Economic theories of globalization

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Introduction

This chapter will show how the notions globalization, capitalism and markets can be used for analyzing economic globalization. We will look at the globalization of markets, from the local market that offers fruits from all over the world to contemporary financial markets that operate around the clock due to a shift work by traders around the globe. This will take us to analyses of global interdependency patterns, but this can only be done if one takes the theories that people have developed to understand the economy into account.

Globalization is often seen as a form of convergence of associated production systems, cultures and even political processes. The neoclassical economic model presents the idea of convergence of prices and products all over the world, as a result of arbitrage and the clearing of markets. Convergence of cultures is sometimes linked with a critique of “Western hegemony,” whereas the democratic polity is even referred to as the end of history. We show that a simple scheme of divergence-convergence cannot fully grasp matters as diverse as international consumption patterns, organizational structures and national policies. Therefore, we do not claim that the world is moving in one direction, we limit our discussion to economic cases for analyzing divergence and convergence.

This chapter addresses a number of concrete questions. How has the view of trading with others and of being dependent on them changed over time? What normative standpoints can be identified in the discussion of economic “Globalization?” What can be said about efficiency and inequality? What markets today are global? Throughout the text we relate the theoretical discussion to empirical examples. This framework is also used to understand the first financial crisis of the third millennium.

We discuss these questions in the light of the large literature on economic globalization. The discussion emphasizes markets and capitalism, and has a historical perspective, which means that we will look at economic and sociological theories that discuss aspects of economic internationalization and globalization. The discussion can only make a few stops on the journey into the history of economic ideas from Aristotle to today. We first try to give some flesh to discussion of economic globalization. The chapter then briefly discusses and defines capitalism. The next section deals with and defines markets. The third section covers globalization. These three
concepts will be used in the remaining sections to analyze the co-evolution of global economic processes and economic ideas about globalization. It should be said that these three notions are only tools to highlight what we think are the most central aspects, whereas others, as a consequence, are downplayed.

**Glimpses from the global economy**

What is a global market? Let us look at a few examples. By the proliferation of the Internet and the emergence of market places like eBay it is possible to access products of all kinds from all over the world. In this global market place it is easy to compare prices of products, both for buyers and sellers. Tramp shipping, to take another example, is an industry with a very long history of being global; ships were, and still are, central for making contact and transporting goods between people all around the globe. This industry is made up of ship owners, agents, shipbrokers, and in the end, those who trade commodities. These actors operate in several interconnected markets all over the world. The tramp shipping market is part of the international shipping industry, a certain market segment in which vessels that operate do not trade regularly between certain fixed ports. Instead they take cargoes from any port to the port required by the customer. Prices in this market can be extremely volatile, about twice as volatile as the S&P index that includes the largest stocks on New York Stock Exchange. The volatility depends on oil prices, wars and much more that boils down to market prices. This market has for a very long time been operated by actors across the world. Today about 150 nations have vessels operating on the seven oceans. The industry has a labor force of people from many different nations who work together on the ships, which means that there is also a global labor market for sailors.

Let us look at a third global market case. The market for foreign exchange is the largest market in the world in terms of turnover. In the same way as we need to trade our British pounds for euros when going from London to Paris for a weekend holiday, large firms, central banks, as well as financial speculators must trade with different currencies to pay for the goods they buy. The financial market is highly globalized and traders are located all over the world. These three cases can of course be seen as different and independent cases. But let us look a bit closer to see how they may be connected. When a student sits in her dormitory in Austin in Texas she can compare prices and objects from virtually every corner of the world. Let us assume that she is looking for a used and rare Gibson guitar, and she decides to go for one that is on sale in Germany. She orders the Gibson guitar from Trier in Germany, for which she will pay with her debit card in US dollars. The retired rock musician in Trier, who has put out this guitar for sale, will soon see that the money he required in euros is registered on his account. This single transaction can only take place given that there is a market for foreign exchange. But neither of them need directly take part in this financial market, though their banks will have to do it. When the rock musician sends the guitar to the USA, he may send it by air, but since this is more expensive, the two have agreed that he shall send it by surface mail. This means that the guitar will go perhaps by cars and on railroad, but certainly by ship, before she can play with it in Austin, USA. Thus, this economic relation ties these two persons with different interest together because one has an item for sale that the other is willing to pay for. But since they never meet and directly hand over the money for the guitar, it is still not clear how this works.

To understand this one must begin to look at economic dependency patterns that involve a number of actors operating in different markets. How does this myriad of actions, interests, goods and money hang together? What, in other words, makes the system tick? Let us first clarify a few things. Free trade has not been the state of nature that governments subsequently diluted. Rather, government regulation and their international organization of exchange rates, tariffs and products...
quality was pivotal in creating free trade. The state may also force actors who transact to pay taxes or custom for the goods. We have also mentioned the motives of the buyer and seller. In between them several transactions may have taken place. But they did not take place because the private companies that take care of the transport of the guitar within Germany are so enthusiastic about music, nor is it because the sailors on board of the vessel who take it across the Atlantic like their tin—can so much that they stay away from home for three months so that the guitar can make this journey successfully; in their eyes, it is not the guitar as such that has been traded. These firms, and those employed by these firms, have made sure that the package, quite regardless of its content, gets to the right address in Austin. Many actors and institutions are involved in the process of taking the guitar in one direction and money in the other. However, in the global economy money travels only as accounts, that is, only as registration of numbers, and never as actual physical money.

Though neither the guitar player in the USA nor the seller in Germany has had as their primary interest to make profit on this trade, they may both have looked at different alternatives to be better off in comparison with other deals. The actors—the middlemen— who made this deal possible are motivated by profit, and may compete with each other. This extremely complicated transaction, which in reality is much more complicated than what has been indicated here, is made possible by people who are organized in firms in order to make money. In addition to the motives, the knowledge of where and how to transact, and the knowledge of the rules of the market-game, are important components for trade to take place. These examples show the interdependence in the global economy. To speak of global markets cannot be done unless one also refers to local markets. In the examples, it moreover becomes evident that one cannot reduce these global economic dependency patterns to technology, nor to individual motives alone. In fact, it is possible to identify these patterns in old societies, long before there were computers. The Silk Road, Athens’ Mediterranean economy or the trading system of Hanseatic cities are only the most prominent historic examples. The human desire to explore, learn and acquire objects that make life easier and more pleasurable has contributed to man’s journeys and trade, and we have, as a result, increasingly become dependent on another. This is, of course, only a necessary condition that does not lead to trade in absence of specific historical constellations or even geographical factors. Having said this, the change, which cannot only be reduced to economic factors (as discussed elsewhere in this volume) has taken place over the last decades means that the globe has become smaller in more than one way.

