Capitalism is an economic system in which most [means of production](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) are privately owned, and goods, services, and income are distributed through markets. Capitalism is also called free-market or free-enterprise economy. Under [laissez-faire](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) capitalism, the state is separated from the economy just as it is from religion.

Proponents of capitalism believe that it can create social harmony through every individual's pursuit of self-interest. Theoretically, in allowing people and businesses to act unhampered by government regulations, capitalism causes wealth to be created in the most efficient manner possible, which ultimately raises the [standard of living](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), increases economic opportunities, and makes available an ever-growing supply of products for everyone. In other words, as one person creates wealth for himself or herself, that person simultaneously creates wealth and opportunities for everyone else—as the rich become richer, the poor become richer too.

Detractors of capitalism contend that it exploits a large portion of society for the sake of a small minority of wealthy individuals. Supporters counter that a properly functioning capitalist system actually prevents exploitation and that in fact, government regulation of labor is what causes problems; it prevents individuals from living for their own sake. There should be no worker exploitation in a purely capitalist society, capitalists argue, because all workers are free to choose their employers. (It should be noted, however, that supporters of capitalism do not consider a job that does not completely satisfy a worker to be "exploitation"; in capitalist theory, exploitation only occurs when someone is physically forced to work against his or her will.) Moreover, in a capitalist regime, because employers are competing for workers, it is in the economic self-interest of employers to provide higher wages and better working conditions for their employees, lest they lose them to a competitor.

In a properly functioning free market, all businesses are competing with one another for profit, which should prevent any one of them from gaining power over the entire field. Only a business that was vastly better than its competition could win a monopoly for itself, and that would be an acceptable result of superior business skills. According to economist [Adam Smith](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) and other supporters of capitalism, coercive [monopolies](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) can only occur when the government grants special treatment to one business in the form of franchises, [subsidies](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), or [tariffs](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism). One of capitalists' main criticisms of socialism is that the government controls all means of production and thus creates the ultimate form of monopoly.

Individual rights must always be upheld in order for capitalism to function effectively; that means that the majority must not be able to violate the rights of the minority. A constitutionally limited [democracy](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), like that of the United States, is fairly effective at keeping a capitalist economic system working smoothly. Systems of government that concentrate power in the state at the expense of individual freedom, including communism, socialism, and [fascism](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), are incompatible with laissez-faire capitalism.

The origins of capitalism can be found in Europe in the 16th and 17th centuries. Before that time, any excess profits made by a manufacturer generally went toward such activities as the building of cathedrals; the Catholic Church discouraged too much pursuit of worldly wealth and tried to get people to spend money on spiritual enrichment instead. With the rise of Protestantism, however, hard work and wealth came to be seen as a worldly manifestation of God's blessing.

During the 16th through 18th centuries, the English cloth industry began following capitalist tendencies; manufacturers began taking their profits and investing them in their production facilities in the hope of making even greater profits in the future. Also around that time, Europe's supply of precious metals like silver and gold was increasing, which meant an[inflation](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) of prices. Wages did not keep pace with inflation, and capitalist manufacturers benefited from that gap by increasing their profit margins. In addition, the rise of strong national states helped capitalism by implementing such social constructs as uniform monetary systems and legal codes, which made it possible for private [entrepreneurs](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) to function profitably and safely.

The Industrial Revolution of the 18th and 19th centuries changed the focus of capitalism from commerce to industry. Political [liberalism](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) of the time supported [free trade](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), the [gold standard](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), [balanced budgets](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), and little poor relief.

The social philosopher Adam Smith wrote the first major work on capitalist political economy,*An Inquiry into the Nature and Causes of the Wealth of Nations,* in 1776. Smith posited that societies progress through four stages: the original stage of hunters, a period of nomadic agriculture, a time of feudal farming, and a final stage of commercial interdependence. Each stage is accompanied by institutions that meet its needs: there is little need for civil government in the earlier stages, which don't involve private property, but the later ones need methods to protect the rich from the poor. Smith thought that the final stage should leave economic determinations to the market rather than let the government regulate the economy. That system, laissez-faire capitalism, was Smith's idea of perfect [liberty](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism).

According to Smith, laissez-faire capitalism would function in an orderly manner through the protective mechanism of competition, which prevents people from following their passions and desires exclusively. Capitalism requires that individuals act in their own interest, but if everyone does that at the same time, the system will remain more or less in equilibrium. Many people competing with one another for betterment results in an "invisible hand" that regulates the economy such that the prices of commodities stay at their "natural" level, corresponding to the costs of their production. Wages, rents, and profits are subject to the same discipline, which results in a natural orderliness in the distribution of income among workers, rents to landlords, and profits to manufacturers.

Smith argued that under the system of competition, national wealth could grow every year. The division of labor, aided by the prior accumulation of capital, would result in greater production than could be achieved by individuals working alone. Yet wealth could only grow if individuals did not inhibit it through artificial regulation. Smith argued against monopoly as much as against government regulation.

Other thinkers have also written in defense of capitalism. For example, [Ayn Rand](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism) thought that individual effort and ability were the sole source of all achievement, and that laissez-faire capitalism was the system most conducive to recognition and exercise of talent. Her connection of capitalism to individual rights and her thesis that individuals have the moral right to live for their own sake is the foundation of her philosophy of objectivism, which is one of capitalism's key philosophic defenses.

Ludwig von Mises, an Austrian American, believed in a liberal marketplace and the power of the consumer; he argued that capitalism was the system that benefited the most people and that socialism was antithetical to individual quality of life. His book*The Anti-Capitalist Mentality* (1956) examined the attitudes of American socialist intellectuals toward big business and the free market. Mises was a proponent of the Austrian school of economics, which has been one of the leading schools of procapitalist thought since the late 19th century. Other leading capitalist thinkers include Eugen von Bohm-Bawerk, Carl Menger, [Frédéric Bastiat](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), Dave Ricardo, George Reisman, Henry Hazlitt, [John Maynard Keynes](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), and[John Locke](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism).

During the 20th century, the application of capitalism changed. After [World War I](http://worldhistory.abc-clio.com/Search/Display/309337?terms=capitalism), international markets shrank, managed national currencies replaced the gold standard, and many nations implemented barriers to free trade. Most countries completely abandoned laissez-faire capitalism during the 1930s, and many of them implemented socialist forms of government assistance. At the turn of the 21st century, however, capitalism still survives in many countries.