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CAPITALISM VS. CORPORATISM

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ABSTRACT: *There are, at present, at least two basic forms of market economy: one that tends to be open to innovative ideas; the other that tends to be more oriented to social services. The normative significance of these two "models" of market society—roughly speaking, the American and the Continental models—can best be appreciated by noticing that in the first model entrepreneurship, and participation in the economy more generally, can be major sources of satisfaction for the entrepreneurs and employees, independently of their financial compensation. In the second model, the economy is primarily a means to the end of the goods it produces. Although the second type may be as suited to producing goods as the first type, it has fallen short—for reasons that economists now understand—in generating employee engagement and the satisfactions of exploration and self-realization.*

In the 1990s I devoted several years to a crusade for greater inclusion in society's formal business economy. My theme was the beneficial externalities and the justice of enacting low-wage employment subsidies aimed at pulling up the demand for low-wage workers, and thus raising their pay and employment. This work led me naturally to the property I call economic *dynamism*, and to the benefits of free enterprise both in greater inclusion and greater dynamism.

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I began with the essentially classical argument that a subsidy paid to employers for every low-wage employee is a sort of matching grant that would induce the private sector to increase its hiring and thus to increase *its* outlay to the working poor; so low-wage subsidies are more cost-effective in getting money to the working poor than are welfare entitlements (Phelps 1994).[1] The consequent rise in pay rates, in turn, would make longer work hours more attractive than crime to low-end workers.

My main argument drew on the importance of jobs for society as a whole, and for low-end workers in particular. Justice demands integrating those at the margins into what is a secular society's central project: its formal business economy. Employment subsidies would serve this cause by stimulating the creation of new jobs among the low paid, reducing their unemployment, and expanding their labor-force participation. Earning one's way in the impersonal world of business—supporting one's self—is, for most people, necessary for what Rawls called self-respect. In fact, for most people, jobs are the only adequate vehicle there *is*, if any such vehicle is present, by which they may pursue some of the central goals in life, such as self-actualization or self-realization (Phelps 1997).

Many scholars voiced radical disagreement with my proposal. They claimed that a state program to boost access to work was neither appropriate nor desirable. One critic said that public policy must aim always to be "neutral" between different values, such as the value of a life of indolence *versus* a life of contribution. Another said he was reminded of the motto *Arbeit macht frei* displayed in Nazi concentration camps. A deservedly respected commentator remarked that African Americans would not have voted for America's economic system had they been given a voice. While I saw access to jobs as offering workers invaluable non-pecuniary rewards, even though pay at the low end was not as ample as it could and should be, my critics saw the economy as a gray, necessary evil—one from which people of low productivity ought to be excused. We seemed to be on different planets, talking about two quite different *kinds* of economies.

Two Models of Market Economies

We *were*, as I came increasingly to see, on two different continents. Bracketing details and exceptions, one can discern in Europe, especially Continental Europe, an economic model—a set of economic institutions and an economic culture—that distinctly differs (despite some basic similarities) from the American model. There are consequently differences in economic performance, including the character of the economy's workplace.

To paint with a broad brush, then, there are two economic systems in the West, both founded on private ownership. The first system is characterized by great openness to the implementation of new commercial ideas coming from people in private business, and by a great pluralism of views among the wealth-owners and financiers who decide which ideas to nurture by providing them the capital and incentives necessary for their development. Although much innovation comes from established companies, as in pharmaceuticals, much also comes from start-ups—particularly the most novel innovations. This is "free enterprise," also known as "capitalism."