The examples, moreover, indicate that there are global markets in the contemporary economy. One could, in fact, talk of a completely global economy if all markets were global, i.e. if there was an oligopolistic structure in all markets, where everyone takes all other market actors’ actions in account and in which most of the trade volume is international (Fligstein, 2001). This, of course, is not the case, and one may talk of economic globalization also in other respects, such as when local garment producers in Vietnam compete with producers in China to get an order of skirts for a European fashion brand. This suggests that people, who live under widely differing economic, cultural, political and social conditions, are involved, and tied together, in a global economy through systems of markets. However, there is not a global labor market, and to gain labor and many other services these firms are deeply embedded in their respective local economy. Furthermore, in both China and Vietnam people buy groceries that are largely of local origin, and they find and pay their housing under conditions that one can only understand if one sees how the economy is embedded in the local culture and formal institutions. Economic globalization more generally, refers to increased international trade that began to take off in the nineteenth century until 1914, after which the breakdown of the international trading system resulted in a heavy slump. The 1914 trade levels were only to be reached again in the late twentieth century (see Figure 3.1).
The examples we have taken, and the discussion so far, suggest that one cannot speak of one global economy, because many people are almost or even completely outside of the economy, and some markets are still local. One must therefore have analytical tools to understand and be able to penetrate the rhetoric of politicians and discourses in the press about globalization and interpretation of facts. We now turn to the first central concept, capitalism, then we will discuss markets, and finally globalization.

**Capitalism and its origin**

The etymological origin of the word capitalism is “head,” and it refers to the time when the wealth was measured in the number of heads of cattle a person owned. The word also means interest, and a capitalist in late eighteenth-century France was a person who aimed for high interest, or was simply a wealthy person. Capitalism as a phenomenon has existed for a long time, but the notion is much younger. Scientists have identified the phenomenon even in Ancient Greece. When one speaks of capitalism today, it is usually the rational capitalism that emerged in the sixteenth century to which one refers. Capitalists should be separated from capitalism. Capitalism refers to the social system and its corresponding values. Usually, a capitalist is seen as someone who has accumulated capital and who reinvests this capital according to a rational logic to increase profit. The capitalist system is driven by competition among capitalists to gain profit. Though competition is crucial to a “well-functioning” capitalistic market economy, the individual capitalist usually strives to be the sole actor, as everyone who has played Monopoly knows. This means that the actor, either a person or a firm, tries to get rid of her

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**Figure 3.1 500 years of world trade-to-GDP ratios**

*Note: Globalization over 5 centuries (1500–2011). Shown is the sum of world exports and imports as a share of world GDP (%). The individual series are labeled with the source of the data.*

*Source: Roser, 2015*
competitors and to become a monopolist (one seller) or a monopsonist (one buyer), to be able to set the price in the market and thereby maximize the profit. Whereas some scholars view this tendency as an inherent destabilizing force within capitalism, others view the individual striving for monopolistic profits as canalized by a benevolent competition in favor of all.

To get a better understanding of the emergence of modern rational capitalism, we turn to those, who had this new development in front of their eyes and who were stunned by this inexplicable cultural phenomenon. Early nineteenth-century capitalism in Great Britain, for example, caused turmoil in society, as cities grew when people moved in from the countryside, starting to work in factories. This change in society produced incredible wealth for some people, but it also generated the first wave of modern mass unemployment and poverty (see e.g. Polanyi, 1954). This caused many to question the cohesion and order of society.

Social theorists tried to understand what they observed with tools they had at their disposal, but they realized that new ideas had to be formed to account for the change. According to the traditional ethical doctrine, a poor person was either unable to support himself and in need of charity, or they were lazy, for which they should be condemned. Another observation that did not go well with the contemporary normative ideas was that the most egoistic traders seemed to be more successful than those who held the more traditional virtues. Thus, daily problems were one reason for seeking new explanatory patterns that centered on a notion of the economy as an independently functioning realm.

But how is one to explain the great transformation of society for which rational capitalism played a key role? There are several theories about the origin of capitalism. The first theory of capitalism was developed by the precursor of sociology, Karl Marx (1818–1883), though he never used the word capitalism himself. Marx transformed a totally idealistic German philosophy into a so-called “historical materialism,” arguing that historical development could not be explained without taking into account material technological processes and real human beings. His scientific predictions about how capitalism would develop and ultimately lead to its demise were empirically falsified. On these and other grounds one may conclude that the scientific value of his theory of capitalism is limited. However, Marx foresaw a global capitalism, and the influence of his theories in society is unparalleled. He is also among the first to address the inequality and social turmoil that is associated with capitalism.

The German sociologist Max Weber (1864–1920) developed the most well-known scientific theory of capitalism, stressing the social process that eventually leads to rational capitalism. Weber acknowledges that various types of capitalism had existed long before the Western rationalistic type emerged, for example in China, India and mediaeval Europe. Thus Weber (1978: 164–66) distinguishes between several forms of capitalisms, such as political, authoritative and predatory, each with a different form of profit opportunities. Weber defines a (rational) capitalistic action as “one which rests on the expectation of profit by the utilization of opportunities for exchange, that is on (formally) peaceful chances of profit” (1968: 17). One important aspect of capitalistic actions is the market, which is a precondition for rational calculations.

As Weber himself pointed out, stability is a condition for calculability, which is vital to rational capitalism (1978: 296). Weber’s analysis suggests that money, which is the primary means of calculation, became an end in itself, and this fundamentally changed the values of society. This analysis, and the role of money in modern society was carried out in great detail by another German sociologist, Georg Simmel, in his work The Philosophy of Money (1978). A further consequence of capitalism is that people not only made some money, and then settled down, or used the money for social display. Capitalisms rather means, according to Weber, that people accumulate money where it was profitable, and reinvest it in industries, which lead to a growth in the economy.
Weber argues that rational industrial capitalism only emerged in the Western world. But what sets the Western rational capitalism and its spirit apart from other forms of capitalism? It is not the “impulse to acquisition, pursuit of gain, of money” according to Weber (1968: 17), since this is common also in non-capitalistic societies. Weber identifies, in contrast to Marx, the capitalistic spirit in certain specific values that became seen as virtues. It is the consequences of the virtue-inspired actions that generated the dominating form of capitalisms in the West. Weber, to be specific, argues that Calvinism in particular is an example of a religious belief that is correlated to how one does business in a capitalistic fashion. Calvinistic ideas, Weber says, promoted, more than others, the spirit of capitalism. Weber makes the point that the interpretation of the religious virtues provided an ethical foundation for “capitalistic actions.” When people, later, became socialized into these economic virtues, they may accept them without their religious undertones. Weber has established a link that indicates the way the religious virtues affect the economy. In fact, he explains how the economy could become an autonomous sphere, separated from the “original” sphere of religion.

