The Future of Capitalism Revisited

John P. Farrell
Oregon State University
Department of Economics, Corvallis, OR 97331
John.P.Farrell@orst.edu

:

Abstract. This essay deliberates on the future of capitalism or, more specifically, the mixture of command and market likely to characterize the modern economy two to three decades on. I start by discussing global trends in the supply and demand for market and non-market goods and the collateral demand for institutions, arguing that the value of non-market goods can be expected to rise relative to market goods, because of the relative fixity of supply of some nonmarket goods (esthetic environmental goods, e.g.), limited substitution possibilities and the high cost of achieving appropriate institutional change. Growing tension between, on the one hand, the demand for non-market goods and the ability of the economy to produce such goods will drive change in the nature of capitalism. If institutions are unable to deliver, if the U.S. economy proves rigid, lacking in ability to adapt, then we can expect bureaucratic resolutions costly in terms of forgone growth. If, however, institutions can adapt in market-friendly way, we can expect continued growth and more efficient production of both market and non-market goods.

Keywords: capitalism, transition, institutions.

1. Introduction

What is the future of capitalism, say 20 or 30 years out? That's an easy one: the future of capitalism is capitalism because, on a national scale, nothing else works. I better refine my question. What will be the mix of command and market in capitalism, say 20 or 30 years out? So the question I am entertaining is about the nature of resource allocation in a general framework of markets and private ownership. Here there are plenty of unsettled questions.

2. Dynamics of Demand for Market and Non-Market Goods

At any time we can imagine a division between market goods and goods for which there is willingness to pay but no supply; i.e., non-market goods. ("Goods" are perhaps best thought as attributes or bundles of attributes.) It is reasonable to assume that non-market goods are superior, so that the demand for non-market goods increases faster than the demand for goods in general as income rises.

Since we all know from our mothers that "money doesn't buy everything," this non-market can be large, including commodities easy to imagine and technologically near at hand (e.g., non-polluting power or vitamin-fortified Coke or Pepsi--a personal favorite) to vague and subjective attributes of the environment and life (such as healthier wolfs or whales, greater biodiversity, more humane working conditions, equity, equal opportunity, etc.)

Of course entrepreneurs have responded to changing demands. But it seems that this supply response has been less than appropriate because either the non-market good is limited in supply and lacks close substitutes (e.g, the Grand Canyon) or there is no cost-effective way to provide consumers sufficient information about what it is they are buying. To the extent that marketizing erstwhile non-market goods requires significant institutional change, there is a challenge to create supportive institutions.

Of course non-market responses are possible, as has been the norm. Government has traditionally responded to demands for equity and security with direct controls. The demand for cleaner air can be addressed by a traditional command and control approach to clean-up rather than the market-consistent method of marketable permits to pollute or even taxes on pollution. If my premiss about growth of demand for non-market goods is correct, how new demands are accommodated--with what mix of market and command--will mean a lot for the nature of capitalism.

3. Recent Events

The last 30 years provide clues about the command-market mix of the near future. For market-enhancing developments, the pre-eminent event is the disintegration of the Soviet empire.

The Soviet experiment--it was supposed to be "scientific socialism" after all--proved that a command economy of the Soviet style could not work well enough to satisfy any major segment of the population, including the power elites. After the colossal Soviet failure, it is doubtful that anyone will seriously advocate adaption of the Soviet model, at least for the next many generations. Thus "large-C command" planning seems secure in the scrapheap of economic systems.

The Soviet experience suggests that inertia is a powerful force. Institutions, once in place, resist change. The mind set of the Western observers of the Soviet economy ran as follows: (i) the Soviet system's leaders are rational, (ii) the objective of these leaders is preservation of power, as suggested by political scientists and (iii) political power rests fundamentally on economic power. It follows that the deteriorating economic performance that accompanied obsolescence of command planning would force substantial systemic change to any variant consistent with a one-party system (e.g., Yugoslav-type market socialism). Otherwise the leadership would lose its grip on power, and no-one willingly gives up political power. Hence reform was inevitable. In the event, substantive reform did not happen and Gorbachev ran the Soviet economic ship aground.

Meanwhile, China, while maintaining a single party system and a large state sector, lurches towards the market. . Engagement with the WTO and with the U.S. and the EU are only the latest moves in a 20-year span of marketization. While China's economic success does not validate large-C command economies--that model was shed long ago--it warns us against exaggerating the grip of institutional inertia and generalization based exclusively on the Soviet experience.

The collapse of the Soviet Empire has had implications for the role of the multilateral institutions (especially the World Bank and IMF). With Russia out of the picture, both have pushed countries for systemic change in the direction of open markets.

While the fall of communism and the subsequent transition have been overwhelming market-affirming, there are some notable dissonant notes. First of all, not all of the transition countries of the former Soviet Union are sailing to market. In fact, Belorussia and Uzbekistan and other central Asian states have docked elsewhere, and Russia remains a question mark. In addition, the average share of privatized output in the 26 transition countries is only 57 percent ten years after the fall of communism (EBRD, 1999).

Security concerns impel the vanguard transition countries (including Poland, Czech Republic and Hungary) towards heavily regulated Europe. This is to the good but it is worth noting that the embrace of free markets is qualified. Europe is far from laissez faire capitalism.

The growth of government in the governments of Western countries continues unabated. US taxes as a share of GDP shows no tendency to drop, despite what was supposed to be a peace dividend. And there is little in the philosophy of candidates Bush or Gore that would suggest change on this front.