The second private-ownership system has been modified by introducing institutions aimed at protecting the interests of "stakeholders" and "social partners." The system's institutions include most or all (depending on the country) of the massive components of the corporatist system of interwar Italy: big employer confederations, big unions, and monopolistic banks. Since the Second World War, a great deal of liberalization has taken place, no doubt. But new corporatist institutions have sprung up: Co-determination (*cogestion*, or *Mitbestimmung*) has brought worker councils (*Betriebsrat*) and now, in Germany, a union representative generally sits on the investment committee of the corporation.[2]

On its face, the system impedes or discourages or simply blocks changes, such as the relocation and entry of new firms. The system's performance depends on established companies, in cooperation with local and national banks. What it lacks in flexibility it tries to compensate for with technological sophistication. So different is this system from the American one that it has its own name—or names: the social-market economy in Germany, social democracy in France, and *concertazione* in Italy.

The two systems are not operationally equivalent, contrary to the neoclassical economic view. A key part of my thesis is that the American system possesses more *dynamism* than the Continental system.

By "dynamism" I mean the fertility of the economy in coming up with new ideas that the innovators believe are technologically feasible and hope will be profitable; the adeptness with which the system selects among these fertile ideas for development; and the attitude of experimentalism with which the system receives the new products and methods—in short, the economy's talent at commercially successful innovating. This "dynamism" is not the same as high productivity or the rapid increase of productivity: Even undynamic economies may catch up—more or less—to the dynamic ones if the latter stay for a long time in the doldrums. But, generally, the "capitalist" system is structured in a way that facilitates and stimulates dynamism, while the Continental European system impedes and dissuades it (Table 1).

Yet historically, *both* systems have been seen as structured for dynamism. When building the massive structures of corporatism in interwar Italy, the corporatist theoreticians explained that their new system would be *more* dynamic than capitalism—maybe less fertile in small ideas, such as those of petit-bourgeois entrepreneurs, but certainly more fertile in big ideas. Not having to fear fluid market conditions, an entrenched company could afford to develop a radical innovation. And with industrial confederations and state mediation available, such companies could arrange to avoid the costly duplication of their investments. The state and its instruments, the big banks, could intervene to settle conflicts about the economy's direction. Thus, the corporatist economy, thanks to its

Table 1. Measures of Economic Dynamism

	Decision-making freedom at work	Turnover of listed firms	Patents granted per working-age person	R&D intensity adj. for industry structure
U.S.	7.4	118%	3.7	2.9
Canada	7.2	106%	1.3	1.8
U.K.	7.0	65%	0.8	1.9
France	6.4	79%	0.9	2.2
Italy	6.7	63%	0.4	1.0
Germany	6.1	42%	1.5	2.2

Decision-making freedom at work is measured on a scale from 1 to 10, 10 being the highest, averaged for 1990–1993 (Inglehart et al. 2004). Turnover of listed firms represents the number of exits from and entries into each country's MSCI National Stock Index from 2001 to 2006 as a percentage of the number of firms in 2001. Patenting data is averaged for 1990–2003 (World Intellectual Property Organization 2009). Research and development intensity adjusted for industry structure is the average percentage of business sector value added for 1999–2002 using the G7 industry structure variable (OECD 2005).

"dynamic efficiency," was expected to usher in a new *futurismo* that was famously symbolized by Severini's paintings of a fast train. (What was important was that the train was *rushing forward*. Mussolini, no doubt acting in part on their symbolism, made sure that the trains ran on time.)

Meanwhile, among theories of *capitalism*, the conception of entrepreneurship presented in Joseph Schumpeter's *Theory of Economic Development* (1911 [1934]) does *not* include dynamism. Schumpeter's invaluable point is that scientific discoveries and inventions are not commercial innovations: It takes the *Unternehmer*—someone with the organizational ability to commercially develop a discovery or an invention—to implement the unexploited profit opportunities created by the new technology. Schumpeter saw the capitalist economies he knew as performing this task perfectly well, and he offered no insights to suggest how well or badly the corporatism that was soon to come would perform it.

One generation later, Friedrich Hayek set out the first theory that viewed capitalism as dynamic (not just responsive)—more so than socialism or corporatism. But not right away. Hayek began what we may term the modern theory of capitalism with the work from his middle years—the mid-1930s to the mid-1940s.[3]

In this work, Hayek contended that virtually every participant in the economy, right down to the humblest employee, has private knowledge, or "know-how," about his work, his firm, and his industry—as opposed to formal book knowledge.[4] The decentralized decision making in the capitalist economy is well adapted to make use of this informal, highly specialized knowledge—much better adapted than centralized socialism.