Though it is clear that there are different theories about the emergence of capitalism, there is at least some agreement on what it means. Capitalism is defined as “accumulation of wealth,” and this implies making profit. Profit is predominately generated in markets. All in all, these ideas suggest that capitalism gave the impetus to the ever-increasing wish for accumulation of wealth, which means that national markets were not enough. As a consequence, economic actors and the corresponding market relations soon stretched beyond the European nation states with the ambition to further increase profit.

Markets

Markets are the central institution of the contemporary capitalistic economy. There is also a second reason for stressing the role of markets. By the development of a global economy, the role of states as regulators or triggers of markets must be analyzed. Furthermore, it is not primarily trade between states (as organizational units) that has increased, but the trade between firms across the globe, though these of course reside in countries. The unit of analysis is the market, not the nation, if one wants to take economic globalization seriously. Ever more companies, however, grow and are best described as multinational or global actors. This development, in other words, cannot be understood unless the role of globalization of markets is considered.

What is a market? In a way we all know what a market is, since we take part in “markets” almost on a daily basis. When we decide to make our tea at home in the morning, or decide to buy a takeaway from one of those who offer this “in the market” on the way from your home to the university, we are “in” the market. A market, in short, is a social structure for exchange of rights, which enables people, firms and products to be evaluated and priced (Aspers, 2011). Let us elaborate on this definition. This means that at least three actors are needed for a market to exist; at least one actor, on the one side of the market, who is aware of at least two actors on the other side whose offers can be evaluated in relation to each other. The social structure consists of roles (buyer and seller, and consumer and producer), divided on the two sides of the market interface. Actors take part in markets to get better off. Different interests or goals characterize these two roles, the one wants to sell dear, the other to purchase for as little as possible. Property rights, often embedded in trust, are conventional in a market, which makes market interaction peaceful. Exchange implies that something, for example money, is traded for something else, such as a commodity. What is traded in a market is usually what gives it a name, for example, “the market for clothes.” That there is a stable social structure made up of roles implies that the market is extended over time. Though the notion of market is used to refer to a specific
place, the proposed definition does not imply a location in space. A market may, in other words, exist “in several” places over time; this is the case of the “market for foreign currencies,” where trade in this market is an around-the-clock-activity. That a market is defined as existing over time usually means that a specific market has its own “market culture.” Culture is defined as beliefs, “tools” and behaviors – e.g. discourse and practice – which are appropriate to the market. This refers, for example, to how one interacts in the stores, how offers are priced and much more. Each market may not necessarily have a unique culture, the culture in the market for clothes and the market for shoes may not be so different. In fact, both are today essentially markets of fashion. More generally, many markets may have similar cultures, and people today are socialized into a general “market culture” that may not differ much, for example, between different consumer markets. What we have just described is a minimal definition, and it assumes institutions – i.e. rules and regulations that govern behavior with sanctions – that may be used also outside the market.

It is important to keep in mind that many markets have been organized by the state, and towards the end of this chapter we will get back to this issue and discuss how states in the form of state-capitalism today operate in global markets. The state provides, of course, the legal system that aims at “law and order.” It is, however, also involved in the creation and governance of many individual markets, as has been showed by the sociologist Neil Fligstein (2001). But does not the development of a large number of global markets diminish the role of the state? So far we have assumed that we know what a globalized market means. But to address this question we need to look at what global and globalization means. Only then is it possible for us to say something about global capitalism and the markets that make it up.

Globalization

The notion of globalization catches how culture, economy and politics, as well as other fields, are transformed in terms of dependency patterns. People depend on each other and what used to be segmented on a local, regional or national level is increasingly turned into a global dependency. The increased number of contacts, including business contacts, correlated with a greater flow of commodities and services around the globe, manifests the process of globalization in the economic sphere. There is both a quantitative increase, but one can also speak of qualitative new relations, such as when large firms come together and organize markets without the states.

Though most researchers would agree that the increase of dependency patterns that reach across the globe constitute the core of globalization, different social sciences have stressed different aspects. Sociologists, ever since Immanuel Wallerstein (1974) – and with later followers like Gary Gereffi (2005), whose works have had an impact also on economic geography and political economy – have stressed global inequality. The relationship between wealthy nations, often located in the northern hemisphere, and poor countries, often located in the southern hemisphere, is a dependency relationship because they need each other to flourish. It is, however, a relationship characterized by asymmetry, as most of the wealth has ended up in the already rich countries. Though few have denied that economic growth has also taken place in poor countries as a result of globalization, the initial idea of the Marxist-influenced world-system theory of Wallerstein emphasize that the very inequality between developing and industrial regions is a precondition for the wealth of the latter.

Anthropologists were among the first to notice globalization. This is because they, in contrast to sociologists and economists, ground much of their research in their “fields,” which is often made up of villages, towns and associations in developing countries. It was also in these
settings, rather than in the developed world, that one at first, and more directly, could observe how activities in one part of the world were connected to activities in another part of the world. In other words, the relative change is much larger in areas that until quite recently have seen hardly any development at all. Anthropologists tend to focus on the notion of culture and they have therefore studied how culture in one place is changed as a consequence of its relationship to other cultures. Economic activities mediated through global supply chains that are organized to meet the demands of final consumers have increasingly penetrated the local cultures and caused traditional commodities, such as pottery, to be molded in a way that they are sellable in the shops in Tokyo or Detroit. Also vegetables have been modified to suit the final consumers. Moreover, vegetables exist in stores, in for example, Nordic countries, in larger quantities but above all in larger variety than they did 30 years ago. These are examples of how dependency patterns change over time and have consequences in both ends of the economic chain of transaction.

