The Paradox of Supercapitalism

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In March 1975, economist Milton Friedman accepted an invitation to Chile to meet with Augusto Pinochet, who some eighteen months before had toppled the democratically elected government of Salvador Allende. Friedman was criticized in the American press for making the trip, but there is no reason to suppose he approved of Pinochet. Friedman went to Chile to urge Pinochet's junta to adopt free-market capitalism – to trim the business regulations and welfare state that had grown under Chile's many years of democratic government and to open itself to trade and investment with the rest of the world. In a series of lectures he delivered in Chile, Friedman reiterated his long-held belief that free markets were a necessary precondition to political freedom and sustainable democracy. Pinochet took Friedman's free-market advice, but Pinochet's brutal dictatorship lasted another fifteen years. The men died within weeks of each other in late 2006.

Of all the nations of the world, America is assumed to best exemplify the idea that capitalism and democracy go hand in hand. [1] But in the years since Friedman visited Chile, the relationship has become strained. Freemarket capitalism has triumphed. Yet democracy has weakened.

Since the 1970s, and notwithstanding three recessions, the United States economy has soared. Consumers have been treated to a vast array of new products – personal computers, iPods, antidepressants, hybrid cars, to name just a few – while the prices of standard goods and services have declined, adjusted for inflation. Health care costs more, but Americans live almost fifteen years longer than they did in 1950 on average, largely due to new drugs and new medical equipment.

Companies have also become far more efficient and the stock market has surged. In 1975, the Dow Jones Industrial Average hovered close to 600. It had not advanced very far in years. By late 2006, it hit 12,000. Moreover, since the early 1980s inflation has been well under control.

These successes have been replicated elsewhere. American capitalism won the contest with communism and has now spread almost everywhere in the world. Most nations have become part of a single integrated system of global capitalism. Eastern Europe has been absorbed into a capitalist Europe and Russia is becoming a capitalist power. China, although officially still communist, has become a hotbed of global capitalism.

All this is a triumph, by almost anyone's definition.

Some observers rightly point out that these gains have been accompanied by widening inequalities of income and wealth. The gains have also accompanied other problems such as heightened job insecurity, and environmental hazards such as global warming. Strictly speaking, though, these are not failings of capitalism. Capitalism's role is to enlarge the economic pie. How the slices are divided and whether they are applied to private goods like personal computers or public goods like clean air is up to society to decide. This is the role we assign to democracy.

Democracy means more than a process of free and fair elections. Democracy, in my view, is a system for accomplishing what can only be achieved by citizens joining together with other citizens – to determine the rules of the game whose outcomes express the common good. The rules of course can affect how fast the economy grows: At the extreme, a rule that divided the pie into equal slices would squelch personal incentives to save, invest, and innovate. Another rule might do more to spur economic growth. Democracy is supposed to enable us to make such tradeoffs, or help us achieve both growth and equity or any other goals we share in common.

Yet democracy is struggling to perform these basic functions. As inequality has widened, the means America once used to temper it – progressive income taxes, good public schools, trade unions that bargain for higher wages – have eroded. As the risks of sudden loss of job or income have grown, the social safety net has become less reliable. More of us lack health insurance. As a nation, the United States seems incapable of doing what is required to reduce climate change. Many Americans are also concerned about the crassness and coarseness of much of contemporary culture, and about the loss of Main Streets and their surrounding communities. In all these respects, democracy has been unable to take effective action, or even articulate the tradeoffs and sacrifices doing so would entail.

Capitalism has become more responsive to what we want as individual purchasers of goods, but democracy has grown less responsive to what we want together as citizens. Surveys suggest a growing sense of powerlessness. While in 1964 only 36 percent of Americans felt 'public officials don't care much what people like me think,' by 2000 that sentiment was shared by more than 60 percent. In 1964, almost two-thirds of Americans believed government was run for the benefit of all and only 29 percent said it was 'run by a few big interests looking out only for themselves.' But by 2000, the ratio was almost reversed: Only 35 percent believed government was run for the benefit of all, while more than 60 percent thought it was run by a few big interests. [2]

Why has capitalism become so triumphant and democracy so enfeebled? Are these two trends connected? What, if anything, can be done to strengthen democracy?

The danger of summarizing my argument in advance is oversimplification, yet I want to give you a basic sense of it. The last several decades have involved a shift of power away from us in our capacities as citizens and toward us as consumers and investors.

