the Great Recession of 2007-2009, needs an in-depth examination and analysis of the basic truth about capitalism—a truth that has been forgotten since the 1970's with the advent of Thatcherism in the UK under the influence of Von Hayek, and of Ronald Reagan in the US under the tutelage of Milton Friedman of the Chicago school, which is credited with unraveling the Keynesian Revolution and re-introducing the cult of self-correcting free markets. In fact, the real world events have proved them false prophets, whose message, spread by neo-liberalists, has done incalculable damage to the well-being of the people in both the developed and the developing economies by decelerating growth and generating large unemployment.

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[14] Robinson, *Freedom and Necessity*, 239.
[15] Ibid., 93.
[•] Prof. Dr. Syed Nawab Haider Naqvi is presently Director General, Federal Urdu University and former Director, Pakistan Institute of Development Economics.

The Occupy Wall Street movement focused on rising inequalities in the US (We Are the 99 percent). Surprisingly, the slogan epitomizes daunting facts: it is the top 1 percent who has garnered most of income gains since the 1980's, while the rest have experienced either a much slower income increase or stagnation and even decline in real terms, resulted in large poverty pockets and the emasculation of the middle class. The most thorough study of the rising inequality is the recent report of the Organization for Economic Co-operation and Development (OECD), which finds that the ratio of the richest to the poorest has increased from 9 percent in mid-1980's to 14 percent in mid-2000 in the OECD countries[16], among which the lowest increase is in Nordic countries and the highest increase in the United States and some other countries. The Gini Coefficient in the same period has risen from 0.29 to 0.316 (a roughly 10 percent increase) and the latest trends are upwards with no end in sight.

Some may argue that the ratio is still quite low by global standards; it, however, needs to be realized that once the sense of inequality and social justice becomes embedded in the basic social institutions, it is hard to eradicate and it tends to perpetuate itself. This sense becomes toxic when growth rates plummet and unemployment rates rise. The sacrifices are borne by the poor and the middle classes while the rich manage to corner a substantial proportion of reduced wealth, and the governments are sitting idly by under the intoxicating liberalist message, that these inequalities are based on merit and the unemployment rates will be corrected by free markets.

At this point, it may be worth recalling the causes of the Great Recession that has slowed down growth rates and significantly increased the unemployment rates, which have stabilized around 10 percent in Europe and have recently come down a little to 9 percent in the United States of America. Truly, this recession has wreaked havoc on world's financial system, which has suffered dramatic failure in managing risk.

To begin with schematically, a sky-rocketing of housing prices by 124 percent during 1997 to 2006 led to an unsustainable housing bubble. This was followed by a fall in housing prices and the bursting of the bubble. It then led to the collapse of the banking system, a stock market crash, and a sharp drop in output and employment. The link between these events is as follows:

- The housing boom was fed by huge accumulation of private debt and bank debt;
- The retail banks were allowed to underwrite and sell securities based on the mortgages of sub-prime borrowers;
- The leverage ratio was increased from 10:1 to 30:1 in 2004. Housing mortgage companies Fannie Mae and Fredrick Mac were encouraged to help middle income house owners, while other mortgage companies lent at practically zero interest rates even to Ninjas: borrowers with no income, no jobs and no assets. This led to sub-prime borrowing to the extent of 100 percent of the home value and more than 6 times the wage income of the borrowers. What made the financial system rickety were the so-called financial

[16] Visit, http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1_1,00.html, to see the list of 34 OECD member countries.

innovations: individual mortgages were bundled together and then sliced and diced into securities to meet the needs of investors in search of higher returns. As a result, a global inverted pyramid was built on private and bank debt on sub-prime borrowers.

- Trillions of dollars worth of these toxic securities got embedded in the world banking and financial system, which when bad times struck collapsed like a house of cards.

The downward slide began in 2007 when the high prices of houses began to fall because at such high prices, houses became unaffordable to the majority of home owners; the sub-prime borrowers defaulted in large numbers; the securities held by the banks lost in value; they stopped lending to borrowers leading to a credit crunch; the fall in commodity prices began and stock market crashed in autumn of 2008. All this led to the collapse of real economy—growth rates hurtling down and unemployment rates rising sharply—leading to a worldwide slump.

Many books were titled as such and published by reputable publishers, such as the Harvard University Press published Richard Posner's 'A Failure of Capitalism' and other books were titled as 'End of Capitalism' etc. The most comprehensive account can be found in the US government's Financial Crisis Enquiry Commission Report, which submitted its report in January 2011. It construes that, among other things, the main culprits were the lack of regulatory oversight, lack of safeguards in lending activities of the financial system and a systemic breakdown in accountability and ethics. More importantly, it concludes that the crisis was man-made and could have been avoided by timely regulatory action.