Globalization has, of course, a spatial dimension, which economic geographers have been quick to notice. Economic relationships, which used to exist in the village, the clan and later in the country or the region, are today reaching all over the globe. Outsourcing, not only to other firms within the same country, but to firms in other countries and parts of the world, is common. This we see in traditional industries as the textile industry and in the auto industry, but also in modern service industries as shown by outsourcing of call centers to other continents. Economic geographers in particular have shown how industrial networks within firms, but also across markets, connect places across the globe. Finally, as we will see later, economists also have discussed globalization. Some, such as Paul Krugman (1991), argue that there are decreasing marginal costs that result from economies of scale, as well as agglomeration effects. A consequence is that one may talk of imperfect competition, and the existence of clustering effects.

Globalization has been addressed in most social sciences, and in the rest of the chapter we will take a closer look at various theories and ideas that address “globalization” in a broad sense, using the concepts that so far have been discussed and defined, capitalism, market and globalization. We suggest that globalization can only be understood in relation to a discussion of capitalist markets, and this of course implies that one takes a historical perspective. One can in addition speak of three modern economic theory positions: mercantilism, liberalism and socialism.

Economic dependence in early societies

We said that globalization must be understood in terms of dependence at a global scale. However, economic dependency does not have to be global. Though we cannot discuss the entirety of economic history, we will make a few stops on the journey to rational capitalism, and the global tendencies that one sees with the increased international trade. This will give a background to the economic phase that is increasingly characterized by a global economy and that some may even take for granted.

Though many of us today are accustomed to markets and to capitalism, this has not always been the case. To address the question of economic globalization, one should remember that there are still economies that to only a small extent are integrated in the global economy. Economic issues in the widest sense – i.e. of production, distribution and consumption of scarce goods – have been solved in all social formations. One form is the household, or “oikos,” which was described by Aristotle. There is no trade within the household; economic transactions take only place between the household and its environment. The household (“oikos”)
can be seen as a form of hierarchy that is organized to the benefit and good life of the master. Those who know each other well and who may even be part of the same household do not trade. This, however, does not exclude the trading of surpluses between households. For the first trade to take place — and that might have happened in the agricultural Mesopotamia around 3,500 BCE — a surplus production is naturally a necessary condition (Swedberg, 2003). In Greece, there were some nobles of one polis who joined forces in order to organize long-distance trade with nobles of other poleis. One could say, however, that these exchanges were mainly based on the autarky-principle and were performed for the goods themselves — mostly luxury goods — and not primarily for profits.

The market was seen as the opposition to the autarky of the household, as it creates interdependence between actors and gives path to the possible profit motive. Thus, the market is in this view the arena that threatens the household. It is not surprising that trade, in the Greek tradition, corresponds with foreigners. Trading for the sake of profits (chrematistic) appeared, however, more and more frequently among the Athenians themselves in the fourth century BCE, and was largely perceived as a decadent phenomenon by Aristotle and others. The making of money for its own sake, decoupled from the agrarian basis, was morally condemned. However, autarky was the inherent telos of the polis and the oikoi, and trade, especially in grains, was strongly necessary. Insofar as the polis could be considered an analogy to the oikos one could even speak of an early international trade regime — regulated by the Athenian-dominated Attic sea alliance. In his “Poroi” Xenophon considers how an increase of trade and the according tariffs on it as well as an engagement of the polis itself in slave-leasing could be a way to secure revenues for the growing inhabitants of Athens.

This brief account of the household as the center of ancient economic life largely covers other forms of organizing the economy. Clan societies, various forms of small groups and of course hierarchical social-economic formations have also been in contact with other tribes or clans to trade. This suggests that economic dependency, between one group and another is reproduced in history. Though trade was not global, actors were not rational, and though early social formations were by and large able to sustain themselves, trade was an integrated part of life. Later, with further division of labor, between different societies, actors also came to see products that they could not produce themselves as “essential,” which increased the dependence between groups of people located in different places. The history of economic development cannot be separated from the history of trade and the web of commerce helped to create a civilization as Fernand Braudel has discussed in his three-volume work, Civilization and Capitalism (1992). We leap forward to the period in which nations, in a modern sense were developed in relation to each other, and in struggle with each other, to the period in economic history called mercantilism.

**Early modern theories of economics – mercantilism**

Contrary to its name — mercatus means trade — mercantilism as an economic doctrine did not favor inter-national trade. It is, in contrast, associated with a trade policy of nations to create national markets, a restraining development and independence of local markets, export monopolism and exchange controls in favor of a positive balance of trade. This doctrine was at its most popular between 1500 and 1750. The unifying name and homogenization of a pool of different ideas are mainly a result of the liberal classics’ reception and opposition to their preceding doctrine. The central political unit of the time in Europe was the emergent nation state and all economic thought was practically devised to enhance one nation relative to another, or in the words of Schumpeter: “The resulting economy was a Planned Economy; and it was planned,
primarily, with a view to war” (1954: 147). If trade could establish interdependences, it was only during the time when war – which was always a latent possibility on the continent – did not rage. Both internal and foreign markets could develop as long as they were perceived to serve the final purpose, the nation state, which was regarded as a purpose in itself. The newly constructed nation and the constant necessity of resources in war-time led to the development of general taxation systems. In this way, something like the economy of a country had to be represented, for example in the early tables of Quesnay. He described how the household of the state developed and one can see how the autarky principle associated with the oikos and polis in Greece was transferred to the nation level, in which the degree of autarky could be measured in precious metals by precursors of trading balances. On the one hand, the idea was to make the nation subsistent and independent of foreign supplies while at the same time gaining from the export of its own surpluses; these were the “conditions of trade.” Great Britain or the Netherlands subsidized monopolistic foreign trade companies (the “East India” companies) not only financially but if necessary with military force. On the other hand, the early manufactures and merchants with a profit-maximizing mentality tried to change medieval structures of craft guilds and their idea that a monopolistic production was favorable to all.

Economic literature of the time reflects its scholastic heritage. Economics was one part of a general ethic that considered the natural development as inherently good. Especially the physiocrats (1760–80) – the dominant economic doctrine in France – considered natural resources and foremost agriculture as the source of all wealth. In their view, only land generated a surplus and thus physiocratic arguments could be used to further agricultural class interests. Quesnay, however, was already a proponent of free trade under the guidance of state activity. Of course, it is difficult to apply the term “capitalism” to mainly agricultural countries which today we would consider as developing. It is however possible to see the development of capitalism in relation to the development of nations and both these developments have affected economic reasoning.

