

2008 YEAR END SERIES

Does Capitalism Have a Future?

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NEW YORK – As 2008 came to a close, many Europeans began to speak about the end of capitalism. They forget that capitalism in Europe had already once given way – often violently – to statism and corporatism in the 1930's, to be revived in only a handful of countries in the 1980's.

In view of the current financial crisis – the latest in a series that capitalism has seen – it is fair to ask whether the benefits of capitalism, if any, still exceed the costs. Although Marx confessed considerable admiration for capitalism, it is now suggested that the good in it – entrepreneurship – can be genetically engineered in another sort of system without the destructiveness to which capitalism is predisposed.

Capitalism was first admired for being “progressive,” as Marx put it. When productivity rose, it did not fall back again. In fact, with the emergence, piece by piece, of finance capitalism, circa 1820, productivity took off in one European country after another – Great Britain, Belgium, France, Germany, and Austria. Productivity sped up even more – began rising even earlier – in the United States. The paltry historical data available for analysis suggest that, around 1820 or so, wages (adjusted down for bouts of inflation in prior decades and up for deflation in subsequent decades) took off in a similar fashion.

Nowadays, there is a respectable body of opinion that questions whether growth in productivity beyond the towering levels seen today is of any great value compared to the fearsome costs that are taken as given in most discussion. But, in my thinking and empirical research, this fashionable hypothesis cannot stand.

First of all, Europeans think of capitalism as the “free market” – laissez-faire. But capitalism means openness to bottom-up innovation. Capitalism does not per se threaten anyone's welfare benefits.

The fashionable hypothesis denies even the most obvious benefit. I concede that the salaries of my overpaid friends are high enough to meet virtually all of their foreseeable needs. Even my own salary suffices to meet my own. But increases in productivity almost always lead to increases in pay across the economy. And increases in the general pay level have a social value that is of huge benefit.

These increases make it possible for more people to shun dull, tedious, or onerous work in favor of stimulating, engaging, and mind-expanding work. The “dark Satanic mills” of Marx's era are gone thanks to greater productivity, not greater state regulation.

The other difficulty with that fashionable hypothesis is that most of the alleged costs are illusory or trumped up. The idea that a well-functioning capitalism makes for a weak job market, leading to higher unemployment and lower participation in the labor force, cannot be substantiated. On the contrary, the innovations stimulated and facilitated by capitalism create jobs – in new companies started to develop new ideas, in marketing, and in managements that must keep abreast of new organizations and tools.

The idea that ordinary people are anguished by the thought that other people have extraordinary wealth is also cultivated in fashionable circles without the presentation of any evidence. Most people are practical enough to see that when, say, they have to go to the hospital for tests, what matters is whether the right kind of diagnostic machine is there for them, not whether there is a better machine for others somewhere else.

True, capitalism creates disruption and uncertainty. But we should not lose sight of the other side of that coin. Capitalism is unique in stimulating entrepreneurs to dream up new commercial ideas and develop them for the market, and generating excitement for consumers in discovering the new.

Perhaps the greatest accomplishment of capitalism was in transforming the workplace from one of routine, and thus boredom, into one of change, mental stimulus, challenge, problem solving, exploration, and sometimes discovery. True, the assembly line, a brain-numbing experience, was a feature of capitalism from the pin factor that Adam Smith wrote about in 1776 until Henry Ford's giant plants in the 1920's. But communist Russia and socialist Europe could not afford to do without assembly lines, either. And, thanks to productivity growth, an ever larger share of jobs lay outside factories as well as farms.

By the end of the nineteenth century, Europe, from Vienna and Berlin to Paris and London, was already celebrating the transformation of business life. Of course, they saw that this excitement and engagement came at some cost in inconvenience and anxiety. But the majority did not wish to return to the tranquility of the past.

Yet return they did, though not intentionally, when statist and corporatist changes in the institutions of the economy curbed innovation and ambition, with the result that the workplace in Europe became once again as stultifying as it had been in the past.

Today, sophisticated and well-meaning people suggest that we can revive entrepreneurship, but in a way that imbeds it in a new economy oriented toward social investment – to combat global warming, to develop energy savings, and so forth. The trouble with that type of thinking, I believe, is that it will bureaucratize the economy, putting much of expenditure in government agencies and putting many companies on government contracts.

In itself, that may be no problem. But it will be if it stifles the ability of individuals to create innovations for an open marketplace. There was a natural experiment in the 1930's that tested this thesis: the newly bureaucratized economies of Western Europe were heavily out-innovated by the relatively unbureaucratized US economy.

So, while 2008 was a year of challenge for the world economy, I am sure that those countries that value innovation are well advised to keep capitalism.

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