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# The Transition to a Market Economy: How Much Freedom Does Capitalism Require?\*

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**D**espite their determined efforts to make the transition to democracy and market economies, dangers of failure persist in many of the ex-Communist countries of Eastern Europe and the former Soviet Union. If falling output and income, rising unemployment and poverty, are not checked and reversed, aggressive nationalism, ethnic hostility, and autocracy could prevail, breeding political instability and civil or international wars.

The high hopes for a better life that came with the fall of communism have, for many who have thus far suffered a decline in their living conditions after the collapse of the old order, given way to anxieties and bitterness over what capitalism means for them. Falling incomes and rising unemployment have given rise to nostalgia among people raised on an ideology of equality, and of income and job security provided by the state. But others—including old apparatchiks and members of what is loosely called “the Mafia,” as well as legitimate business types who have adjusted quickly and profitably to the opportunities created by free markets and privatization—see the new capitalist order as a boon to their interests and ambitions.

Hence, as the ex-Communist nations struggle to rebuild their economic and political systems, the question “In what image?” underlies debates, both in the East and the West, over what the future of capitalism will be. Many in the East are wondering whether capitalism is too selfish, corrupt, and narrow a system to meet their needs, and seeking to learn how capitalism might be modified to provide everyone with a better life, not just the lucky ones at the top.

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\* Read 10 November 1994.

† Deceased

Virtually no one, even among ex-Communist political leaders who have achieved greater power in Poland and elsewhere, favors a return to the totalitarian regime of the old Soviet order; with its economic failure to keep pace with the West, and its cruel and merciless effects on their personal freedom, communism is defunct. At the same time, however, with growing awareness of the failures of capitalism to solve many social and economic problems, and of the widening gap between rich and poor, the people of the ex-Communist nations—and indeed people everywhere, in rich and poor countries alike—are looking for a political-economic system that will be both more efficient and more humane.

Conventional economic prescriptions for reforming the ex-Communist countries by liberalizing and privatizing state-owned enterprises have often neglected the barriers to economic growth and equality of opportunity created by their countries' inadequate or flawed legal and institutional foundations. Crime and corruption seem more pervasive even than in the old days. The conduct of business is marked by demands for bribes or other forms of "lubrication" before deals can be consummated. Political life is more chaotic.

Communism collapsed because it failed, both politically and economically. It cannot be propped up again on its blood-stained throne.

#### MODELS OF CAPITALISM

Yet, while rejecting the Communist model, the majority of people who grew up under communism are not sure where to turn. For those millions experiencing or fearing unemployment and greater poverty, capitalism looks like a bonanza for the few. Capitalism, just three years into its history in the East, cannot be complacently defended as better than "all the alternatives"—a common joke in Russia these days is that capitalism is succeeding overnight in doing what seventy years of communism had failed to do: "making communism look good."

Despite immediate hardships and uncertainties, most people in the ex-Communist countries are still hoping to find a free economic and political system that works better. What sort of system will that be? Does any country offer an acceptable model?

There is no single model of capitalism that the countries of the former Soviet empire can simply imitate. While many economies are distinguished by largely private ownership of capital and largely open markets, and by their democratic political structures, a closer look reveals that there is no single capitalist model, but many "capitalisms." In every nation, the economic system is shaped by particular historical, social, and cultural forces and by specific and politically-determined national goals and needs.

Finding the right systemic answer, whether for ex-Communist or long-term capitalist countries, will involve not only the pursuit of economic efficiency but also of other values determining the broad public interest.

What is the public interest and how do different nations define it? Is it simply the sum of all private interests? Or, considering the clashes

among individuals and groups and the wide disparities among them in income and wealth and power, should the public interest be defined in terms of some overarching principle, such as equality, social stability, economic progress, or humanitarian concerns?

Perhaps the resolution of clashing interests and values is best left to the market, not because its solutions are necessarily fair or just in some abstract sense, but because market outcomes (whether rewards or punishments) usually produce more efficient and fairer results than the decisions of politicians and the interests they represent, including *their own interests* as people in power.