Modern theories of the market economy

The discipline of modern economics, represented by Adam Smith and later David Ricardo, emerged out of a critique of the physiocratic tradition and of mercantilism, a critique which was voiced in Great Britain already at the end of the seventeenth century. They set out the liberal theory that was to accompany the upcoming industrialization, increasing world trade, and nation building in Europe. At that time the connection between moral philosophy and economics was still strong. Adam Smith, for example, had a chair in moral philosophy and taught classes ranging from astronomy to ethics. Whereas Smith still thought of economic life being integrated in the natural order of a cosmic whole, the nineteenth century representations of economics turned to naturalistic laws governing a separable realm of the society. This idea has prevailed until today. In the introductory words of a standard textbook on international economics (Krugman and Obstfeld, 1994) the extent of a country’s international trade is considered in terms of Newton’s law of gravity (gravity model of trade), i.e. depending on distance and size. The basic tenets of liberalism can be summarized as the proposition of competition on all markets, especially the newly created labor market, the free trade amongst all nations and – later on – the gold standard (Polanyi, 1954: 141ff.). These conditions are seen to guarantee within a certain legal and political framework the transformation of divergent individual interests to a harmonious optimal order. The idea of bees – each concentrating on one thing according to the principle of division of labor, contributing to the good of society, without having this as an explicit goal – became a popular metaphor that in fact could be
applied for how society should be organized. This “invisible hand” argument allowed for the individualistic explanation of a macro-phenomenon via recurring wholly on the unintended consequences of intentional actions.

Adam Smith (1976) had already dealt with globalization – on the one hand he considers both the geographical spread of markets and the improvement of transportation as the prerequisite of further division of labor, which he claims to be the major source of the wealth of nations. The explanation of the mysterious abundance of goods was thus shifted from land into man’s labor power. Adam Smith is a major proponent of free trade and competition between nations – only through the surpluses on foreign markets can the wealth-generating division of labor prosper. On the other hand, he explicitly deals with foreign trade questions such as the dependence on colonial resources or the disturbance of market expansion by protectionist measures. In fact, the controversy of free trade versus protectionism stems from the class conflict between agricultural versus trading interests (Polanyi, 1954) in which Smith and Ricardo were strongly involved. The first coherent theoretical consideration of the international trade phenomenon is ascribed to Hume and his “Of the Balance of Trade” (1752). A first major explanation of why free trade happens and why it should happen was furnished by Ricardo (1970) when he explained the international division of labor via the differences in labor productivity. If a country is able to produce a good more efficiently than another country, it shall specialize in this activity. This argument about the absolute-cost-advantage was proposed by Smith against mercantilism and it relies on the idea that international trade is a constant-sum game. But even if one country produces two goods with higher efficiency, each country should specialize in making the product it can do best, expressed in terms of relative comparative advantages. As a consequence, Ricardo claims that even developing countries should enter in the international trade system to the benefit of all. Ricardo was the first thinker who rigorously separated the economy as a self-organizing system from the social whole and thus put a wrench in between different social sciences, also separating them from general ethics. His argument about the comparative advantage of trading and the concomitant rise in economic growth is still the major anti-protectionist argument in trade policy debates such including the latest debate about the Transatlantic Trade and Investment Partnership (TTIP).

The optimism about the positive economic consequences of international trade has traditionally been complemented by one about the positive political consequences. Thus, trade ever since Montesquieu was not only thought to refine individual virtues (Hirschman, 1986), but also to prevent nations from fighting wars. One version of this capitalist-peace thesis suggests that the availability of global markets have made wars for resources and territories less attractive. Another version holds that the shareholders in transnational capital investments are likely to veto any security-endangering behavior and that governments of capitalist nations tend to control each other’s political agendas (Gartzke and Hewitt, 2010). Though there is some evidence to support the capitalist-peace thesis, there are also some striking counter examples, such as the First World War occurring at the first peak of international trade.

But market optimism was also dampened with regard to the social question. When it became evident that social disruption, mass poverty and dependency on a seemingly uncontrollable economic system accompanied the supposedly orderly wealth-generating processes, antagonistic socialist, utopian and nationalist ideas emerged, out of which the most lasting were those proposed by Karl Marx. Raised in the Hegelian tradition he took over the idea that modern life is characterized by deep bifurcations that are to be overcome to reach a true whole. These bifurcations were not mere logical contradictions, such as the lack of consistent theory of truth, but could be witnessed on a daily basis in the modern economy: capital has the tendency to cover the whole world with markets in order to maintain the necessary profits to
survive, but the movement of market expansion will find its natural limit. Capital moves beyond
the nation state, even undermines it, but still relies in parts on its existence (Engels and Marx,
1969:30). Furthermore, the exploited labor as a source of profit is constantly reduced by the
ferocious competition, impoverishment and impending automation, and as a consequence it
diminishes the surplus value of production value and consumer demand in home markets.

In his *Communist Manifesto* of 1848 Marx anticipated essential features of the globalization
process.

The need of a constantly expanding market for its products chases the bourgeoisie over
the entire surface of the globe. It must nestle everywhere, settle everywhere, establish
connections everywhere. The bourgeoisie has, through its exploitation of the world
market, given a cosmopolitan character to production and consumption in every country.
To the great chagrin of reactionaries, it has drawn from under the feet of industry the
national ground on which it stood. All old-established national industries have been
destroyed or are daily being destroyed. They are dislodged by new industries, whose intro-
duction becomes a life and death question for all civilized nations, by industries that no
longer work up indigenous raw material, but raw material drawn from the remotest zones;
industries whose products are consumed, not only at home, but in every quarter of the
globe. In place of the old wants, satisfied by the production of the country, we find new
wants, requiring for their satisfaction the products of distant lands and climes. In place of
the old local and national seclusion and self-sufficiency, we have intercourse in every direc-
tion, universal inter-dependence of nations. And as in material, so also in intellectual
production. The intellectual creations of individual nations become common property.
National one-sidedness and narrow-mindedness become more and more impossible, and
from the numerous national and local literatures, there arises a world literature.

