Where Is Capitalism Going?

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Q. Exactly ten years ago this November, you were interviewed in *Challenge* (November-December 1982). Then you talked about the severe U.S. recession under Reaganomics and the state of capitalism. Here we are, ten years later, and except for the two or three prosperous years, 1986 to 1988, the nation's economy is again mired in recession and stagnation. What do you make of this? What is the future of American capitalism?

A. It seems to me that two great shadows are hanging over the present. First of all, the American economy is suffering what I call a "contained depression." This is not a classic recession in a typical post-World War II business cycle.

Q. Why "contained" depression?

A. This is a contained depression because today we have in place the federal government reforms that provide income supports to the system—unemployment benefits, social security for the retired, Aid to Families with Dependent Children (AFDC), Medicare and Medicaid. We have deposit insurance to protect households and businesses from losing their savings and checking accounts when commercial banks and S&Ls fail. Without such an income safety net that helps to support aggregate spending and demand, the U.S. economy would be sinking much more deeply into a 1930s-style "uncontained" depression.

Q. If this isn't a typical business cycle, what triggered it and why does it persist?

A. The cause goes to the very core of what drives the capitalist system. The American economy in the '80s has come to the end of one of its "transformational" booms, to use a phrase I owe to my colleague, E.J. Nell.

Great transformations have buoyed capitalism at irregular intervals all through its history: the railroad

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boom in the nineteenth century, the electrification boom, the automobile boom that began in the 1920s and in turn fed into the spread of suburbs and the extended highway network. After World War II, we saw in Europe first a reconstruction, then a modernization and integration boom. These booms were also fed by major technological, institutional, or organization transformations. The last of them was the jet plane boom that gave us tourism, the trillion dollar industry of the post-World War II era. And then of course there was computerization that changed the work process of every industry. We are now waiting for a new wave of technological change or organization stimulus to launch another period of transformational growth.

Q. And the second shadow hanging over us?
A. It really flows out of the contained depression. In this period between booms, the future looks empty. I'm not trying to point to any apocalyptic eventuality around the corner. The future of our political economic system, the future of our lives, even the future of Western civilization has a bleakness, because of the absence of some shining goal. In my youth it was called "socialism," a vision beyond capitalism, what I have called "slightly imaginary Sweden." That vision served as a lodestar. It offered opportunities for responsible and responsive planning. It pointed toward a much higher degree of economic equality and a more equitable distribution of income and wealth. It opened our eyes to the prospect of increasing participation of people at all levels. These very attractive goals have not lost their appeal. But they have lost what once seemed to be their relatively easy availability, their access. And, with that we have lost an old-fashioned sense of progress, of optimism and hope for the future.

Q. But didn't this bleakness emerge also in the late twenties when the great boom gave way to the global Depression of the thirties?
A. I don't think so.

Q. Why? What's the difference?
A. I think the twenties had two bright hopes: one was the bright hope of prosperity under capitalism. In the twenties, it was still very much cowboy capitalism. When that capitalism suffered a comeuppance in the thirties, hope for our system was still very much buoyed by visions of "socialism," and by that, I don't mean Soviet socialism. I'm talking about the practical alternative posed in those days for government intervention, both as a source of stimulus to the private economy—the Keynesian fiscal alternative—and as a provider of support.

Q I want to come back to the nature of booms from the Second World War onwards. Military spending was a major impulse in getting the economy back on a full employment growth path that continued for a quarter century, buoyed along the way by new technology in the space and nuclear industries, as well as by defense. The cutbacks in defense now weaken that backbone of autonomous spending and that is at the very least a drag on economic growth and employment. The new Clinton-Gore Administration has pointed to the environment and energy as areas in which new technology could feed new booms and new jobs.
A. I'm a tremendous supporter of the possibility of mounting the first self-created boom, that is to say a public-sector boom, based on infrastructure investment, using the word in its broadest sense to include education and the environment. But it faces real obstacles. One is the bugaboo of the deficit that will persuade many to oppose an increase in government investment, and the other is the profound distrust in this country of the legitimacy, much less the feasibility, of actively using government's power as a propulsive force in the economy. Government is still regarded as the necessary evil, doing its best when it's needed most, providing for law and order and other absolutely essential and inescapable regulations, but never to be an active force.