But does capitalism have more *dynamism* than corporatism? In his middle period, Hayek says little on this point. However, it is natural to think that out of the great soup of informal, dispersed knowledge, someone might come up with a new idea for commercial innovation—an idea so new that few if any other business people would be likely to have thought of it already. Clearly an economy might generate a plethora of ideas this way. In the 1960s Hayek sketched the "discovery process," in which the conceiver of a new idea, such as a novelist, brings his idea to the market (presumably with the cooperation of an entrepreneurial publisher), having little idea of whether the public will buy it except that he knows that he himself likes it.

Clearly, the rate of such innovation will depend not only on the number of people oriented toward, and talented at, conceiving new ideas—what we might call an economy's innovational creativity—but also on the selectivity of economic institutions in choosing among new ideas, and the receptivity of the economy to the new ideas chosen for development and then offered on the market. It was left to subsequent theorists to point out some of these crucial factors.[5]

The pluralism of experience and knowledge that a capitalist economy's financiers bring to bear in their decisions radically widens the range of entrepreneurial ideas that have a chance of getting an informed, insightful evaluation. And it is very important that under capitalism, the financier and the entrepreneur do not need the approval of the state or of social partners. Nor are they accountable later on to such social bodies if the project goes badly, not even to the financier's investors. This allows projects to be undertaken that would be so opaque or complex as to be too uncertain for the state or social partners to endorse.

A pioneering spirit among the economy's other actors is also crucial to the economy's dynamism. The body of knowledge, formal and informal, that managers and consumers bring to bear in deciding which innovations to try, and which of those to adopt, is crucial in giving a good chance to the most promising innovations. Where the Continental system convenes experts to set a product standard before any version of an innovation is launched, capitalism gives market participants access to all versions.

This modern theory of capitalism conflicts with the corporatist notion that private businesses tend to be dormant in recognizing new opportunities. A well-known corporatist remedy is to put businesses into a state-run contest to be the "national champion" in their industry. In contrast, the modern theory of capitalism suggests that corporatist institutions and culture reduce dynamism by hampering managers' adoption of new methods and products, and by hindering start-up entrepreneurs from forming companies to develop innovations. And, owing to the lack of pluralism among the government decision makers who evaluate the potential national champions (as compared to the pluralism among market participants), the reduction in dynamism is unlikely to be offset by the state's backing of national champions.

The question, then, is whether capitalism's edge in dynamism matters.

The Benefits of Dynamism

The main *benefit* of a dynamic economy is commonly said to be a higher level of productivity—and thus, generally speaking, higher hourly wages and a higher quality of life.[6] There is a huge element of truth in this belief, no matter how many dozens of qualifications might be in order. Much of the gigantic rise of productivity that the world has seen since the 1920s can be traced to new commercial products and new business methods developed and launched in the relatively capitalist economies.[7] There were often engineering tasks along the way, yet business entrepreneurs were the drivers.

At least one qualification ought to be addressed, however. Have we not finally reached the point, after a century and a half of rapid growth, where yet more growth would be of negligible value? (D. H. Lawrence, writing about Ben Franklin, spoke of America's "everlasting slog.")

Whatever the answer, it is important to note that advances in productivity, in generally pulling up wage rates, make it affordable for low-wage workers to avoid labor that is tedious or grueling or dangerous in favor of work that is more interesting and formative. Thus, at least in the advanced economies, the most important benefit conferred by the capitalist model may not be productivity of goods so much as satisfaction in their production.

Dynamic innovation transforms the workplace (in the firms developing an innovation and also in the firms competing against them). The challenges that arise in developing a new idea and gaining its acceptance in the marketplace provide the workforce with high levels of mental stimulation, problem solving, and thus employee engagement and personal growth. An individual working alone cannot easily create the continual arrival of new challenges; it "takes a village" or even a whole society.