*(Marx and Engels, 1948: 12–13)*

Marx’s main oeuvre, *Das Kapital*, was intended to be completed by a volume on the world
market as the final and therefore most evidently contradictory stage of economic theory and
reality. The first economic world crisis in 1857, in which large amounts of accumulated wealth
were destroyed, and the fact that suddenly the New York Stock Market became relevant to
workers in Manchester’s manufacturers and the Ruhr’s coal mines, give a plausible underpin-
ning to Marx’s idea that even the dullest consciousness would be awakened. The fact that while
the capitalist system becomes richer the proletarian becomes poorer, less able to realize her
human capacities and thus alienated, must at a certain point strike the proletarian conscious-
ness as a human-made fact that can be overcome only by concerted human action.

Marx deals with themes of international trade, though mainly in an unsystematic way, in
newspaper articles from the 1850s onward. Subsequent Marxist theorists were to systematize
these texts, adding much of their own thoughts. Lenin, for example, considered the interna-
tional system as imperialistic and anticipated a rise of the peripheral economies that could only
be prevented by the capitalist core countries through wars. Marx’s ideas, as is known, became
an important component of economic life itself — to be reckoned with by later economists,
social theorists, activists as well as politicians.

Within economic theory proper the classic models about world trade also did not remain
unchallenged. One major point of critique is the assumption that wealth and different special-
izations within the world economy would hinge solely upon the unique factor of labor. In
contrast to these ideas, the Swedish economists Heckscher and Ohlin considered the actual
amount of different production factors such as land, labor and capital as major causes for the
degree to which countries are involved in international trade (Ohlin, 1933). If a production requires, for example, much labor input and if accidentally a country is well-equipped with labor, it will specialize in that production. Whereas in Ricardo’s model all benefit directly from trading, in the Heckscher-Ohlin model more trade involves more competition with imports and relative losses for those scarce factors in a country, that do not profit from more exports. In another more recent model, the standard trade model put forth in Krugman and Obstfeld (1994), different elements of the two proceeding models have been combined. This is to say that demand and supply are mediated by the relative terms of trade, quoted in the ratio of export- and import-prices. Export growth and subventions of exports reduce the terms of trade in this model and lead to diminishing wealth. This can be seen as a refinement of the original liberal Ricardian ideas.

Although the first wars of protectionism began during the 1870s, the world trade still grew within the system of the gold standard until 1914. Schumpeter says that in the 1870s many “predicted confidently that universal and perfect free trade would prevail before the century was out” (1954: 766). Each new leading industry – railway, coal and iron, engineering, electronics and communication, the chemical and pharmaceutical industry – did not only propel the national economies, but furthered international trade as well. Another major economic factor was the ongoing colonialization, guaranteeing a supply of raw material and sales markets at the same time. With the First World War, however, the trading system broke down, the requirements of the gold standard were loosened or abandoned and during the 1920s the international trading regime could not be re-established. The USA and also Germany had meanwhile overtaken the Commonwealth as the world biggest traders – while the US-home-market remained highly protected by tariffs – and the USA had become the world greatest creditor at the end of the war.

When the 1929 crash eliminated fortunes and savings of millions within a month, resulting in the Great Depression, the classical ideas about the merits of self-regulated markets and uncontrolled exchange were put in question. How could one trust an abstract mechanism that eliminates one’s life-time savings, which shuts down companies via uncontrolled interest rates on loans and which creates the paradox of food destruction and simultaneously starving people in the Midwest? And how could one claim that economic theories that had allegedly contributed to the clash were true?

The most lasting intellectual and political-practical critique of the classic theoretical view was put forward by the Cambridge economist John Maynard Keynes. In his early years he followed his teachers in advocating the advantages of free trade, but he revises this view in his General Theory (Keynes, 1967: 333ff.), and argues for governmental interventions to stabilize the economy and gain a positive balance of trade. In his argument he supposes an economy with a currency tied to gold, relatively rigid wages, liquidity preferences and banking conventions. As follows, the only factor influencing the interest rate is the amount of gold that depends on the trade balance (more imports lead to less gold implying a falling interest rate). Thus, the only way to influence a factor that is important for the national economy is to have an active trade policy. Keynes did not hold a protectionist view, as he clearly acknowledges some advantages of free trade. Nevertheless, in his consideration of the economy as an economic-political whole, he theoretically criticized classical ideas about a naturally self-adjusting rate of interest. The General Theory can be called the first coherent work in which the national economy is represented as a self-contained system – not only a somewhat separated realm – functioning according to mechanical laws. This representation was additionally backed by the macroeconomic econometric constructions that soon came to be a fact of its own, connecting economic activities and the comprehension and interpretations of these activities. After the decline of the
economically rather disperse empires, one could more easily associate the nation state with an economic system.

In the era following the Second World War the consensus position could be described as a trust in free market forces if institutionally regulated. The Bretton Woods System – that built on Keynes’ ideas to some extent – was to give international trade an institutional underpinning: relatively fixed exchange rates, an anti-protectionist regime and transnational finance institutions such as the International Monetary Fund and the World Bank. These institutions were designed to grant financial and knowledge-based aid to developing countries and were meant as a stabilizing mechanism. The 1970s oil shocks, free-floating currencies, debt crises and the rise of huge multinational companies changed, however, the economic conditions.

The neo-liberal ideas of a free market, especially in the UK and the USA, but also in traditional welfare countries such as Sweden, must be seen in the light of the strong state and strong influence by unions in many Western European countries. Free trade and less regulation were seen as essential components to increase wealth, but also to keep control of the economy. At the end of 1980, with the collapse of the communist system, the global liberal economy expanded into the virgin land of Eastern Europe.

While the 1980s was the time when classical ideas reappeared in the form of neo-liberal and neoclassical theories, new forms of intra-economic critique emerged. Whereas all previous classic economic models explain the advantages of trade through the differences in countries and the subsequent gain they have when cooperating, the New Trade Theory was developed in the 1980s as an explanation about increasing returns in production. Mass production in some countries, often initiated by contingent historical events, can offer goods at a much lower price than dispersed production in many countries. One interesting feature of this theory is its connection with a monopolistic market structure. These economists argue, in a way that resembles Smith’s argument, that the initial protection of a growth industry via the state is favorable in the long run. Krugman, as one of the theory’s main proponents, linked its ideas with classical themes in economic geography such as agglomeration effects and transportation costs (Krugman, 1991). The theory captures the path-dependency of export industries in many countries, such as Swiss watches or German cars. It also explains why some network industries tend to remain domestic given that transport costs are high and the domestic market sufficiently large to exploit increasing returns to scale (home-market effect).