But even if free markets, in general, work tolerably well, and better than highly centralized political control-and-command systems, how can nations best supplement and correct the malfunctioning of markets, to meet the needs of all citizens and especially those who are poorest and in greatest need of help? Or does politics, whatever its intentions or pretensions, inevitably serve the interests of the most powerful elements or classes in the society? The economics of a system cannot be divorced from moral issues, such as the obligations of the rich to the poor and of present generations to unborn generations; the need for “sustainable human development”—a byword at the United Nations these days—is heavily charged with moral content.

#### CAPITALISM AND ETHICS

Does capitalism have an ethic, joining it to human freedom, or is capitalism the very nemesis of ethics, rejecting social concerns and focusing narrowly on relatively short-term self-interest? Or are social concerns and needs best served indirectly, in a free political and economic environment, as a consequence of individuals’ pursuit of their own interests?

The original assault on capitalism, nearly a thousand years ago, was on moral grounds. Centuries before the system we call capitalism acquired a name or a theory, medieval theologians sensed its revolutionary nature and the danger it posed to the social, religious, and moral order. As early as the twelfth century, the stiffening attitude of the Roman Catholic Church toward usury represented an awareness of the threat of this new and powerful force to the medieval ideal of a harmoniously ordered society.

For it was usury—the payment of interest, making it possible to earn money on money—that brought capital into being and launched capitalism upon its revolutionary career. No wonder the guardians of the medieval order of values were against it, said the Catholic historian Werner Stark, for here

was the cancerous cell which, if not excised from the body politic by the surgeon’s knife, would grow ever more rapidly until it had eaten out the vitals and brought on destruction and death. It has been said more than once that the Doctors did not understand the phenomenon of capital, but that is decidedly less than fair. Certainly, they did not have an express theory of it, but they realized, however

dimly, what its true nature is—to be the spring of economic change and advancement, to be the motor force of progress. Here again the contrast between medieval and modern conceptions becomes strikingly obvious. We think economic progress desirable, whatever the cost; they counted the cost and found it excessive.<sup>1</sup>

Capitalism represented a radical change in the power relations within society—from the ruling class of feudal princes and aristocrats, whose power was supported by the military and the church, to merchants and bankers who knew how to accumulate capital, not just by making things but by making money beget money. This new dominant class put its capital to work primarily for its own enrichment but with side benefits to the state, which won it the support of the prince. With the passage of time, the wealth generated by capital spread down to the middle classes and even, in some cases, to workers, causing them to identify their own interests with those of the capitalists. A propaganda campaign early in the cold war of the twentieth century sought to rename the system “people’s capitalism.”

Capitalism has now spread all over the globe, adapting itself to all sorts of cultures and political structures as different as those of the United States, Japan, Germany, the Islamic nations, the ex-Communist countries like Russia and Ukraine, and even Communist China. Despite the enormous differences in the political systems in which it is embedded, capitalism has certain characteristics that make it recognizable where it appears: the existence of private property—the ownership of assets by individuals rather than the state, and the right of those private owners to capture the returns on their investment of capital; freedom of enterprise—the right of individual capitalists to start new businesses or change, expand, or get out of their existing businesses; the profit motive, more broadly the desire for economic gain, as the dominant force behind individual and business behavior; and free competition in the marketplace as the spur to efficiency, the creation of new and more attractive goods and services, and the control of costs. Only in the textbook model of perfect competition and “pure” capitalism do all of these characteristics exist without some interference or control of the state or of monopolies and cartels in the private sector.

The capitalist ethic, ironically enough, was most clearly enunciated by the Chinese Communist leader Deng Xioping in his message to his people: “It is good to get rich.” Chinese merchants, manufacturers, bankers, traders, and others responded enthusiastically and effectively to that call to capitalist arms.

This is far from saying that capitalism, wherever it is unleashed, will meet with a like response in other countries, or is universally approved as the best road to a good society. In many countries, East and West, de-

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<sup>1</sup> W. Stark, *The Contained Economy: An Interpretation of Medieval Economic Thought (The Papers of the Aquinas Society of London, No. 26, London, 1956. Reprinted in Leonard Silk and Mark Silk, *The Evolution of Capitalism* [New York, 1972]), 18–193.*

veloped and developing, the terms “capitalist” and “capitalism” remain pejorative, synonymous with greed and selfishness. But in others, especially the United States, the terms are honorific: Many Americans identify “capitalism” with “Americanism,” and regard socialism as anti-American, almost a synonym for the hated enemy, communism.