In supporting government as a source of investment stimulus, I don't mean that I perceive government as the builder and operator. But I do see it as a financer, a blueprinter, impulse generator, and coordinator. It can quite effectively set the stage and of course, provide the money. But the high deficit and the large and growing national debt, coupled with the deep suspicions about government, make it difficult to support this role now. We are a people still captivated by the romantic images of the frontier. It is not easy to exchange the values and behavior of the cowboy society for those of a negotiation-minded, social-contract-minded society. So it is still hard to accept formal institutions of government deliberately giving power and force to the economy rather than relying solely on free-wheeling entrepreneurship.

Q. But if we look back over the two centuries of the Republic, we see at the very beginning, Alexander Hamilton writing the *Report on Manufacturers* (1791), the *Report on the Public Credit* (1790 and 1795), and the *Report on a National Bank* (1790). He built a strong case for the federal government to play a powerful role in shaping the course of the economy and giving thrust to development.
A. I have often written that a clear alternative exists to cowboy capitalism. It is the American Plan to revitalize the growth process by undertaking investment in the public sector, particularly infrastructure. Specific programs can be set in motion by the federal government, defining large projects, organizing the finance and providing some of the capital, along with state and local governments and private firms. Such programs would be carried out by private firms. We have many examples, as you suggest, in our history: the transcontinental railroads, the Tennessee Valley Authority and rural electrification; the interstate highway system. There are similar projects that could be started today to invigorate the economy as effectively as any new wave of technological change or organizational technology, apart from the desperate need to restore bridges, roads, dams, water supply systems, sewage and refuse disposal, mass transit systems within major metropolitan areas and between major cities. And there is the need to develop human capital and upgrade education and skill training at all levels. When some new wave of inventions or technological innovations fails to appear and propel our growth process, government investment can fill the gap and inject the appropriate stimulus.

Q. Doesn't our chronic deficit at already high and rising levels impose a constraint on your alternative?
A. That is certainly a troublesome legacy of the Reagan-Bush years. The United States has run a deficit of some $382 billion in fiscal '92 and the excess of spending over tax receipts may be as high as $400 billion in fiscal '93. In the face of such numbers, popular opinion says that we can't launch a bold investment program. According to conventional wisdom, we have to cut the deficit with some combination of spending cuts and tax increases. But if we actually follow that advice, the contained depression will probably continue.

Q. So what do you propose?
A. I propose setting up a federal capital budget. That would remove much of the mystery surrounding the budget deficit. Private corporations like AT&T or General Motors use capital budgets to distinguish receipts and costs involving capital investments from those related to current operations of producing and selling the company's goods and services. The capital budget includes those revenues used to finance capital investments that come from new stock and bond issues, bank borrowing, or accumulated capital reserves. Of course, certain costs from capital investments will appear in the current operations budget. I'm referring here to interest costs on outstanding debt and the depreciation costs of newly installed plant and equipment.

Q. Doesn't this raise all the difficult questions about how to define capital expenditures?
A. Yes, it won't be easy. And that may be a reason why politicians haven't up to now passed legislation to set up a capital budget. The Office of Management and Budget, for example, counts outlays for military equipment as investment, but not expenditures for retraining soldiers for new jobs in the civilian economy. That is wrong in my way of thinking. But even in clear-cut cases of civilian infrastructure investments, there are legitimate issues. What depreciation rates do you apply to research and development, which has long-delayed, perhaps rising returns? How much of education expenditures is consumption and how much is human capital investment?

Q. Shouldn't it be a fairly easy exercise to follow the experience in other advanced economies, in setting up capital budgets? Even conservative countries like Switzerland have public-sector capital formation for infrastructure which provides an important thrust to long-term growth.
A. It is absurd that the United States has not moved in that direction, especially when politicians and government generally stress the efficiencies and advantages of business methods and procedures in the private sector. After all, capital budgeting is a private business technique.

But the economics profession bears the main responsibility for the reluctance to adopt a capital budget. In the national income accounts and in our basic Keynesian model for income determination, we define three main categories of aggregate demand: consumption spending, designated by "C"; private investment, "I"; and government spending, "G." Note that "G" is not broken down into public consumption and public investment. All "G" is assumed to be "C"!