America emerged victorious from World War II, already having survived the Great Depression, with both its economy and its democracy in good working order. Then it experienced unprecedented prosperity, widely shared. It was not quite a golden age – women and minorities were still relegated to second-class citizenship, and communist witch hunts scarred politics – yet every income group and social class gained ground, inequality of income and wealth declined, and a far larger middle class emerged. Larger middle classes also emerged, after some lag time, in Europe and Japan. Most Americans professed high levels of confidence in American democracy, as they filled their newly acquired homes with dishwashers, refrigerators, television sets, and stereo systems, and their driveways with Fords, Chevrolets, or Plymouths. The two systems – capitalism and democracy – seemed to be working in such remarkable tandem that they came to be seen as one system, the American system of democratic capitalism, which was to be a model to the world and history's alternative to Soviet communism.

The system for producing goods and services was far more predictable and stable than it is today, and more concentrated in a relatively few large firms, like the big three automakers (GM, Ford, and Chrysler). In order to reap the vast economies of large scale, the huge companies needed predictability and stability, and minimal competition. They also needed the willing cooperation of blue-collar workers because strikes or work stoppages would interrupt the smooth flows of production on which they depended. So the companies agreed to give their workers, organized by industry, a higher share of the profits. These giant companies played such large and conspicuous roles in the economy that they also needed the support of the public. So they negotiated with government over how the additional benefits of economic growth would be distributed, while also protecting jobs, communities, and, eventually, the environment. Some of these deals were struck within regulatory agencies, some within legislatures, some through the mediation of CEOs who played the roles of 'corporate statesmen.' The result was an expression – however indirect and approximate – of what was then understood as the common good.

The trade-off for this relatively stable and equitable system was a very limited range of choice for consumers and investors. Better deals could be found only with great difficulty. Major product innovations were rare. Fins grew longer, grilles more ornate, and chrome more expansive in automobiles, but the underlying technology did not undergo major alteration. My father stuck with Plymouths, but he admitted the choice didn't much matter. Investors also tended toward passivity, rarely moving their money. There was little point because almost all investments offered about the same moderate returns. The Dow Jones Industrial Average plodded along.

Since the 1970s, this has all changed radically. Large firms became far more competitive, global, and innovative. Something I call supercapitalism was born. In this transformation, we in our capacities as consumers and investors have done significantly better. In our capacities as citizens seeking the common good, however, we have lost ground. The shift began when technologies developed by government to fight the Cold War were incorporated into new products and services. This created possibilities for new competitors, beginning in transportation, communications, manufacturing, and finance. These cracked open the stable production system and, starting in the late 1970s and escalating thereafter, forced all companies to compete more intensively for customers and investors. Consumer power became aggregated and enlarged by mass retailers like Wal-Mart that used the collective bargaining clout of millions of consumers to get great deals from suppliers. Investor power became aggregated and enlarged by large pension funds and mutual funds, which pushed companies to generate higher returns.

As a result, consumers and investors had access to more choices and better deals. But the institutions that had negotiated to spread the wealth and protect what citizens valued in common began to disappear. Giant firms that dominated entire industries retreated, and labor unions shrank. Regulatory agencies faded. CEOs could no longer be corporate statesmen. And as the intensifying competition among companies spilled over into politics, elected officials became less concerned about the Main Streets and communities in their districts and more concerned with attracting money for their campaigns. Lobbyists swarmed over Washington and other capital cities seeking laws and rules that would give them a competitive advantage (or avoid competitive disadvantage) relative to their rivals, wielding greater and greater influence over decision making. Thus did supercapitalism replace democratic capitalism?

To understand what has happened, and what can be done to make democracy function properly once more, requires a detailed inquiry into the changing structure of the political economy. I offer this in the coming chapters.