Indeed, much of the world sees the United States as the epitome of capitalism. The passion for growth, founded on technological progress and free enterprise, became virtually a national religion from the earliest days of the new Republic, as Alexis de Tocqueville showed. Late in the nineteenth century, the German sociologist Max Weber contended that capitalism was the social counterpart of secular theology; he stressed the Calvinist concept of a person’s “calling,” which was not the role in which the individual had been placed by Heaven but the earthly business he chose for himself and would pursue with religious fervor. The obligation to work hard, to be thrifty and responsible, to save and invest money prudently, never to deplete one’s capital but always to enlarge it, acquired sanctity as “the Protestant ethic.”

#### THE AMERICAN WAY

Weber was contemptuous of what he regarded as the abandonment by America of what he called the “highest spiritual and cultural values.” “In the field of its highest development, in the United States,” he wrote, the pursuit of wealth, stripped of its religious and ethical meaning, tends to become associated with purely mundane passions, which often actually give it the character of sport. No one knows who will live in this cage in the future, or whether at the end of this tremendous development entirely new prophets will arise, or whether there will be a great rebirth of old ideas and ideals, or, if neither, mechanized petrification, embellished with a sort of convulsive self-importance. For of the last stage of this cultural development, it might well be truly said: “Specialists without spirit, sensualists without heart; this nullity imagines that it has attained a level of civilization never before achieved.”<sup>2</sup>

Though Weber’s caustic attack on the American culture was written a century ago, many European and other critics of the United States and its cultural exports, from Disneyland to MTV, would repeat it today. What reply should Americans make? Perhaps, in this age of worldwide striving for affluence, higher productivity, better technology, mass consumption, and entertainment values, with evil consequences for intellectual and environmental pollution, Americans should say, “*Tu quoque!*”—“You, too!” But such a retort would be foolish. All nations, including the United States, should strive to provide more intelligent and humane answers to the question how to improve the morality and humanity of capitalism or whatever other system they espouse.

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<sup>2</sup> Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (New York, 1958 [first edition in German, 1904]), 181–82.

The post-cold war world confronts a host of moral issues—from genocide and “ethnic cleansing” in former Yugoslavia or Rwanda to the corrupt links between business and government in Italy, Japan—or the United States. No economic system, whatever it is called, can be proof against moral cowardice, inertia, and the cruelty of those who inflict pain or death on others, or just look the other way, when such crimes are committed.

Capitalism is intensely “rational,” with its rationality commonly defined as the pursuit of pecuniary self-interest, with *more* always preferable to *less*. Some economists go so far as to define the pursuit of gain as the *only* form of rational behavior. One should not underestimate the force of this concept of rationality in transforming the world, not only the economic world but science and technology as well.

“Primarily a product of the evolution of economic rationality,” said Joseph Schumpeter,

the cost-price calculus in turn reacts upon that rationality; by crystallizing and defining numerically, it powerfully propels the logic of enterprise. And thus defined and quantified for the economic sector, this type of logic or attitude or method then starts upon its conquering career subjugating—rationalizing—man’s tools and philosophies, his medical practice, his picture of the cosmos, his outlook on life, everything in fact including the concepts of beauty and justice and his spiritual ambitions.<sup>3</sup>

#### CLASHES OF VALUES

But the new rational calculus of capitalism does not in fact subordinate all other values to its logic. Clashes among values and the means of achieving them—clashes between liberty and equality, equality and efficiency, economic growth and environmental protection, even between capitalism and democracy—are inescapable, and every nation must work out its own choices and how to resolve conflicts over values and interests. The countries of the ex-Communist world must choose from a long menu of capitalist models:

- The libertarian or laissez-faire models, restricting the role of the state to defense with minimal or no intervention in economic and social matters;
- The neoclassical model, which lets the market resolve all *microeconomic* issues but stresses the importance of national fiscal and monetary policy to achieve *macroeconomic* stability, low inflation, and high employment;
- The mixed economy, welfare state, or social market economy, blending government and private market decisions to resolve clashes between economic interests and social needs, and particu-

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<sup>3</sup> J.A. Schumpeter, *Capitalism, Socialism, and Democracy*, 3rd edition (New York: Harper), 120–21.

larly to insure a “social safety net” for those who fail in the market economy;

- The corporate state, with business and government working closely together, whether overtly or covertly, honestly or corruptly, to pursue national and business interests;
- Authoritarian or totalitarian systems, whether fascist, communist, populist, or a blend of all three, in which a powerful government preserves the market and promotes the interests of favored businesses but represses genuine democracy and personal freedom.