The notion that people need problem-solving and intellectual development is an old one. Aristotle wrote of the "development of talents;" in the Renaissance, Cellini jubilated in his own achievements; and Cervantes evoked vitality and challenge. In 1892, Alfred Marshall observed that the job is in the worker's thoughts for most of the day. And Gunnar Myrdal wrote in 1932 that the time would soon come when people would be more satisfied by working than by consuming. This view, sometimes called vitalism, became strongly associated with the Pragmatist school of philosophy, but perhaps most famously with Abraham Maslow's concept of "self-actualization."

All of these writers were pointing out the importance of a person's emerging sense of mastery. The American application of this Aristotelian perspective is the thesis that most self-realization in modern societies can come only from work. Today we cannot go tilting at windmills, but we can take on the challenges of a career. If a challenging career is not the main hope for self-realization, only family could be a competitor in that role for large numbers of people.

I should also mention a "derived" benefit of the capitalist model that flows from the effects of dynamism on productivity. A more innovative economy tends to devote more resources to investing of all kinds—in new employees and new customers as well as in new offices and factory space. Although this may come about through a shift of resources from the consumer-goods sector, it also comes from the recruitment of new participants into the labor force. Employees who are thus engaged—employees who do not need to work for pressing financial reasons, but are drawn to work for its intrinsic satisfactions—are less likely to quit, reducing the "natural" unemployment rate. Thus, dynamism tends to bring a pervasive prosperity to an economy, in addition to higher levels of productivity caused by product innovation—and in addition to higher levels of self-realization.

I know I have drawn an idealized portrait of capitalism: the reality in the United States and elsewhere is much less impressive. But we can nevertheless ask whether there is any evidence in favor of these claims on behalf of dynamism. Do we find evidence of greater benefits of dynamism (or benefits we might impute to dynamism) in the relatively capitalist economies as compared to the Continental economies as currently structured? Indeed we do. In France, Germany, and Italy hourly labor productivity is lower than in the United States. Labor-force participation is also generally lower and unemployment generally higher. And the World Values Survey indicates that the Continent's workers find less job satisfaction and derive less pride from their work than do their counterparts in the United States (Table 2).

Drawbacks of Dynamism

The main downside of dynamism may be that it creates a level of unpredictability that is quite unlike the bucolic equilibrium growth paths of neoclassical theory, where the future is essentially known and everything is understood—up to a random disturbance term or two. The same capitalist dynamism that adds to the desirability of jobs also adds to their precariousness. Just as the creative artist does not create all the time, but rather in episodes separated by breaks, so, too, even the healthiest of

Table 2. Benefits of Dynamism

	Pride derived from one's job	Job satisfaction	Men in the labor force in pct. of work-age men	Employment in pct. of the labor force	Annual mean compensation per worker	Market output per hour
U.S.	2.9	7.8	85	94	$31,994	100
Canada	2.7	7.9	85	92	$23,751	–
U.K.	2.8	7.4	85	95	$22,008	73
France	1.7	6.8	76	90	$24,192	92
Italy	2.0	7.3	76	91	$21,822	–
Germany	1.8	7.0	79	91	$23,946	92

Pride derived from one's job is measured on a scale from 1 to 3, 3 being the highest; and job satisfaction on a scale from 1 to 10, 10 being the highest. Both are averaged for 1990–1993 (Inglehart et al. 2004). Men in the labor force and employment are computed for 2003 (OECD 2005). Labor compensation per worker is computed as the ratio of total compensation to the labor force using 1996 data (Extended Penn World Tables). Market output per hour worked is for 1992 (Baily and Solow 2001).

dynamic economies is subject to wide swings in asset prices and thus slumps in activity.

