

**CAPITALISM**

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When I first came to San Francisco in the early 1950's I went to work in the Trust Department of the Wells Fargo Bank feeling lucky because it was one of the few jobs available to me. I was impressed upon reading a copy of the bank's annual report that one of its directors, James Flood listed his occupation as Capitalist, not a popular title at that time. Several years earlier my economics professor at college had told me that Capitalism had proven itself to be evil and stated that the problems of the 30's were the result of too much capitalism in the 20's. Samuel Insull, the utility wizard, was seen as the embodiment of the excesses of capitalism, and the failure of his empire in 1934 was one of the main reasons for the establishment of the New Deal. One of the first things done was to change the definition of liberalism from the concept of a reduced role for the state, maximization of individual liberty, economic freedom and reliance on the marketplace to more government economic planning, control and allocation of resources by tax policy. This new liberal role of the government was expected to be the wave of the future, as already, evidenced by the success of Communism in Russia and the US's government mobilization to win World War II. It was believed that government could now control the business cycle with the help of deficit spending, tax policies and regulations. The concept of Capitalism as a driving force was seldom used to describe the prospects of the post World War II economic future. Rather, the idea of government regulation of the economy was systematized and sanctified by Keynesianism, with its promises of growth and full employment. And indeed the brilliant progress of the West's economies from the Marshall Plan until Vietnam seemed to bear Keynes out. But of course Keynes only favored government deficits when the economy was in need of stimulation. The idea that deficits would be used as a permanent form of electioneering by a new class of career politicians appears not have occurred to him – or to nearly anyone else. However, in the 1830s Tocqueville is supposed to have said, “A democracy will always vote itself more benefits than it is prepared to produce”.

Milton Friedman -who was an early advocate of free markets and capitalism -was struggling for recognition in this early post war period. In 1941, not even the determined president and dean of the

University of Wisconsin could get Friedman appointed to a teaching job over faculty objections to his writings defending economic freedoms. Duke University in the 1950's had none of his writings in its library, as they were not considered by the economics department to be of any worth. Out of step with the socialistic thinking of his time, Friedman was passed over for a Nobel Prize award until the mid-1970s, by which time the role of an omnipotent government had come under question and the value of his views was finally recognized. This acknowledgement marked the real beginning of the return of Capitalism in the United States. Big government had failed to win either the war against communism in Viet Nam or the war against poverty at home begun by President Johnson. Big government had not worked and the continuing financial deficits were creating massive inflation unlike anything experienced in the previous hundred years.

A new book, "Commanding Heights; The Battle Between Government and The Marketplace That Is Remaking The Modern World" by Yergin and Stanislaw details how the commanding heights of the world economy [ this phrase was coined by Lenin] have been stormed and conquered by the free market idea. On March 28, 1979- a day when Britain was so paralyzed by labor strife that even the catering staff at the House of Commons was on strike – the Labour Party Government fell on a vote of no confidence by just one vote. In the general election that followed, the Conservatives returned to power, led by a new prime minister, Margaret Thatcher. In the words of one of her cabinet ministers, Mrs Thatcher "believed in hard work, achievement, and that everything had to be paid for". A grocer's daughter, Mrs Thatcher started the global economic revolution that has become the defining event of our age. That same year Paul Volcker assumed the chairmanship of the Federal Reserve, and Deng Xiaoping initiated reforms in China. The next year Ronald Reagan was elected President. Five years later Mikhail Gorbachev introduced the policies of glasnost and perestroika. Five years after that communism collapsed in Eastern Europe. The following year the Soviet Union disintegrated.

Despite these land mark changes the United States government could still cite many social accomplishments over the past 50 years and continued to exert some control of the economic cycle that had only partly been returned to businessmen. Federal Reserve Board Chairman Allan Greenspan still has considerable influence through control of short term interest rates but even that influence is of less importance than it was ten years ago. As time has passed, deficit spending during periods of economic

slowdowns leading to subsequent inflationary pressures has proven to be non-productive. Government regulations influencing the flow of capital through interest rate controls and tax policies has resulted in a boom and bust in the real estate industry and created notable examples of failure in attempting to control of agriculture production. Today, many of these policies are being abandoned. It is again believed - worldwide -although reluctantly by many, that capitalism may be the best hope for the economic future.