Within these broad categories, there are many subspecies of capitalism, varying not only from country to country but, within a country, from time to time. Communist China and Middle Eastern states like Syria, Iran, and Iraq employ different models of capitalism—which might be called *fascist*—mixtures of dictatorship and private enterprise. An old saying goes, “Give a dog a bad name and hang him.” One cannot dismiss out of hand the combinations of authoritarian political regimes and capitalist enterprises found in Singapore, Taiwan, South Korea, and other newly industrialized countries of Asia. Such states assert the need to prevent political instability and to repel would-be revolutionaries from within or without as justification for political authoritarianism. The United States supported that combination in early postwar Japan, with secret C.I.A. support, and open diplomatic and political support, of the Liberal Democratic Party, which would best serve American interests in the cold war. Such concerns have not yet entirely disappeared. A disastrous failure of a major country like Russia to make the transition to capitalism, or a breakdown in the world economy spreading unemployment higher than we have seen since the Great Depression, could revive totalitarianism in Russia and possibly bring the military dangers that dictatorship and aggressive nationalism invariably pose. Many mixtures of capitalism with different degrees of democracy or authoritarianism are possible. The present world scene exhibits virtually all of them.

#### THE CHINESE MODEL: ECONOMIC FREEDOM/POLITICAL AUTHORITARIANISM

China’s success, at least until now, in achieving economic growth rates of double-digit proportions by combining strong state political control with an expanding capitalist sector may provide a mode that some countries in transition will be tempted to imitate. Many ex-Communist societies are asking themselves: Which should we take as our model, China or Russia? Which model—chaotic democratization à la Russe, or oppressive government with economic liberalization in the Chinese style—is more desirable, at least during what is likely to be a long transition period?

Not only the ex-Communist but also the long-time capitalist countries are trying to find ways of combining market forces with greater human security. How can we protect economically vulnerable groups from exces-



sively volatile market forces? But if the state must be the agency for guiding social and economic development, how do we stop the state from degenerating into corrupt cliques of politicians and bureaucrats?

The end of the cold war was expected to bring great benefits to humanity, as resources were shifted from military to social uses. Thus far, it seems as though the so-called peace dividend is being paid in lost jobs and incomes. There is no reason why this must be so; peace should enable nations to spend more on welfare-enhancing consumer goods and on productivity-enhancing investment. But that will happen only if people are able to take new jobs and if financial and physical resources are reallocated to create those jobs.

In the absence of such shifts of human and material resources, there will be intense pressure to maintain high levels of military spending and to sell weapons wherever buyers can be found, to create jobs, keeping the military-industrial complex busy and solvent. Without a revival of national economies and the world economy in the wake of the collapse of communism, the production and proliferation of weapons and of internal ethnic conflict and international hostility will continue to endanger peace.

The need for a stable and expanding economy extends beyond the pursuit of wealth to the search for peace and the protection of human rights and freedom. Such goals, historically protected only within the borders of a nation-state, and often not even there, must now be sought within the context of weakened or dissolved national states and within an emerging but still inchoate global economic and political order.

In the wake of the triumph of capitalism, we need to construct political-economic systems that protect each of us from the harm that a blind pursuit of self-interest can inflict on all of us. Our hope is to establish a healthier relationship between the market mechanism and the community, to enhance both economic and political freedom.

#### HOW MUCH FREEDOM DOES CAPITALISM REQUIRE?

In the long run, will the authoritarian political controls of a China provide a better model for the economic development of poor countries, if combined with a large and growing capitalist sector, than the more democratic political systems of a Russia or an India?