Almost contrary to the views of the economic theorists that do not imply one totally free market, the European Union began to deregulate and at least to construct a European telecommunications market in the 1980s. This project would be accomplished in 1998, despite the obstacles of technological compatibility problems and the specific national interest in providing a telecommunication access. But as a result of a political struggle within EU policy, the technical standards could be harmonized and in the 1990s all major state-owned telecommunication companies could be privatized. Although this does not imply that the old major companies were driven out of competition, nor that states ceased to play a role in the market, new technologies could be adopted and especially the market for mobile phones was entered by a considerable number of new private companies. This development is accompanied by further delegation of competences to the European level – market-making is in this case at least partially accompanied by further state-building at the European level.

**Global capitalism**

Since the 1990s, the notion of “the global market” has become common, not only in academic economics, but also in newspapers and in everyday gossip. The rising food prices due to
increased demand for grain in the world market do not need further explanation when mentioned. Moreover, Russian energy politics influence the calculations of European households. At the same time, some formerly nation-based multinational firms have become true transnationals, whereas the political integration or a cosmopolitan identity construction among the “economic subjects” within the trading zones usually lags behind. The representation of economic globalization in discourse, however, is highly ambivalent and not especially clarified by its excessive use even in everyday conversations.

Throughout history, capitalism has been criticized – from Aristotle and onwards – by the nobilities, who looked down on capitalists and merchants. Later on, during the period of industrialization and large factory production, capitalism became associated with an inmanently destructive and alienated form of society, as argued by Karl Marx. In Marx’s version the rivalry is not between the nobility and capitalism, nor between various types of capitalists, but between workers and capitalists. Marx eventually saw a global struggle approaching, with capitalists on the one side and the internationally unified proletarian army on the other. Though the original class concept cannot be translated one-to-one to today’s circumstances, the idea of international social movements as expressed in international boycotts of polluting oil firms or donations for catastrophes can be observed also today.

Capitalism has been seen as the road that poor and less developed countries should travel along in order to flourish. Free trade in markets, rather than protectionism, is the remedy that global economic-political bodies, such as the International Monetary Fund, propose. The shock therapy proposed by the international finance institutions, which use the neoclassical model to predict outcomes without considering the cultural and historical contexts of the different “cases,” have often resulted in disastrous consequences on the environment and local communities. Nonetheless, there is empirical evidence supporting the view that many countries, especially in Asia, have seen great improvements in their living standard from the 1970s onwards, due to increasing international trade, though this may have little to do with trade theory.

At the same time as many people have seen improvements, due to increased international trade and global competition, others have not. In some countries there is a gulf between those who have and those who lack economic resources. In other words, global capitalism is the most superior economic system of increasing the total amount of wealth, but it may also create wealth gaps between countries and also among people within the same nation.

The critique of capitalism is not only directed to these effects, it is also argued that it is ecologically unsustainable. Though capitalism per se perhaps cannot be blamed for pollution and other effects of industrial development, it has become the target of criticism. It may be because there is no global organization capable of fulfilling the role of protecting and policing the global arena. Legislation and politics is, at the dawn of the twenty-first century, still essentially national, though markets and the economy at large are becoming increasingly global. This may cause tensions.

One of the more academic but equally fervent and popular critiques against neoclassical versions of globalization stems from Stiglitz (2002), the 2001 Nobel prize winner, and economics’ enfant terrible. His arguments are quite forceful as his theoretical critique of the efficient market model based on his economics of information is accompanied by his first-hand empirical accounts of the model’s failure in developing countries and the ideological involvement of the IMF in generating these failures. If markets within more developed countries with a long capitalistic tradition tend to lead to inefficient results in cases of small information imperfections, it is not surprising if a shock-therapy implementation of the market system in Russia or Latin America does not function as intended. Stiglitz concludes that for free trade to have favorable effects it needs to be regulated. Moreover, the institutions governing world trade regulation
today – the WTO, World Bank and the IMF – need to act more transparently and be open to the institutional peculiarities of countries. Whereas Stiglitz’s critique is still directed at enhancing existing imperfections within the market system, there is an amount of left-wing opposition, such as ATTAC or rising socialist thought in Latin America, who consider the market system itself as the core problem. One constant point of criticism is the dimension and impact of speculative international finance markets in which a day’s trading exceeds the annual trading in real goods. James Tobin suggested in the 1970s to apply an international tax of up to 1 percent of the volume traded in order to avoid major fluctuations.

The criticism is nourished by the observations of the most recent economic crisis, which erupted in 2008. It had its epicenter in the American financial system, initiated a worldwide economic downturn, and has been described as the most severe crisis since the Great Depression of the 1930s. Global trade per GDP collapsed by almost 30 percent between 2008 and 2009 (Eaton et al., 2011). This crisis showed, first, that even local markets are affected by the global finance markets. Second, and independently from historically specific conditions, financial markets seem to follow a certain pattern of destructive development that suddenly makes globally unpredictable events locally relevant. Finally, it shows that, as in the first global crisis in 1857, purely financial events have repercussions on the real economy through the credit market within the global market system. Below we take a closer look at these three points to get a better understanding of this crisis and to demonstrate the interconnection of markets.

(1) Local markets are affected by the global finance markets

In the aftermath of the technological bubble after the turn of the last millennium, the local American housing market – an asset that is national and immobile – was made globally relevant through the creation and dispersion of sophisticated financial instruments. The low interest rates set by the US Federal Reserve, made it easy and cheap to borrow, which meant that markets were flooded with credit. Low interest rates, in addition to the expectation of continuously rising house prices, furthered the demand for mortgage credit in the USA. The rising house prices meant that people could borrow more money as the worth of their home increased, with their houses as an underlying asset; money that could be used for renovating the house, but also for consumption and speculation. The so-called subprime loans are loans primarily given in the USA to people who normally would not be seen as credit-worthy. The loans the financial institutions had given, which included more than sub-prime loans, were transformed into investment products known as collateralized debt obligations that could offer high interest returns to international capital from, for example, Asia or the oil producing countries. The speculative moment of the investments were multiplied through hedging instruments making huge wins and losses possible with only limited amount of capital. When it became evident that many homeowners could not pay their debts, that the ever-rising housing prices came to an end, and that even well-known and established financial institutions had sub-prime loans in their portfolios, international capital demanded much higher interest rates or simply stopped offering money in the credit market. As a result, even high-risk investors found it hard to obtain money. Because of the so-called “credit crunch,” banks were thus pressured from two sides: from the one side by the problem of finding capital as their capital bases decreased with the lowered value of their stock of credit, and from the other, by customers who increasingly were unable to pay their mortgage. Several retail banks and investment banks in the USA, UK and many other countries, had to be rescued by the state. The connection between local mortgage markets and the global level is a clear indication of a global economy, in which markets are tied together.
(2) Financial markets seem to follow a certain pattern of destructive development