Perhaps *some* slumps have sped the way to a renewal of creativity and high prosperity. But this is not to deny the heavy cost of a slump. Our public policy toward structural slumps is to take measured countercyclical actions—to "cushion" employment from the downturn by "shaving off troughs"—fearing that to do more would weigh down the economy for some years into the future. Of course, malfunctions in an economy may exacerbate its speculative bubbles and its vulnerability to the corrections that follow. In that case, we look to the government to identify the chief malfunctions and fix them to the extent possible.

It is worth noting that unemployment is viewed with far more anxiety and far more fear by politicians in the United States than it is in Continental Europe—no matter that there is unemployment compensation in the United States as well as Europe. The reason, in part, may be that in an economy with as much dynamism as the American one possesses, there really *is* no "compensation" for unemployment. Employment has become a good in itself. The paradox is that the greater the dynamism of an economy, the more anxiety there is over the prospect of unemployment.[8] If so, another paradox is that many Americans call for an end to dynamism in the interest of job security—as if their own job would then remain as engaging and rewarding as ever.

But that is in the realm of speculation. As a matter of empirical fact, it is the corporatist economies that have suffered the widest economic swings in recent decades. Compared to the Continental countries, American and British unemployment rates were remarkably steady (and low) for the two decades prior to the crisis of 2008. It may be that when the Continental economies are down, the paucity of their dynamism makes it harder for them to find something new on which to base a comeback.

The capitalist economies—the relatively dynamic among them at any rate—also suffer from incomplete inclusion of the disadvantaged. But that is a fault that my wage-subsidy proposal was intended to remedy; in any event, it is a fault of electoral politics, not economic dynamism. Nor are the relatively capitalist economies unambiguously worse than the Continental ones in this regard. In the former, low-wage workers have access to jobs; in the latter, they have access to social benefits that, given the high unemployment rates, may be considerably overrated (from the perspective of the intrinsic satisfaction of challenging work).

Why, then, if the "downside" is so exaggerated, is capitalism so reviled in Western Continental Europe? It may be in part that elements of capitalism are seen by some in Europe as morally wrong in the same way that birth control or nuclear power or sweatshops are seen by some as simply unacceptable—in spite of the consequences of banning them.

It appears that the street protesters against global capitalism associate business with established wealth; in their minds, giving greater latitude to businesses would increase the privileges of old wealth. By an "entrepreneur" they appear to mean a rich owner of a bank or a factory, while for Schumpeter and Knight it meant a newcomer, a *parvenu* who is an outsider. A tremendous confusion is created by associating "capitalism" with entrenched wealth and power. The textbook capitalism of the 1911 Schumpeter and the 1930s Hayek meant opening up the economy to new industries, opening industries to start-up companies, and opening existing companies to new owners and new managers. It is inseparable from an adequate degree of competition. Monopolies like Microsoft are a deviation from the model.

It would be unhistorical to say that capitalism, in my textbook sense of the term, does not and cannot exist. Alexis de Tocqueville, writing about America, marveled at the relatively pure capitalism he found there. The greater involvement of Americans in governing themselves, their broader education, and their wider equality of opportunity all encouraged the emergence of the "man of action" with the "skill" to "grasp the chance of the moment."

Dynamism and Justice

Everyone likes the idea of people being free to pursue their dreams. Yet Ayn Rand and Milton Friedman went too far in taking such freedom to be an absolute—the consequences be damned. In judging whether a nation's economic system is acceptable, the consequences of dynamism for the prospects of the *realization* of people's dreams—and all its other consequences—matter. Since the economy is a system in which people interact, the free endeavors of some may damage the prospects (and outcomes) of others. So a persuasive justification of well-functioning capitalism must be grounded on its all its consequences, not just those called freedoms.

To argue that the consequences of dynamism are just, and that the suppression of it is an injustice, requires some conception of economic justice, of course, such as the one articulated by John Rawls (1971). In any economy, the participants will score unequally in the extent of their self-realization—how far they manage to go in their personal growth. An economy that leaves the bottom score lower than it would be under another feasible economy is unjust. So a new form of economy that raised the scores of some while reducing scores at the bottom would not be justified. On the other hand, a high score is not unjust if it does not hurt others. "Envy is the vice of mankind," said Kant, whom Rawls greatly admired.