The answer to that question depends in part on the *goals* nations seek. If accelerating the rate of economic growth and raising living standards are the only criteria of success, the prize may go to free markets combined with political authoritarianism, as in China; but if the criteria of success include not only higher economic growth and living standards but the safeguarding of human rights and people's feelings of worth and self-respect, the judgment may be that India, Russia, and other democratic societies will ultimately do better in meeting their people's most important wants and needs, including the protection of life itself. Chinese dissidents, during their political protests of recent years, noted that al-

though China had signed the United Nations Declaration of Human Rights, which includes such provisions as these: "Nobody shall carry out unreasonable arrests, detentions and deportations"; "Everybody has the right to freedom of ideas, conscience, and religion"; and "Everybody has the right to enjoy the freedom of advocacy and expressions of views," the Chinese government has violated all of those principles.

Optimists on China's future, however, maintain that economic development will bring greater political freedom in its train. They argue that the demands of China's intellectuals and workers for greater political and personal freedom have grown with the economic advancement of their country and that, as in other countries throughout history, economic advancement in China will not create a passive and quiescent population, but one that demands freedom from fear of oppression by the state and freedom of speech. They assert that such changes are already evident. But, without continuing internal and external pressures for political freedom, it would not come of its own from some vague, impersonal historical process.

Democratic institutions, especially freedom of the press and of popular expression, and the right of assembly, are the best way to ensure that government will not neglect the needs and rights of its people. Whereas China has suffered millions of deaths from starvation or violence under Communist totalitarianism, particularly during the Great Leap Forward and the Cultural Revolution under the autocratic rule of Mao Zedong, a democratic country like post-independence India has, despite severe droughts and extremes of wealth and poverty, *not experienced mass starvation since World War II*. India's free press has alerted the nation and government to the urgency of rescuing famine-imperiled people in different parts of the country, and government has responded in time to head off threatened disasters.

Democracy, a free press, and a free market cannot, in themselves, guarantee solutions to all the problems of human misery. In India, despite faster economic growth in the past three years as a result of market liberalization and other economic reforms, the urgent need to focus national policy on healing the abysmal living conditions of the poor was dramatized by the outbreak of pneumonic plague in the city of Surat in September 1994. While the number of recorded deaths was less than a hundred, the plague, because of its horrific history and the speed with which it struck, spread fear throughout the country. It forced the political elites to pay greater heed to the dreadful social and sanitary conditions in which the poor lived, crowded into slums with open sewers and virtually no means of getting rid of human wastes—conditions for breeding plague or other diseases that threaten to infect rich, poor, and middle-class people in all parts of the country.

During the political debate set off by the outbreak of plague, Prime Minister Rao, who had led the drive to liberalize the Indian economy, said that the economic reforms of the preceding three years were not enough to bring "genuine prosperity" to the great mass of Indians. India's growth

could be dragged down by maldistribution of the economic benefits of growth and neglect of the masses of poor people. Hungry, sick, homeless, and illiterate people cannot contribute to economic development and technological and industrial modernization. Still worse, they are a disgrace for a nation whose affluent and middle-class people are moving rapidly ahead. Those who benefit from marketization and privatization cannot ignore those left behind without threatening the entire Indian economic and political system.

The economic role of the market, whether in democratic or authoritarian societies, must be augmented by social, health, housing, and educational policies of government that reach the poor. Governments need to safeguard economically vulnerable groups from volatile market forces and from the tendency of capitalist revolution to widen the distribution of income between rich and poor—or, to put it differently, between the able and well-educated on one side of the divide and the socially and educationally deprived on the other side.

This is true not only in developing countries but in highly developed countries like the United States, where crime, drug abuse, mental and physical disease, poor housing, homelessness, and other social problems afflict the “underclass”—which we may define simply as those at the bottom of the income ladder. How can the problems generated or worsened by poverty best be addressed? If the state alone can do the fundamental job of dealing with welfare problems, how can the state itself be kept from degenerating into corruption in the running of welfare programs?

Extending state programs, or those of private profit-making and nonprofit or charitable organizations, to improve the quality of life of a society, should not be regarded as just a cost that must be borne. On the contrary, if such programs work to increase the freedom of poor and unemployed people and their ability and will to solve their own problems, even greater benefits will result for the entire society, through expanded production of goods and services and through greater economic efficiency, less crime, better health, and so forth.