Along the way, several puzzles will be unravelled: Why, for example, CEO pay has soared into the stratosphere and what prevented it from soaring before. Why inflation has become less of a threat than it was three or four decades ago. And why antitrust laws are less important today as a means of restraining economic power than they were previously. I'll also explain why there are so many more corporate lobbyists and lawyers in Washington, D.C., than there were three decades ago, when there would seem to be less reason for them now (after all, discretionary government spending is lower as a portion of the national economy than it was then, there are proportionately fewer regulations, and organized labour's power in Washington is a pale shadow of its former self). Why politicians demand that companies be patriotic and put America before other nations, even though companies are less and less able to play national favourites if they want to compete successfully. And why a bigger and bigger fuss is being made over corporate philanthropy when corporations were never set up to be charitable institutions and are less able to operate in that sphere now. I'll also account for some hypocrisies: How someone can fret about the decline in hourly wages and simultaneously hunt for the best deal from China or India, which is often at the expense of an American's wages or even job. How someone can lament the decline of independent retailers on Main Street while at the same time do most of their shopping at big-box retailers and online. Why a person who is deeply concerned about global warming might nonetheless buy an SUV. And why politicians like to publicly excoriate CEOs (oil company executives who enjoy ballooning profits, tobacco company CEOs who encourage smoking, high-tech executives who trample on human rights in China) but then enact no laws making what they did illegal.

Finally, I will come to some conclusions you may find surprising – among them, why the move toward improved corporate governance makes companies *less* likely to be socially responsible. Why the promise of corporate democracy is illusory. Why the corporate income tax should be abolished. Why companies should not be held criminally liable. And why shareholders should be protected from having their money used by corporations for political purposes without their consent.

My primary focus in this book is America, although the changes that have occurred here have spawned similar changes elsewhere. People around the globe are more able to pursue their own desires and profit from their investments with increasing fervour. Yet despite the satisfaction they feel as consumers and investors, many are frustrated in their capacities as citizens. Their democracies, too, are finding it more and more difficult to articulate and act upon the common good. Voter surveys in Britain, Italy, Spain, Belgium, the Netherlands, Norway, Sweden, Ireland, and Japan show citizens who have grown to feel almost as disempowered as Americans. [3]

Capitalism is almost certainly a precondition for democracy, as Milton Friedman argued. Democracy requires private centers of economic power independent of a central authority; otherwise, people can't dissent from official orthodoxy and also feed their families. Yet as we've seen over the past several decades, particularly in Southeast Asia, democracy may not be essential to capitalism. China, the world's second largest capitalist nation after the United States, whose economy will surpass America's in some twenty years at current rates of growth, has embraced market freedom but not *political* freedom. China's market freedom does seem essential to its capitalist success; unless people there can own their property and exchange it without worrying that the central authority will confiscate their goods, they have no incentive to save and invest. And only if they're confident the capitalist game isn't rigged against them are they willing to play it to the best of their abilities. But political freedom may not be essential. Some observers believe China will move toward democratic capitalism, eventually. Others think China represents a new kind of system that might be termed authoritarian capitalism. [4]

Many more nations today call themselves 'democracies' than did thirty years ago. Former Soviet Eastern European satellites have become independent democracies. Russia views itself as a democracy. Many former colonial nations in Africa and Asia have emerged as democracies. Latin America has embraced democracy. Three decades ago, about a third of the world's nations held free elections; today that number is closer to two thirds. In the 1970s, fewer than fifty countries possessed the sort of civil liberties we associate with democracy; by the end of the twentieth century, nearly ninety did. [5]

That's surely cause for optimism, until you look more closely. Many of these places are democracies in name only. They are encumbered by the same problems that have hobbled American democracy in recent years, only to a greater degree – endemic corruption, political dominance by small elites, or one-party rule. None is coping effectively with supercapitalism's negative side effects.

My account is at odds with several established views. Some observers attribute the triumph of capitalism and the weakening of democracy to the rise of global corporations powerful enough to play nations off against one another and buy off politicians in order to enhance the wealth of their owners. But, in fact, large corporations have less economic power now than they had three decades ago. Then, for example, the United States harboured three giant auto companies that informally coordinated prices and investments. Now at least six major companies produce cars in the United States, and competition among them is fierce. Three decades ago there were only three major television networks, one giant telephone company, and a handful of movie and recording studios. Today, thousands of businesses compete intensely within a large and amorphous space where telecommunications, high-tech, and entertainment overlap. Three decades ago, most people put their savings into banks, and had access to only two or three of them within their own towns or cities. Today, thousands of financial institutions – including mutual funds and pension funds – compete for people's savings. Look almost anywhere in today's economy and you find the typical company has less market power than the typical company of three decades ago.