Initially, a near-consensus got built that these events constituted a 'market failure' on a massive scale and that if the system is allowed to proceed without strong corrective measures, then a situation like the Great Depression would be created, when output had fallen by 34 percent and unemployment had risen to 24 percent. Fortunately, it did not happen. The main reason being the big stimulus package of 700 billion plus and a total of 7 trillion plus were pumped into the banking and financial system in the US and similar efforts were made in Britain and also in China (500 billion plus) and other East Asian Tigers economies. There was a consensus initially that these steps prevented the worst—the Great Recession was prevented from plunging into Great Depression. It was recognized that Keynes was back in the saddle and saved capitalism once again from itself. China and the rest of the fast-developing countries, who rejected the liberalist medicine, got back on their high growth path soon thereafter.

But in the US and later in the UK and the rest of Europe just as their economies started to stabilize, a 'great intellectual confusion' ensued. Perfectly sensible economists—mostly the Fresh Water Economists, the ones schooled in the Chicago School—argued that these packages, in fact, obstructed the economy's revival because the long-run multiplier of these packages was negative. They argued that the real remedy lay in lowering the taxes of the rich, cutting social welfare spending and balancing the budget. In the UK and the Europe, conservative governments have argued that balancing the budget will revive the economies and that fiscal austerity would lead to economic recovery. The recent agreement among the European Union countries has sealed this perverse doctrine in the economic policies of Europe, which amounts to committing an economic suicide on a massive scale. In the US the fight is on and nobody knows the outcome just yet.

It would be interesting to re-visit the core of these liberalist ideas to understand why they cannot work anywhere—indeed, have not worked anywhere. Contrary to the Keynesian type view, the liberalist doctrine is ascendant once again, even defying common sense. Conveniently forgetting the lessons learned in the post-war years, they have again reposed their faith in self-clearing markets and minimal government. According to them involuntary unemployment cannot exist and if it does it represents the failure of labor to accept a wage cut so that wages could be lowered below their marginal productivity. Once they do accept enough cut in nominal wages so that what they produce is worth more than what they get in terms of wages, everyone seeking the job would be fully employed.

Here economic agents hold rational expectations and know all possible conditional probabilities. Since these 'all-knowing' private agents can anticipate government intervention, say to control inflation, so the government action would either be redundant or counterproductive. Surprising as it may seem, these views have been held widely in the academia and, through the IMF patronage and the Washington Consensus, exported to the slow-growing countries in need of external help, the fast-growing economies of Asia, Latin America and Africa having rejected these views. These ideas are not new: they existed even before the Great Depression, and yet they have been resuscitated.

This intellectual confusion contrasts with the intellectual clarity that came to prevail in the wake of the Great Depression, when it was realized that since a capitalistic economy is liable to go off the rails mainly because of the uncertainty that normally beclouds the future; the fact that economy is governed by human instincts that are both rational and irrational; and that instability is part and parcel of capitalism, which needs constant, not off and on, course correction; it needs constant government oversight, meaning thereby, a significant role of the government in economic affairs. As this lesson took roots in the Western World, after the Great Depression was ended by the large spending to fight the Second World War the Keynesian view prevailed throughout the world; and fairly long period of economic prosperity—high growth, very low unemployment rates and moderate inequalities of income and falling poverty—ensued throughout the world. These views are needed again to save capitalism from itself.

The point needs to be remembered that the capitalistic system is crisis prone and breeds inequality. It has rocked stable democratic countries like the US and Europe. To offset these de-stabilizing tendencies, it needs constant public oversight. The liberalist idea of rational individuals guided by nothing better than a selfish regard for their own interests, hell-bent on maximizing their private gains, oblivious to the effects of these decisions on others in the society is no more than a myth. Several contributions to the current debate have pointed out the need for honesty in financial matters and an ethical regard to the needs of the people whom it is supposed to serve, especially those of the least-privileged in the society, to secure socially desirable outcomes in a capitalistic system. In other words, the capitalistic system, based on greed and an uncontrolled love for money and without active oversight by the government, cannot, repeat cannot, function for the good of the society. The clouds of confusion that have engulfed the realm of thought and policy-making need to be decisively dispelled. *Fasih Uddin*[•]

The rich world is under persistent stress for the past several years. Along with recession some countries are under added pressure: the US is hit by corporate scandals and greed; European Union by threat to Euro; and Japan by the devastating earthquake of last summer. The gravity of the situation is heightened by protests and agitations across major cities of the Western world. Some surmise it as the fall of capitalism while others consider it as the cyclical phenomenon.