Freedom of individuals and businesses to serve their own interests as they see fit enhances the functioning of a capitalist society. It helps to allocate resources, human and material, to their best uses. It broadens and deepens the knowledge and information base of the society; growing knowledge is the most important source of economic growth. The free pursuit of knowledge and information is vital not only instrumentally, but in lifting the morale of a society. *It motivates people to their best efforts, where lies fomented by those in power debase and corrupt a society.* Freedom is the necessary condition for a society of law and order, one in which individuals learn to respect ethical norms of behavior.

The political and legal institutions of a free society, safeguarded by democracy and individual freedom, may make politically open countries like India or Russia more attractive in the long run to foreign or

domestic investors than authoritarian states like China, where the arbitrary use of power can threaten the security of capital and property, and derail progress.

#### POLITICAL FREEDOM AND THE GLOBAL ECONOMY

A system of law and justice, administered by an independent judiciary and accompanied by public and private ethical codes that protect all people and not only the most powerful, conjoins with economic freedom to provide the best hope for both social and economic development within the global economy that is emerging as a result of technological and communication revolutions throughout the world. There has been a corresponding weakening of the nation-state as a force for control or threat to other nations. The weakening of the nation-state may lead to a more peaceful world community of nations. How to achieve that kind of peaceful and open world society is the cardinal problem facing us in the coming century. The alternative course of aggressive nationalism and ethnic warfare, illustrated by the Yugoslavias and Rwandas of the present, is the fate that awaits us if we fail.

The burst of optimism that hailed the downfall of communism in Eastern Europe and the former Soviet Union has given way to widespread anxiety that it will take many years for the ex-Communist countries to become effective market economies and political democracies—and that some may not make it at all before dictatorial regimes return. Throughout the region, among those who have seen their living standards decline and jobs disappear, there is growing nostalgia for the old Communist system with its greater job security. This has led to growing electoral support for ex-Communists and demagogues who exploit nationalist and ethnic hostility to secure power for themselves.

Historically, democracy developed in the struggle against oppressive structures of the state or in the inherent conflicts and social inequities of unfettered capitalism. The evolution of Western capitalism is, to a great extent, the history of how capitalism and the interests it served have gradually been restrained by democratic processes. A similar process may now be under way in the Far East, possibly even in China, despite stubborn resistance from the leadership of the Chinese Communist Party. But it would be foolish to regard such self-serving actions taken by the political hierarchy to court international investment, as sufficient to ensure a country's economic and social development.

#### THE FUTURE OF CAPITALISM

What, then, is the future of capitalism likely to be in the ex-Communist countries and in developing countries seeking a better life, now that the attraction of communism is gone?

With the end of the cold war, the world confronts not the end of history—that is, the end of the dialectical process of change created by

antithetical political-economic systems—but new systemic issues: Will capitalism (or capitalisms) be national, regional, or global? Will capitalist institutions be embedded in free democratic societies or authoritarian or totalitarian regimes?

The end of the cold war has brought about a dissolution of the bipolar structure of world power. The industrialized countries of North America, Japan, and Western Europe, which had been held together by their common enemy, the Soviet Union, may be moving toward a “capitalist cold war,” with the United States particularly suspicious of Japan’s economic intentions and mercantilistic practices. Within Europe, there is strain and mounting resistance, especially in Britain, to a deeper federation of states.

*Disintegrative* pressures have stemmed, paradoxically, from growing global *integration* and competition, with workers and some businesses in advanced countries believing that their interests, jobs, and incomes will be adversely affected by free trade. Some of these disintegrative pressures represent a reversion to nationalism and protectionism. President Clinton had a hard fight in gaining the North Atlantic Free Trade Association over labor and populist opposition. He has encountered further resistance to ratification of United States commitment, made during the Uruguay Round of trade talks, to a broader General Agreement on Tariffs and Trade and to replacing the present GATT with a stronger World Trade Organization. The world economic slowdown, resulting in high rates of unemployment in many countries, and sluggish or negative income growth for the majority of people in developed countries, has exacerbated these disintegrative pressures.

Working against these disintegrative forces is a widespread recognition, especially by many leading business corporations, that open markets and a free flow of capital, technology, and knowledge are vital to the future of the businesses themselves and to national and world economic growth. An open world economy is also a powerful means of promoting regional and world peace, in the face of the dangers of aggression posed by authoritarian nationalism. Capitalism plus authoritarianism spells fascism.