So, in today's debate over stimulating the economy, the outcome is hopelessly biased against using the public sector. Because there is no national income account labeled public-sector "I," government spending is assumed to be non-investment. Therefore there is no inescapable need to break down public spending into "I" and "C," as is the case with the private sector. Thus much of the one-sided national debate about macroeconomic policy comes from economists themselves, and from policy prescriptions based on their misleading accounting framework. Incidentally, that may change when the United States finally adopts the standard UN accounting procedures for GDP, in which government investment "exists" as a category up front. By implication, government spending is presumed to be socially wasteful, according to this view. Economists, especially, should see government borrowing for long-term capital investment as a constructive use of our national saving.

Q. If we look at the policy strategy for full employment growth in European countries—and I recall particularly experience in Switzerland, Austria, Germany, and France—heavy public infrastructure investment was a major impulse for growth and job creation.
A. Europe has come from a long history of active state leadership and the interweaving of public- and private-sector activity. The state has always been considered an absolutely essential, and perfectly legitimate, arm of the whole economic system. In this country, with the exception of some marvelous growth periods, government's role, especially in the Reagan-Bush years, has been subject to great suspicion, and therefore has suffered retrenchment. What really annoys me is that economists recoil at any hint of ideology and swear by value-free analysis, yet the profession as a whole doesn't seem to take issue with the sloppy analysis that equates "G" with "C." That position is absurd, because it is implicitly at least an ideological point of view.

Q. You aren't frightened, then, of the prospect of borrowing more, raising the deficit, and increasing the national debt to pay for infrastructure investment?
A. Look, I'm sure we spend a great deal of "G" foolishly and wastefully. I have no doubt that after full allowance for public investment, much "G" is in fact "C." Unless we know that, we can never have a rational fiscal policy. That is why setting up a capital budget is important. That would force Congress, the administration, and the electorate to evaluate projects and set priorities. Under the current consolidated budget, we have no clear idea as to what we're borrowing for, or whether it is in the instance good or bad. The capital budget approach won't make our fiscal problems disappear. The difficult decisions over priorities and the ultimate budget constraint will remain. Congress and the White House can't escape those hard choices. Besides, the capital budget will expose their choices and priorities to the voters, thereby rendering the decision-makers more accountable to the public.

Q. Since capital budgeting is such a common practice among private firms, state and local governments, and in foreign countries, why has the federal government not adopted a management system that is so reasonable?
A. That brings me back to my earlier comments. Ultimately, such reluctance is deeply rooted in Americans' distrust of using federal government investment as a means to drive long-term economic growth. Indeed the Reagan-Bush administrations capitalized on that distrust in launching their own policy strategies in the last twelve years. A longer view of American history shows the distrust was not always so pervasive. After all, the federal government financed the transcontinental railways in the nineteenth century, the interstate highways in our own time, great systems of power dams and rural electrification, and the Panama Canal. The November election was in large part about the role of the government in the economy, and Governor Clinton's victory has swung the balance toward government activism, though with an obvious fiscal constraint.

Q. Let's come back to your point that economic theory at least implies an ideological point of view in the way government spending is regarded as unproductive. I'm reminded of Ross Perot's comments during the presidential campaign debate, when he stated that the United States was pursuing nineteenth century economics while Europe and Japan are practicing twentyfirst century economics. His observation, whether accurate or not, reflects the typical economics textbook mode of a perfectly competitive market system that might have described our economy in the last century, but hardly sheds any light on the contemporary system, with concentrations of economic and political power resting in both the public and private sectors.

A. I am very sympathetic to attempts by people like Amitai Etzioni to broaden the scope of economics, to embrace sociological, political, and institutional elements. At the same time I think that economic theory is distinct from, and in some ways elevated above, sociology, anthropology, political science and other social sciences. Economics, despite its inadequacies, has the power to make predictive statements that have important significance for policy. If a drought hits the wheat and corn belt, we can predict prices are going to go up. If there is a surplus, prices are going to come down. There is nothing like that in sociology. There is no political theory in terms of stimulus-response reactions that can be generalized into analytic sequential statements. Economics is alone in that respect and that is, of course, the source of its power and the source of its prestige.