To be sure, some corporations are very large and many have global reach. But companies of all sizes are competing more vigorously than before. The world economy contains far fewer oligopolies than it did decades ago, and almost no monopolies apart from those created or maintained by government. The power and the impetus that once came from the giant corporation – the planning and execution of large-scale production – are gone.

As for politicians, they have not grown noticeably more corrupt, rapacious, or otherwise irresponsible than they were three decades ago. Politics has no more rotten apples than most occupations, although other occupations are typically spared the rotten headlines. In recent decades, however, politicians have been subjected to a great deal more lobbying than before, and the need for money to finance their campaigns has grown. For this reason, their behavior has changed. The immense increase in lobbying and campaign money, however, is not due to any increase in the market power of any individual corporations; as I will show, it stems, paradoxically, from a decrease in their market power.

Others want to credit or blame Ronald Reagan, Margaret Thatcher, or the predominance of conservative leaders in general over the last several decades. Politicians are important, but they cannot effectuate economic and social change unless the preconditions for change already exist, or unless extraordinary circumstances allow it. By the time Reagan came to power, the economy had already started to shift. Deregulation, for example, unleashed many of America's industries before Reagan took office. Small, profitable airlines, banks, and high-tech companies had already gained a competitive foothold and were intent on bringing down regulatory barriers. The percentage of American workers belonging to labor unions was already declining. And the number of business lobbyists in Washington, D.C., had already begun rising; indeed, the number escalated sharply during the Democratic administration of Bill Clinton.

A final theory is that America, followed by much of the rest of the world, became captivated in recent decades by a certain set of ideas about how societies should be organized. Variously dubbed 'neoliberalism,' 'neoclassical economics,' 'neoconservatism,' or 'theWashington consensus,' these precepts included free trade, deregulation, privatization, and, in general, more reliance on markets than on government and more concern for efficiency than equity. That these ideas emerged from academics based in universities may suggest why those who give them most credit for altering the world over the last thirty years are usually themselves academics who harbor a generous view of the impact of academic ideas. It is true that policy makers occasionally pay attention to those in the academy, as did Pinochet when he took Friedman's advice. 'Madmen in authority, who hear voices in the air,' wrote the economist John Maynard Keynes, 'are distilling their frenzy from some academic scribbler of a few years back.' [6] But the particular academic scribblings at issue here had been around in much the same form since Adam Smith divined them in the eighteenth century. Most likely they suddenly gained prominence in the last decades of the twentieth century, in the United States and elsewhere, because they offered a convenient justification for the shift already under way. They did not cause the shift; at most, they legitimized it.

Stories about heroic or villainous CEOs and financiers, brilliant or corrupt politicians, or diabolically powerful merchants of ideas, however gratifying they may be, should be surrendered to reality. Although a few of these figures have been especially insightful or particularly unscrupulous, in terms of the big picture their deeds are almost completely beside the point. The changes at issue here are structural, not personal. Similar assumptions about immoral and economically powerful corporations conspiring against the public also need to be abandoned because they are too simplistic. Companies are neither moral nor immoral. Any such explanation is a convenient diversion, assigns credit or blame incorrectly, and thereby imperils meaningful reform of capitalism and democracy.

The fact is, most of us are consumers and investors, and as such are benefiting enormously from supercapitalism. Wal-Mart, for example, has caused prices on a wide range of items to be lower than they'd be otherwise, to the benefit of its customers. In turn, Wal-Mart's success has redounded to the benefit of its investors. But most of us are *also* citizens who have ideas about fair play. And in this respect many of us are appalled at Wal-Mart's low pay and elusive benefits, its power to force suppliers to slash their own pay and benefits and to outsource abroad, and its decimating effects on Main Streets.

Yet the executives of Wal-Mart or any other large company are not brutally insensitive or ruthlessly greedy. They are doing what they're supposed to do, according to the current rules of the game – giving their customers good deals and thereby maximizing the returns to their investors. Just like players in any game, they are doing whatever is necessary to win. But just as all games require rules to define fair play, the economy relies on government to set the economic ground rules. If the American government wanted to do something about the means Wal-Mart employs, it could change the current rules. In theory, it could enact laws to make it easier for all employees to unionize, require all large companies to provide their employees with health insurance and pensions, enact zoning regulations to protect Main Street retailers from the predations of big-box retailers, and raise the minimum wage high enough to give all working people a true 'living' wage. All such measures would have the likely effect of causing Wal-Mart and other large companies across the board to raise their prices and reduce returns to investors.