Capitalist organizations and states, portrayed by Lenin as inherently and aggressively imperialist, have come to seek not territorial acquisition and control, but rather expanding markets, bigger profits, and lower costs from transnational business activities. While business sometimes seeks the support of the state to gain particular objectives (such as access to foreign markets), what it basically wants from the state is freedom to operate without interference at home and abroad.

Labor and other groups on the left fear that the emerging global economy may mean not only a loss of jobs and income for themselves, but a loss of power by the nation-state that will undermine its ability to serve the interests of those groups within each nation. But such reasoning assumes little or no growth in total output. The theory of free trade and the law of comparative advantage, on the contrary, assume that

the more efficient use of resources resulting from free trade will bring expanded total world output and hence more production and jobs for each nation. This does not, of course, imply that every working group or industry will be better off as a result of more open markets; in the absence of adequate mobility of labor and capital, nations need to assist the adjustment process through educational, training, investment, transportation, housing, or other programs. Freedom does not necessarily imply a laissez-faire role for government; this was the distinction stressed by the philosopher John Dewey in his seminal *Liberalism, Old and New*, and embodied in Franklin Roosevelt's New Deal.

The future of capitalism cannot be *predicted* from present trends; it must be *created* by nations, whether separately or working together. On present trends, one can discern sharply conflicting possibilities: at one extreme, a world that falls back into hostile forms of nationalism and protectionism, which, in causing the global economy to fail, would exacerbate those very nationalistic trends; and, at the other extreme, a world of increasingly close integration, vigorous economic development, cooperation for building and maintaining peace, and international cooperation to protect the natural environment, which no nation, acting alone, can do. Intermediate outcomes between those extremes may be even more probable, with nationalism and internationalism varying with pressures on the system and with the kind of leadership nations get or fail to get. The goal of enlightened leadership, in my view, should be to reinforce the institutions we call capitalist, involving economic freedom for all elements in society, with widely shared democratic and moral principles, which help distribute the benefits of economic freedom and growth more equally among the people of any one nation and among all nations.

Such abstract principles must be translated into concrete, practical policies to ease the transition from communism to capitalism in Eastern Europe and in the countries that composed the former Soviet Union. Recovery from the breakup of a great empire can never be easy—and never without risks of ethnic or nationalistic bitterness and internecine warfare. One must guard against the danger that such outbreaks of violence in the ex-Soviet empire and Eastern Europe could spread to Western Europe, the Middle East, Africa, and Asia. Inescapably, the United States would be affected.

While internal and external deficits seriously constrain the financial aid the United States can provide to countries in transition, this country, counting both its private and public resources, has a great deal of physical, financial, and intellectual capital to contribute—as have the other developed countries of Europe and Asia, together with the International Monetary Fund, the World Bank, and other regional development banks.

However, the United States must strengthen its public finances and redeploy its resources to bring its latent economic strength to bear on both its internal and external problems. We can never forget how America's vigor re-emerged from the Great Depression of the 1930s and

sealed the fate, first of fascism and nazism, then of Soviet communism. Anxieties about America's decline are now common, but experience should strengthen belief in the potential for a strong American revival.

The collapse of Communist regimes in the former Soviet Union poses unprecedented problems of political and economic reconstruction that are even more difficult than those faced by the war-devastated nations after World War II. The problem of capital shortage is only one of the problems that the former Communist states must overcome. They must also get rid of the Stalinist economic institutions and the habits and attitudes inculcated by years of communism, which now stand in the way of economic advance. And they must learn how to master macroeconomic policy; huge budget deficits and loose monetary policies have threatened hyperinflation and the collapse of the ruble and other national currencies. Political weakness and an effort to favor or bail out enterprises facing bankruptcy commonly underlie such blunders in fiscal and monetary policy.

Despite all the hazards of the transition period, the coming century offers hopes for peace and global economic development, if nations have the determination and skill to secure these opportunities. After a century of wars and proliferation of weapons of terror and mass destruction, Hobbes's *Leviathan* seems more realistic and pertinent than ever:

The passions that incline man to peace, are fear of death; desire of such things as are necessary to commodious living; and a hope by their industry to attain them. And reason suggesteth convenient articles of peace, upon which men may be drawn to agreement.