But problems with theory persist. In our time, for all sorts of reasons, the conditions necessary for theory to work in the real world, as the models suggest, have been progressively eroded. The size of institutions, the increasing intrusion of externalities of every kind, the economics of scale and the sheer size of the necessary government regulatory structure, all lessen the force field within which economics exerts its power. As the real world diverges from the theoretical model, economists tend to avoid its complexities by building formal models. Needless to say, they must therefore be very cautious about applying these models to social reality. The "rhetoric" that binds policy conclusions to the original theory is loose and shaky. People know that laissez-faire, free trade theory does not serve as an adequate basis for an operative model for international economic policy. This is equally true for many fields in economics. Sociological arrangements and political institutions "louse up" the model.

Q Hasn't the nineteenth century capitalism of economic theory already died? I'm referring here to Peter Drucker's contention that much of private enterprise is no longer owned by individuals and managed by owners, but is owned increasingly by social institutions—pension plans, equity funds, and other financial institutions.

A. True, like many others, I see the American system as a two-tier economy, the top tier dominated by large enterprises that "obey" one kind of theory—say, game theory—and the bottom tier by small enterprises obeying the laws of the competitive marketplace. So of course I resist using competitive theory to describe the whole.

Nevertheless, there is an important addendum. When I get done railing against neoclassical theory, with its rational maximizers and its focus on "the individual," I come back to a point that must also be taken into account. It is that modern capitalism mainly runs itself, and with all its depressions and business cycles, it has not fallen apart. We see what happens when an economy does fall apart, as in the former Soviet Union. People roam the streets looking for food, production stops, distribution dissolves. Capitalism has enough centripetal force and self-correcting feedback mechanisms to give to the system the capacity to continue through history. What it also has—and what escapes the reach of any economic theory—is enough political feedback to change economic policy when it is in trouble.

Q. Wasn't that what the last election was about?

A. Yes, and the New Deal was about that on a larger, more institutional scale. The post-World War II emplacement of the welfare state through Europe was about the same political response to address economic problems.

Western capitalism hangs together because as a sociopolitical whole, it supplies the necessary redress when the economic self-guiding system fails. Or at least, so far it has, and I see no reason to doubt that it will continue to do so, at least for the next generation. There may well be problems ahead for which we seem to have no possibility of depending on such self-generated sociopolitcal adaptations—I'll come to that.

But if economic theory is "enlarged" to give recognition to the presence of a degree of protective sociopolitical support, it gives us a way of dealing with the outlook as a whole that is unique in history. No such capability applied to the Roman empire, or for that matter to the Soviet empire. In more static societies, perhaps the ancient Chinese kingdoms, one might make the "prediction" that inertia would continue to be the great rule of history, and probably one would have been right most of the time, wars or other disruptions aside.

But only capitalism offers the remarkable spectacle of a *dynamic* society that maintains ongoing historical coherence. That is partly testimony to the properties of its economic system, but it is also, I would stress, testimony to its self-generated sociopolitical adaptability.

Q. But American capitalism has changed since 1900, and certainly after the reforms coming out of the Great Depression.
A. Yes, indeed, but there are some fairly fixed characteristics that nevertheless identify capitalism—three necessary and sufficient identifiers, if you will. First, it is driven by acquisitiveness and by the rage for accumulation. The *necessity* to accumulate capital is the driving force. It's not imperial glory of Victorian England or imperial Germany. It's not the preservation of past tradition, or religious authority. Capitalism is not held together or driven by any of those things that gave cohesion to other social systems in world history.

Second, capitalism is characterized by two distinct realms of authority—the private realm and the public realm—and they intermix. The capitalist economy is contiguous with, and also larger than, the geography of the nation state. They live side by side in a position of uneasy mutual tension, friction, collaboration, and conflict. Finally, capitalism has the market. It's the great integrating mechanism that takes the place of tradition or outright planning. Those three characteristics have not changed over time.

Certainly capitalism in the twentieth century has moved away from nineteenth century models into some not entirely new, but still innovative, interaction of the public and private realms. The most likely prediction is that there will be a spectrum of capitalism. There have been other such spectrums in history—periods in which varieties of a social formation existed side by side—variants of absolutist states or feudalisms, for instance. Some managed to adapt and survive. Some did not and went under. That "prediction," such as it is, very likely applies to capitalism over the coming century.