Is the current crisis an expression of a general cyclical phenomenon inherent in market economies or is it a historical contingency? Without giving a clear answer to this question, we here take a position in between, pointing at the weaknesses of the two approaches. The argument of economic historians is quite strong: from 1618 onwards, one can discern at least 38 crises, which were all characterized by a self-disequilibrating financial market due to self-enforcing expectations, the inability of the actors involved to learn and a knowledge-divide between insiders and outsiders with massive financial redistributions to the former (Aliber and Kindleberger, 2005). These general characteristics can be found also in the most recent crisis: with the Fed’s low interest rates, American and international actors in the financial markets mutually fueled positive expectations of continuously rising prices; the abstracting force of the financial instruments created an even smaller community of insiders who had at least had some knowledge of what was offered, which left out even major American bank experts. At the same time, pointing to the general characteristics does not allow us to answer the question of who were the concrete actors of the general trajectory and why the crisis finally erupted at a certain point in time. It is, in this respect, necessary to consider variables such as the economic bubble of 2001, and the Fed’s low-interest response, the collapse of Bear Stearns, Lehman Brothers and others that were the first signs, and the business-worldview of “shareholder-value” that makes the financial representation of business more important than, for example, its business-to-business-image. However, this universalistic approach does not account for the fact that two economic crises are not independent events: historical actors associate a certain meaning with a crisis, which often becomes entrenched in financial institutions that emerged in reaction to the crisis or even in stories and gossip about the crisis that circulate among traders. Thus, even in recent events former crises played a constituting role: the governmental responses to the crises in 1929 or 1987 were an implicit part of the institutional environment in which the recent crisis took place. If one accepts the idea that these regulations have also an enabling effect, one could claim that institution-building by governments not only guaranteed a longer period of stability, but also a more severe crash to take place, because financial traders could put much more (over-)confidence in the stability of the system than before. Another point proving the dependence on former crises are the stories remembered and told by the market actors – the constant comparison with the 1929 crash might well have been an accelerating moment to the disruptive market movements. Thus, in the recent crisis, comparisons with the 1929 crash became a constituent part of the debate about the stock market crash.

(3) Purely financial events have repercussions on the real economy

The up and downs on the financial market are connected to the real economy, as the latter depends on the stability of prices, exchange and interest rates in order to make the necessary profits. If the stability is lacking and production slows down and massive strategies implying the laying off of staff are announced, the economy enters almost inevitably into a spiral of negative expectations. Already Max Weber observed this in his treatise on the stock exchange in 1894:

The long series of numbers at the back of the newspapers, which even readers who are neither capitalists nor businessmen cannot fail to notice, are not only of importance to capitalists and businessmen. Rather, the manner in which the dry numbers listed there change in the course of a year signifies the flourishing and decline of whole branches of production, upon whose situation hangs the happiness or misery of thousands.

(Weber, 2000: 326)
The stock exchange is often considered the epitome of the market model and the source of inspiration for the market-theorists. Economists usually point to the financial market, in addition to the stock exchange, as the empirically most developed version of their abstract market model. It is therefore surprising that this market seems to require massive institutional interventions for its stability to be maintained, though this is not a recent finding: “central banking and the management of the monetary system were needed to keep manufactures and other productive enterprises safe from the harm involved in the commodity fiction as applied to money” (Polanyi, 1954: 138). The recent crisis has caused massive state interventions, which quickly put much of the former liberalization politics in question. In contrast to previous crises, national governments coordinated their intervention plans, with the public, politicians and media in one country, often at the same time as other national governments. Intensified competition and expansion of self-regulated markets at the global level seems to require new, and perhaps, more rules and the creation of transnational institutions to stabilize the market system.

The recent crisis has been less virulent in some economies such as Russia or China, in which a certain kind of state-capitalism contradicts the globalization logics that are often presented as inevitable. Both these countries are centralized and governed by politicians who actively promote economic interests using an economic-political framework. Russia has regained some of its strength due to export of natural resources and China has grown as a result of its capacity to produce and export goods for the world market. This development in the global economy emphasizes the role of the state in the global economy. As a result, some countries have begun to protect their economies from state-run companies and investment funds that operate from outside of its borders. Will this lead to yet a new form of capitalism, such as global state-capitalism?

Conclusion

From an economic perspective, our globe has become smaller. Economic dependency patterns that used to be within the clan, between clans in the form of long-distance trade, between economic actors who could not produce everything, today include most people of the world, directly or indirectly. The relationships today are more complex and above all more indirect. Technologies – for example the Internet – and a great number of mediators and a differentiation of markets, have contributed to make the global market more difficult to understand. We may only, at best, have a vague idea of how the parts of our computer upon which this text is written have been produced, compiled and sold; we are unlikely to know who took part in the large number of steps of development, testing and production operation that made it what it is.

We have stressed how the forms of dependency have changed over the last two thousand years (Durkheim, 1984), focusing on the last 500 years. In this chapter, we have argued that to understand economic globalization and the theories that are relevant both for explaining this change as well as for actually generating some of the changes, one must – besides the theories – take markets, capitalism and globalization into account. Today we see some industries, like the garment industry, as practically impossible to operate in the way they do, were it not for the global opportunities and division of labor. The ambition of firms for profit, and the fact that people wish to buy the garments, all of which is coordinated via markets, means that competition between actors, sometime all over the world, may result in a global market capitalism, when many markets (all of which are driven by profit motives) are interconnected. These market relationships imply that actors operating in markets in which quite different capitalistic modes dominate can also be connected. From a more general sociological point of view, the global interconnections make it problematic to speak of kinds of societies, as notions like
“consumer society” or “knowledge society” suggest. Markets are the central coordination form in the economy and we suggest that the degree of globalization and the kind of capitalism should be connected to the level of markets.

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