Modern capitalism began its long and tortuous evolution over two hundred years ago. Adam Smith, in his classic 1776 book "Inquiry into the Nature and Causes of the Wealth of Nations" was one of its first disciples. He stated that labor - not land or money- is the real source of a nation's wealth. He advocated free trade and free markets unrestricted by government controls or private monopolies. Smith argued that individuals know best what is good for them and that under the influence of the profit motive would turn out the product society desired most. In this manner, self-interest would be harnessed to the common good. Up to this time the transition from feudalism to capitalism in Europe had been slow, tortured and complicated. Work was not yet seen as a means to an end - the end being money and the things it buys. Rather, work was still an end in itself - while encompassing money and commodities as products, work was viewed as something one engaged in as part of a tradition or a natural way of life. The great social invention of the "market" had not yet been recognized. The great arbiter, the church, held the idea of gain as a normal goal and guide for daily life in active disrepute. This contrast in view constituted an enormous difference between the strange world of the tenth to sixteenth centuries and the world that developed from that point on, a world that slowly began to resemble that of our own. Moral justification for worldly activity was one of the more important results of the Reformation and marked a change in attitude, the prevailing Middle Ages' religious view having been that working hard to accumulate assets represented the lowest sort of avarice and evidenced a personal character entirely lacking in self respect. John Calvin made the importance of the work ethic a central theme in his religious teachings, the foundation of Puritanism. One of the reasons for the success of Western Capitalism, particularly in the United States has been the balance between the drive for monetary success on the one hand and moral and ethical beliefs on the other. Adam Smith, as the first to identify and explain the principals of capitalism recognized the dangers of corruption among businessmen as the greatest Threat to the social and economic benefits of free

markets, if they lacked the dual protections of law and a moral society. In this country the strong Puritanical influence of the early Colonial days was very important to the early success of capitalism. Nevertheless, since then there have been recurring cycles of excess greed and speculation in the United States – as elsewhere among capitalistic societies – in which subsequent periods of correction and depression caused the public in general to suffer, not excepting the perpetrators of the excesses. These cycles were of shorter duration in the nineteenth century but subsequently began to lengthen, culminating in the Great Depression of the 1930's, the last major down cycle and correction. Since that time the business cycle trend line, with exception of the early 1970's has been upward with only minor fluctuations. Today the economic cycle is running so well and has been so free of cyclical interference for so long that the question is appropriately asked: "Do we finally have the right balance between commercialism, morality and ethics or are we poised to yet again experience a period of excess followed by another period of painful economic depression?"

So much of the world has now adopted "capitalism" as a mantra that it is important to understand that there are now possibly differences in the requirements for its success from those set forth by Adam Smith. This is now being tested in the Asian economies where "capitalism" evidences many differences from the USA brand. Such differences include among other things the customs, mores and religious beliefs that define and govern the relationship among individuals and between individuals and their governments. It is only in periods of stress that we can evaluate how deeply the capitalistic philosophy is rooted in a given society. Indonesia has for many years fostered a capitalistic system, but one accompanied by a dictatorship form of government. Others, such as India, Thailand, Malaysia in the far East and Argentina and Brazil in the southern hemisphere are struggling to maintain recently faltering capitalistic systems accompanied by governments that are less than true democracies. Russia provides another example of a former totalitarian government attempting to foster and cope with a capitalistic system one that it once taught its people to regard as evil. Will these new more or less capitalistic societies be able to survive politically the hardships of what we call corrections that seem inevitably to follow the resource allocation excesses that are part of the system? Or, will these countries return to a state controlled economy when confronted by the frustrations that accompany the disciplines of capitalism?

The French Revolution occurred at about the same time as the American Revolution, but in the rest of Europe where land had great value and yielded political power, real democracy began much later, often not until the end of the nineteenth century. Universal voting rights are a very recent phenomenon. Historically, there have been very successful societies that have existed for a very long time with enormous inequalities in the distribution of economic resources – ancient Egypt, imperial Rome, Classical China, the Incas, and the Aztecs to name some of them. But all of those societies had political and social ideologies that were congruent with their economic realities. None believed in equality in any sense whatsoever – not theoretically, not politically, not socially and not economically. In ancient Egypt and Rome the official ideology called for a very unequal sharing of power and the economic rewards. Ancient environments made slavery seem fair even to great thinkers, such as Aristotle, as well as to the slaves who were bought up in those societies. In such regimes the political sphere and the economic sphere co-existed successfully even while based on congruent inequalities.