Q. What challenges do you see ahead for this spectrum of capitalism?
A. There are two large problems that seem really in some way almost beyond the grasp of capitalism, because solutions require transnational or international cooperation. They cannot be resolved by a single nation, however successful. One is the conflict between the drive for accumulation and growth, and preservation of the global ecology. We really don't know how fast global warming is coming about, or even whether it is coming about. We just have an uneasy feeling that we're entering a zone of ecological danger, maybe extremely disruptive danger. If that turns out to be a false alarm, three cheers. If it turns out to be true, it poses extraordinary challenges, above all with respect to the political apportioning of whatever industrialization we figure the world can absorb. The crucial thing about the global warming problem is that it respects no frontiers. What do we then say to an underdeveloped country that has finally got its act together and wants to launch a modernization program that includes a great deal of heat-emitting technology: "Sorry, folks, you can't do that because the citizens in Washington, D.C. are too hot already?"

Who gets "industrialization rights"? They can't be auctioned off for two reasons: first, those who need them the most could never afford them; second, because the externalities do not respect national borders.

Q. With new technology, it may be possible to industrialize without creating the old nineteenth century pollutants.
A. Yes, possibly so, but that brings me to the second major problem, and it's not essentially technology: the increasing globalization of production. A world economy is emerging, and it is clearly mappable with its own capital cities. It has its great transportation routes, and loci of production. That world of global production, distribution, and finance does not coincide neatly with the world of political boundaries and values. Vast international corporations are beyond the reach of the most successful democratic capitalisms that I mentioned earlier. I don't know what the resolution is. The resolution may be transnational and international instrumentalities for arranging trade patterns, finance, and the adjudication of international disputes. But that is far easier said than done.

Q. You are really raising the big question. How can we bring about order in a chaotic world?
A. I don't know. We see sovereign entities, whether Indiana or Brazil, that compete for a significant link in the global production chain, so they can create jobs and grow. On the other side are global enterprises locked together in ferocious competition. They form, for all their competitive buying and selling, an overarching

web of production, a global input-output system linked to international trade and finance. An economic map now becomes a map of such tremendous proportions, with such imposing dimensions, that it cannot be overlaid on top of the political map. The United Nations is not capable of regulating the concentration of production in Europe or in the Pacific rim countries or elsewhere. It's not capable of applying some degree of orderly progression on the development of trade and finance.

This presents immense problems for which there are really no economic solutions. Up until now, we lived in a period in which a configuration of economic forces seemed to provide sufficient coherence, sufficient orderliness as to be regarded as the appropriate order-setting mechanism for the geographical entities in which those forces worked. More and more we recognize political, social, and institutional boundaries and obstacles within those nations and it makes it very difficult to apply economics as if it were the only or the central order-creating mechanism. We have to confront a conflict between the thrust of economics and the resistance of politics. Which side wins in such a conflict? Over most of Western history, economics wins. But now the balance of forces changes, as the Periphery confronts the Center with fearsome weapons—many of which they bought from the Center—and perhaps with a recklessness that comes of having "less to lose." In this fearsome situation, the balance swings toward politics, not economics. The Council of Economic Advisers is displaced by a Council of Political Advisers. Alas, there is no "theory" of political threat and action that provides at least that first approximation to prediction that is economics' claim to recognition.

Q. Back in your 1982 *Challenge* interview, you expressed concern about the lack of a U.S. social contract. Here we are in 1992, after ten years of economic turbulence and a deteriorating standard of living. Have we learned anything from that experience that might bring Americans closer to a social contract?

A. I wish there was, but I don't see anything that enables me to be very positive about the chances for a social contract. Labor unions have been ignored or fought against, quite unlike the situation abroad where they are legitimated and supported. Management is still largely negative about its relations with government. Government is horrified at the idea of market sharing arrangements. None of the preconditions for a stabilized, negotiated social settlement exist. Perhaps President Clinton can change this prospect. He seems to have sympathies with the idea of a capitalism in which the two sectors cooperate rather than fight, and in which labor and capital seek mutual accommodation rather than antagonistic self-destruction. But that will take a formidable display of statesmanship. I suspect that seeking some sort of social contract will constitute Clinton's longest, most difficult, and most important task. I wish him luck—he'll need it.