In this context, it is important to analyze the gravity of the situation and highlight some critical elements of the crisis, which would help draw some lessons for Pakistan.

Critical Elements of Crisis

Cyclical ups and downs are common economic phenomena—boom is expected to be followed by recession and vice versa. Why is it that the current recession that began with the banking turmoil in the US in 2007 is not being considered as a normal feature and is being seen by many as the collapse of capitalism? One may search for an answer in the events of past two decades.

The beginning of nineties ushered in an era of economic growth and prosperity which is being attributed to the policies of liberalization and globalization. This era was interrupted by the East Asian financial crisis of 1997 and the consequential slow down of output and trade in the next few years. The world economy recovered around 2003, and after a boom period of four years, again went into recession that began with the financial turmoil in the US in mid-2007. Despite forecasts of recovery, the situation not only remains grim but highly complex. Some critical elements, which have added to the complexity of the situation, are:

1. **Growth-Employment Dilemma:** The growth-employment relationship, which, in theory, is inversely proportional, remained weak since early nineties, as despite robust economic growth, the unemployment rate remained high. Since then, the situation has worsened—in 2010 the unemployment rate in the US reached 9 percent, Euro Zone 10 percent, Greece 16 percent and Spain 21 percent. An area of concern is the high rate of youth unemployment which is twice as high as the general unemployment rate. Some of the reasons are:

   - Firstly, the rapid technological advancement is shifting the job openings from traditional sectors, like industry and services, to information and knowledge-based

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areas. For instance, between 1990 and 1998, the demand for routine jobs in the United States declined by 8 percent and for knowledge-based increased by 14 percent. The job seekers are slow in acquiring the new skills and knowledge.

- Secondly, the restructuring of the economy is not keeping pace with the fast technological advancement. It also failed to cope with the challenges of globalization and liberalization.
- Thirdly, industry is reluctant to graduate; labor prefers status quo; and the government policies are focusing on unemployment benefits rather than on launching programs of retraining and new skills development.
- And fourthly, education system is not geared to imparting to the youth knowledge and skills needed in the 21st Century.

Jeffrey Sachs, in his recently published book "Price of Civilization: Reawakening of American Virtue and Prosperity" laments on the 'poorly educated American children' and 'America ceding technology leadership to China'. He is not alone in pleading for educational reforms and additional budget expenditure on workers training and early childhood development.

2. **Rising Inequality:** Another area of concern is the rising inequality and disparity in income and wealth. A weak aspect of free economy is that the gains of growth are disproportionately shared by the rich and powerful. This was more apparent in the 'Roaring Nineties' for various reasons.

- Firstly, the growth was more a reflection of financial 'Bubble' than rise in real output.
- Secondly, the unemployment rate remained stagnant despite growth depicting less income for the working class.
- Thirdly, capital has prospered more than labor during this era.
- And fourthly, the state failed to adopt measures (such as raising the tax on rich and regulating the perks of corporate executives and improving safety nets) to address the issue of inequality.

The current recession has aggravated the situation. Unemployment has gone up; real wages of workers have fallen, while pension rights of middle-aged diminished. The collapse of the financial market has severely hit the small investors and pension fund of workers. The government policies not only failed to mitigate the rising disparity, many of their measures (like tax rebates, bailout package for banks, etc) were, in fact, tilted in favor of the rich. An indication of the rising income disparity is reflected by the fact that the highest paid chief executive of a company (Discovery Communications) in Washington DC area earned twice as much as the US President, his cabinet, Vice President, Supreme Court Judges, leaders of the House and entire Senate. In 2010 he made $42.6 million as against President's pay cheque of $400,000.

3. **Misplaced Faith in Private Sector:** Advocates of the free economy paint the behavior of individuals and private institutions as more rationale, logical and just than that of the state. This myth has been dispelled by the inappropriate behavior of some leading corporate executives, banks and private institutions that contributed significantly in the collapse of the financial market in 2007-2008, fueling to the current crisis.

   The liberalization and globalization of the financial market; introduction of innovative financial instruments, like derivatives, without proper regulatory framework; transfer of corporate control from shareholders to professional executives; lax banking practices; and faulty accounting procedures provided ample opportunities to people in position and power to amass wealth during the boom. The boom covered up these malpractices which were then exposed in recession. Through such practices, companies like ENERCON (an energy company based in California) inflated the value of their assets and earnings, heavily borrowed from the banks and minted money by exercising share options and selling their shares at manipulated high price.