In contrast, capitalism and democracy are very incongruent when it comes to their assumptions about the proper distribution of power. Democracies have a problem with rising economic inequality precisely because they believe in political equality – one person, one vote. Democracy holds out beliefs and reference groups that are not compatible with great inequalities. Capitalism has no problem with inequality, inasmuch as inequalities are a part of what operation of the system generates. However, capitalism's defense of these inequalities holds out a contrary set of beliefs as to why they are right and fair. Capitalism can argue that the economic process is fair, but it must be agnostic about the "rightness" and "fairness" of any specific outcome. But it now seems as though if anyone believes the process is unfair and goes looking for a justification for not accepting the outcome, it is always possible to find some aspect of the process that is not in accordance with the theories of competitive markets. As a result, those who defend capitalism usually assert that capitalism will provide rising real incomes for almost everyone while admitting that inequalities may sometime arise from government interference with an otherwise perfect system. The social objective should be achieving the right balance between a desired democratic form of government and the economic benefits of capitalism. Can this "right balance" be found?

The answer to this question lies, I believe, in the future of capitalism in the USA as the world's leader and capitalistic role model. Can capitalism invest in the human capital, infrastructure, research and development that will allow it to flourish, or will the focus be on getting rich in the short run and refusal to make the social investments upon which its long run success depends? History shows us that very different balances between the public and private sectors and between consumption and investment are possible for short periods of time but it also shows us that it is not possible to run a successful society without eventually achieving some sort of acceptable balance in both areas. All public, the model of communism, does not work. All private, the model of feudalism and the implicit model of Capitalism also does not work. The people who run governments and business organizations are not perfect for indeed they too experience greed and self-illusion that is destructive both to them and to public trust. However, people and Democracies react well to crisis since crisis focuses everyone's attention on the same issues and demands action. Without a crisis to galvanize public attention, democracies tend to reflect the lower boundaries of people's ambitions and almost never change dramatically. The USA is no exception.

Capitalism stands out today in a way that it has not stood since the mid-nineteenth century. Capitalism is efficient precisely because it harnesses the ruthless, competitive forces of greed and the desire to get rich that force profit maximization. But operating in a democratic society it is essential that society have strong basic ethical and moral values to balance capitalism's negative aspects. Despite the need for balance, governments, in their desire to assist people who are not able to participate fully in capitalism's benefits, create welfare programs that take the incentive, to even try to participate, away from these same people. Such programs tend to focus just on meeting basic human present needs rather than on providing essential long-run development assistance- food stamps vs job training. Thus, a short-term focus plus bureaucratic inertia and their inherent political appeal have caused the programs to become not the answer, but the problem. As capitalism develops over coming years it is the creative human mind that is the capital of the future. Organizations can go anywhere and function well in diverse environments so long as creative individuals are given the requisite incentives. Conflicts involving acquisition of real estate and natural

resources, with the possible exception of petroleum, are no longer as important as effectively managed brainpower. It matters little where the brainpower may be, because it is moveable.

It is my judgement that capitalism will survive and flourish if it continues to recognize that there must be a balance between the ideals of a democracy and the force of the drive for competitive, material success. Failure to maintain this balance appears to doom either democracy or capitalism to an eventual “withering away”. Further capitalism will flourish best in political environments that successfully recognize and accommodate the inherent weaknesses of the process, neither denying the fact of weaknesses that foster democratically-unacceptable inequalities nor seeking to counter their presence by providing assistance programs that fail to focus on enhancement of skills as the primary means of support for people who cannot fully participate in the wealth-creation process. The presence of defects is not an evil nor does it imply that a different system will have superior value for democracies. The solution lies not in denying the imperfections nor in fostering out-of-process dependence on government, but in imparting an ability to those who would otherwise be removed from participation to become involved to the fullest extent of their potentials through participation incentives that are more attractive than the rewards offered by the out-of-process dole. Political actions based either on the notion that it is wrong for the system to produce both winners and losers or that the winners should be bled through income distribution to provide permanent succor for losers who are serviced by welfare programs designed to insure they remain losers may well insure failure of both capitalism and democracy. Political actions, rather, must serve as the primary balancing medium, not as a champion for one element at the expense of the other. History has shown that a pure laissez-faire approach does not work – because there will always be losers – and that pure welfare state approach does not work –because there will always be winners. We know that people are neither equally smart and talented, or equally dumb and stupid. What we not yet know, or understand, given that capitalism’s success as an economic engine makes it the obvious system of choice, economically, is how to fully harness the system in the interests of a democratic society, politically. That understanding must be gained before capitalism and democracy can become the universal societal model. And, we – the USA – need to be mindful that it is us, “The most successful capitalistic society,” that is standing in the world’s spotlight.