What would be the consequence, from this Rawlsian point of view, of releasing dynamism into the economy? In the classic case to which Rawls devoted his attention, the lowest score is always that of the workers with the lowest wage, whom Rawls called the "least advantaged": Their self-realization lies mostly in marrying, raising children, and participating in the community, but these activities, and others they may choose, require some degree of wealth, so they will gain from a higher wage. If the increased dynamism created by liberating private entrepreneurs and financiers tends to raise productivity, as I have argued that it does; and if that, in turn, pulls up the bottom wages, then it is just; if, at any rate, it does not lower them, it is not unjust. Does anyone doubt that the past two centuries of commercial innovations have pulled up wage rates at the low end (and everywhere else in the distribution) on a global scale?

Yet as Kant also said, people should not be treated as instruments for the gain of others. Suppose the wage of the lowest-paid workers would be reduced by the innovations conceived by entrepreneurs. Are those whose dream is to find self-expression and personal development through a career as an entrepreneur not to be permitted, then, to pursue their dream?

To take full account of this objection, we have to go outside Rawls's model, in which work is all about money. We have to recognize that in an economy in which entrepreneurs are forbidden to pursue their dreams of self-realization, *they* may have the bottom scores in self-realization—no matter if they take paying jobs instead—and that this counts in assessing the justice of the system. So even if their activities did come at the expense of the lowest-paid workers, Rawlsian justice, in this extended sense, requires that entrepreneurs be accorded enough opportunity to raise their self-realization score up to the level of the lowest-paid workers—and higher, of course, if the workers are *not* damaged by freedom of entrepreneurship.

* * *

Actual capitalism in a country such as the United States, I must emphasize, departs from the well-functioning dynamic capitalism I have discussed. There are monopolies too big to break up, banks too connected to fail, undetected cartels, regulatory failures, and political corruption. Capitalism, in its innovations, may even plant the seeds of its own encrustation with entrenched power.

These departures weigh heavily on the performance of capitalism, particularly the wages of the least advantaged, and give a bad name to capitalism. But it does not follow that we should reject a dynamic economy on the grounds that it is less dynamic than it could be.

NOTES

1. If the given government budget available were instead just handed out to the working-age poor as an entitlement, whether they work or not, many of them might work less and the resulting fall in their earnings would offset some of the government outlay.
2. For an account of recent developments see Wiesmann 2006.
3. This runs from a 1935 publication, "The Present State of the Debate," and a 1937 lecture, "Economics and Knowledge," to the famous 1944 book *The Road to Serfdom*.
4. A column in the *Wall Street Journal* told of a deliveryman who was asked whether he found it best to work from the top floor down or the reverse. "It depends on the time of day," he replied. A beautiful Hayekian moment.
5. The literature includes Nelson and Phelps 1980, 133–39; Frydman and Rapaczynski 1994; and Bhidé 2003.
6. This productivity effect is a shorthand way of saying that when a society restrains its consumption expenditure in the present in order to divert resources to an innovative project, the society can consume not just more in the future; it can consume more—or better—than what it sacrificed in the present. In other terms, there is a positive social rate of return to investing in new products and methods, just as there is from investing in more physical capital.
7. These include household appliances from vacuum cleaners to refrigerators; and movies with sound, frozen food, pasteurized orange juice, television, transistors, semi-conductor chips, the internet browser, the redesign of cinemas, and the recent retailing methods.
8. I notice that many Continental Europeans focus more on the "stress" of jobs compared with the Americans, who complain little about it. My sense is that

most Americans crave a certain amount of stress. A New York physician, Robert Ascheim, told me that in his clinical experience stress is good in general, though presumably not in every case. The question is worth researching.

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