Personally, I'd be willing to sacrifice some of the benefits I get as a consumer and investor in order to achieve these social ends – as long as I knew everyone else was, too. Yet how to create new rules of the game? The market is adept at catering to us as consumers and investors, but democracy has become less responsive to us in our roles as citizens seeking to make the rules of the game fairer. That's mainly because, as I will show in these pages, supercapitalism has spilled over into politics. The money Wal-Mart and other companies are pouring into Washington and every other major capital gets in the way.

The answer, I believe, is *not* to try to push companies to be more 'socially responsible.' Condemning Wal-Mart for not giving its employees better pay and health benefits may be emotionally gratifying but has little to do with the forces that have impelled Wal-Mart to keep wages and benefits low and bestow good deals on Wal-Mart's customers and investors. Wal-Mart, like every other capitalist player, is, as I have emphasized, following the current rules of the game. But *we* should make the rules – rules that reflect our values as citizens as well as our values as consumers and investors.

THE STORY I will tell is not technologically or economically deterministic. Our future is still very much in our hands. But to make the best choices we need to fully understand our past and present, and forsake mythic thinking. There is no prospect of returning to American democratic capitalism of the 1950s and 1960s – nor should we want to – but it is certainly possible to shape the future in ways that better serve our goals and interests as citizens.

The first and most important step is to have a clear understanding of the appropriate boundary between capitalism and democracy – between the economic game, and how its rules are set – so that the boundary can be better defended. Companies are not citizens. They are bundles of contracts. The purpose of companies is to play the economic game as aggressively as possible. The challenge for us as citizens is to stop them from setting the rules. Keeping supercapitalism from spilling over into democracy is the only constructive agenda for change. All else, as I shall make clear, is frolic and detour.

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Notes

[1] In his *Capitalism and Freedom*, first published in 1962, Friedman made clear that, in his view of history, 'capitalism is a necessary condition for political freedom … [but] not a sufficient condition.' He noted that fascist Italy and fascist Spain, Germany at various times in the twentieth century, and Japan before the two world wars were dominated by private enterprise, yet were not politically free. 'It is therefore clearly possible to have economic arrangements that are fundamentally capitalist and political arrangements that are not free.' *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962; 2002 ed.), p. 10. Since the eighteenth-century Enlightenment, much Western thought has assumed a connection between market freedom and political freedom. Both Adam Smith at the University of Glasgow and Anne Robert Jacques Turgot at the Sorbonne in Paris came to see economies progressing through predictable stages, with each stage giving rise to progressively more complex political and legal institutions, and social advance. Smith's thoughts were contained in his *Lectures on Jurisprudence*, which exist today only in the form of notes taken by students who heard them delivered between 1762 and 1764. Turgot's musings appear in his *Plan of Two Discourses on Universal History*, originally written in 1750 or 1751, and not published until the nineteenth century. See also Sir John Dalrymple, *Essay Towards a General History of Feudal Property* (London, 1757). See generally Ronald L. Meek, *Smith, Marx and After: Ten Essays in the Development of Economic Thought* (London: Chapman & Hall, 1977), Chapter 1, and Benjamin M. Friedman, *The Moral Consequences of Economic Growth* (New York: Alfred A. Knopf, 2005), Chapter 2.

[2] See *The American National Election Studies*, University of Michigan, at http://www.umich.edu/~nes/nesguide/toptable/tab5.

[3] See, for example, Hans-Dieter Klingemann and Dieter Fuchs, eds., *Citizens and the State* (New York: Oxford University Press, 1995); Michael Adams and Mary Jane Lennon, 'Canadians, Too, Fault Their Political Institutions and Leaders,' *The Public Perspective 3* (September–October 1992), p. 19; Susan Pharr, 'Confidence in Government: Japan,' prepared for the Visions of Governance for the Twenty-first Century Conference in BrettonWoods, New Hampshire, July 29–August 2, 1996.

[4] I first heard the term 'authoritarian capitalism' applied to China from Orville Schell, a China scholar at the University of California at Berkeley.

[5] Data on civil liberties are from Freedom House.

[6] John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London: Longmans, Green, 1936), Chapter 12, p. 134.