   The credit rating agencies also erred by giving very high rating to these companies. When the real position came to light, their share value tumbled, the small share holders suffered severe losses and finally the companies went into bankruptcy. ENERCON is a classic case of corporate greed, accounting scandals, public influence, banking malpractice and misuse of deregulation.

4. **Poor Governance:** The prolonged period of growth in the nineties led many to believe that less regulations and marginal role of government in economic management is the best policy. Subsequent events proved that it was not so, as it created socio-economic distortions. The contention that the benefits will trickle down to the lower strata of the society also proved wrong. The policy of financial liberalization provided a unique opportunity to people in power and position to amass wealth at the cost of the society. The government remained a silent spectator only to intervene to salvage big banks and corporations.

   The government policies lack the long term vision and strategy to address the changing technological, demographic, and social realities. The fiscal policy has failed to contain deficit mainly due to inability and unwillingness of the governments to raise revenues. In the US and many European countries the fiscal deficit exceeds 9 percent of GDP with public debts reaching unprecedented levels. It is for the first time in recent history that the rating of the US Treasury Bond, (which is used as benchmark for other sovereign borrowings) was downgraded.

   Countries are contemplating fiscal austerity measures to contain budget deficits. These measures should focus on taxing the rich and well-to-do and economizing on nonessential expenditure rather than curtailing the benefits of the workers and poor. These should also be fair and temporary because severe measures could re-bounce as recent research studies show a close relationship between fiscal austerity measures and protests. (Economist, October 22d, 2011)

Lessons for Pakistan

Keeping these fundamental problems in the modern paradigm of governing economy, Pakistan can also draw some lessons from this crisis.

1. The future employment potential, both within and outside the country, will increasingly be in technology and knowledge-based activities. Besides primary education, emphasis should, therefore, be laid on technical education and skill development. In addition to literacy and numeracy, operacy (skill to do) should be a part of the educational system.

2. Irrespective of the stage of economic development, poverty and inequality remain key issues. It is particularly so in case of Pakistan which is based on the ideals of Islamic social justice.

3. The individuals and enterprises should be permitted to act freely within a broad regulatory framework and social and moral norms. The activities of the entities that use the resources of others or exercise authority on their behalf, like banks, financial institutions, insurance companies and stock exchanges, should be closely monitored. These entities should function as trustee rather than owner.

4. Good governance is the most critical element as no society can progress without it. The conduct of the state should be fair, just, efficient and effective. The real test of a government is its ability to shun political interference and pressures of vested interests and be solely guided by law, justice and ethical norms. In this, fiscal discipline, responsibility and accountability have a key role.

Capitalism as practiced today is under immense pressure, yet it will be presumptuous to call it the demise of capitalism. The situation is grave but remediable. Stakes are too high to let the system fall. As Stiglitz argues: ‘an alternative vision should be the one that is based on ‘global social justice and a balanced role for the government and the market’. The question, however, remains: what should be the precise role of each?

Khurshid Ahmad[•]
(Concluding Remarks)

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The foundations of capitalism are said to be in the self-interest motive, property and enterprise, and market mechanism; but the question is whether these began with capitalism. In fact, the efforts to improve one's position and to have a prosperous life have always been part and parcel of human existence on the earth since time immemorial. As far as private property is concerned, it is true that originally there was some kind of community ownership but then, of course, private property ownership started despite some sense of participation from community. Sophistication of the market that is witnessed at present, particularly the technological advancement, information, transport and the exchange processes, shows a qualitative change. Yet, the fact is that market has always been there and supply and demand had been the important forces in economic activity. The question arises, 'what is unique with capitalism then?'

The unique characteristic of capitalism is the very world view or the particular vision that constructed the total milieu of capitalism, topped off with the imbalance, introduced by the liberal paradigm in which rationality was equated with self interest and profit maximization for a particular class of capitalists or entrepreneurs, who amassed economic and political power, and dictated what to produce and consume. Making the market as the only decision making instrument with the assumption that market is a self correcting mechanism and does not need any regulation, oversight or check was the milieu that transformed the universal values of interest, profit motive and property.

Under this umbrella of world vision, Economics developed as a discipline. The Wealth of Nation by Adam Smith was preceded by the forces of morality. According to Smith, the idea of prudence preceded self-interest, but over the course of two centuries, six major delinks took place, which transformed the whole system and vision.

The first and foremost was the delink between economics and ethics. The post renaissances obsessions, for instance, with confining reality, facts and truths to what was observable and measurable brought in the crucial delink between economics and ethics that had changed the entire course.

The second delink took place between economics and other disciplines, meaning that economics was extracted from other disciplines, such as sociology, psychology and anthropology etc. and it was thought that economics is self sufficient. So, the world of economics became limited. As a result, society was reduced to economy and economy was reduced to market, which became the domain of key players: capitalists, entrepreneurs and financiers.

Third is the deliberate delink between analysis and vision. In past, vision had played a dominating role and analysis was subservient to it, but the former is absent now and the most of the scholarship is contented with the latter. Thus, the present situation can truly be called the crisis of vision.

Fourth was the delink between efficiency and equity. While efficiency and optimal use of resources are very important, they are not enough and cannot go without social and human dimension. The shift from man to matter has taken place today that has done the greatest damage both to economics as a discipline and economic as a policy.

The fifth delink i.e. between the monetary economy and fiscal economy aggravated the entire problem, and had the snowballing affects over the years. Since barter system was able to satisfy the needs of people only to a particular level of development, money brought revolutionary change in the economic history of mankind as a facilitator and intermediary for production, and soon became the instrument for the promotion and production of goods and services, transforming trade from commodity-commodity (CC) to commodity-money-commodity (CMC), leading to protection of commodities and services. That is how a balanced prosperous society would be created.

However, in the capitalist system, money became an instrument of producing only money, playing the role of increasing production; affecting physical economy; enhancing flow of goods and services as well as their production; exchange and distribution; becoming exploitative. This is precisely the reason why the interest, banking, financial houses, and the whole financial arrangement has played a very important role in the transformation of both domestic and global economy.

The worst transformation has taken place in the last 70 years. The difference between monetary transaction and real physical transaction is 1 to 50. According to an estimate, 1.3 trillion dollars worth of monetary transactions is taking place every day that makes about 50 times of the real sector transactions, which is roughly 50 trillion dollars globally. The banking assets of the western world exceed only 200 trillion, but the derivatives are crossing over 900 trillion dollars. This whole fiduciary is enriching the rich without affecting the production, resulting in the affluence for some and deprivation for many. The whole idea of Wall Street occupation that may be expressed in the one liner that 'we are 99%' is indicative of the situation.

Presently in the United States of America, 17 percent of the population is below poverty line. Real unemployment is over 20 Percent whereas this crisis has not made any difference to upper 1 percent. In one go, the US provided 760 billion dollars bailouts to a dozen banks and investors who were responsible for this crisis, while 2 million house owners were ignored. The same financial institutions started again and the owners were thrown out of their homes in this 'richest' and 'largest democracy'. Those 760 million bailouts were paid by the tax payers. So the irony of capitalism is that it wants non interference from the government to enable them to make their profits, but in case of crisis it wants the government to step in and bail them out at the cost of common man. This is the real crisis. Studying the different economic reports of 2007, one will find that scholars from both mainstream and minority-stream have similar questions as were had been raised in the Great Depression of 1929.

To come out of this perennial crisis, a new approach is needed, instead of a bit of tinkering here and there, some regulatory oversight, one stimulus plan or another, or merely a ‘reform’ of paradigm from within. The urgent need is to rediscover the relevance of above mentioned five delinks not but a paradigm shift.

One can say that there are voices which are emphasizing this aspect, at least on the periphery. Some important publications in this regard are worth mentioning: Roger Bootle’s “The Trouble with Markets,” Anatole Kaletsky’s “Capitalism 4.0: The Birth of a New Economy in the Aftermath of Crisis,” Joseph E. Stieglitz’s “Freefall: America, Free Markets, and the Sinking of the World Economy,” and Robert Fogel’s “The Fourth Great Awakening and the Future of Egalitarianism” to name a few.

One may argue that these voices do not represent the mainstream thinking, but important phenomenon is the increasing inflow of these alternate articulations. All these prominent scholars and respected economists refer to the moral deficit in the contemporary economic paradigm that needs to be rectified through a complete transformation or paradigm shift. Muslim *Ummah*, despite its failings in the past, could offer the much needed alternate paradigm in form of Islamic economic paradigm, provided the Muslim scholars and thinkers articulate it properly in all its ontological, epistemological, empirical and applied dimensions. They also need to realize the fact that while ideas have important role in history, a change comes only when a model is there. So, while the crisis of capitalism is a global challenge, it is an opportunity for the Muslim World to present its economic model for the alleviation of human suffering.

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