Private property rights continue to erode; that is, property rights are being redefined to include various public interests. Witness the growth of environmental regulations and land-use requirements in the state of Oregon.

In addition, citizens continue to demand protection from events taken in earlier times as "acts of God." I have in mind, e.g., demands for compensation for flood damage and other natural disasters. Communist governments got themselves in trouble by pretending that everything was "planned" and therefore immune from the "chaos of the market." On this score, citizens believed the Party and held it accountable. If the crops did not come in on time, it was the fault of the communists; if the trams did not run on time or yogurt was no where to be found, it was blundered planning. It is much easier to govern a society that admits of economic fate, where, if a worker loses his job, he might eventually say that it was "written in the sky". With time, communist governments began appealing to forces of nature to explain agricultural shortfalls (wet springs, dry summers, frigid winters, etc.), which led inevitably to jokes such as the following:

> Question: "What are the four enemies of socialism?
> Answer: "Winter, summer, spring, fall."

Extension of product liability suits constitutes market-antagonistic development. Most dramatic in this category is the amazing fall from grace of the tobacco lobby and commensurate attack on tobacco companies. Is there a more jaw-dropping event in recent U.S. political economy?

3. Institutions and the Market

The demand for goods is accompanied often if not always by a demand for supportive institutions (rules of the game). North (1990) argued that institutions develop in response to changing relative "prices" (terms on which alternatives are available). Given incentives inherent in the institutions, entrepreneurs and organizations demand new institutions. Whether they are successful, depends crucially on their relative bargaining power. In the happiest case, these new institutions are growth inducing. The story that fits this case is the nineteenth century development of the U.S. frontier which evolved through ever finer specification of property rights. The results were declining transactions costs (cost of monitoring and metering deals) and economic growth.

The sad story, however, is one of stagnation where entrepreneurs struggle over distribution rather than production and institutions change all right but only in the direction of ever more effective engines of redistribution. Along similar lines, Feige (1993) notes that while every society must devote resources to production, protection and predation, the mix of activities is crucial. In Russia today as an example the returns to predation are altogether too high to promote healthy development.

Unfortunately, North was unable to resolve the question of why some societies get locked into a "bad" (non growth-inducing) institutional path while others glide forward on good institutions. Consequently, North's work, as developed so far, is much more adept at explaining what happened rather than what will happen. It lacks one of the essentials of good theory: the ability to predict.

.

Nonetheless, North's framework is useful for it establishes that institutions are important because they affect incentives and transactions costs, institutions--rules of the game--do not automatically and costlessly adjust to eliminate bottlenecks or constraints on growth of one kind or another and the direction of institutional change derives from demand reflected in changing relative prices, and all this is anchored in a mostly neoclassical framework..

I mentioned above that market has responded to the increasing (latent) price of non-market goods in cases where no particular institutional change was required. Certainly there has been a market response to this demand, where normal conditions for market survival obtain (ability to collect money and exclude-non payers). Witness the mass shuttle of mostly well-healed tourists on cruise ships to Alaska and eco-tourism in more authentic forms. Even where new or refined institutions are called for, there has been substantial change: e.g., in the implementation of marketable permits (e.g., coal burning electric plants) and eco-labeling of all sorts. Then there's environmental capitalism via Nature Conservancy and the Coase Theory (payments from environmentalists to farmers for water rights or forest tracts, e.g.).

What is it the consumer satiated with run of the mall products and services desires? What is the real "stuff" of a wilderness experience. Can not that experience be replicated or nearly replicated through other means, perhaps electronic or even pharmaceutical? But while substitutes exist, one has to think that there are limits to substitution, goods for which no clear substitutes exist.

In addition, the potential for marketization is limited by our ability to create appropriate institutions. If this is so, the growing gap between what he market can deliver and what is demanded will grow, and there will be commensurate growing pressure on the economic system to deliver what it cannot.

4. Past Predictions

It is time to put some gravitas in this discussion by appealing to the old masters. What did they say about the future of capitalism?

Let me remind you that musing on the future of capitalism was not so long ago a serious part of scholarship. At least the great economists felt obliged to offer their opinions about the trajectory of economic systems, especially in light of poor performance in capitalism, criticism from the left and, after 1917, existence of a real alternative. Now-a-days economists refrain from predicting the future--it's too hard to call. Long-term systemic prediction is left to the domain of "air port" books (and even most of that genre is short-term, of the type "How to Profits from the Coming Crash") and a small band of imaginative futurologists of vague academic pedigree..

Famous economists have quit foretelling the future because they have been wrong and wrong big time. Marx and the Marxists missed the rise of labor unions and, of late, the increasing identification of workers with owners via stock ownership. Mill saw a steady state of zero growth as investment opportunities dried up. So did Ricardo, although for different reasons. Keynes argued in 1936 that in "one or two generations" capital would be deprived of its scarcity value. And Hansen and the stagnationists of immediate post WWII, bearing Keynesian crosses, saw a dwindling frontier, exhaustion of investment opportunities and flagging population growth, all of which pointed to relapse into the Great Depression (Heilbroner, 1990). It is no wonder that economists have quit the business of long-run forecasts; with a record like that, who would not quit?

Nonetheless, there may be something in these old predictions for us. Of the famous economists, Schumpeter was closest to the mark. He foresaw a day when the illustrious entrepreneur--the engine of growth in his model of capitalism--would be overtaken by routinized research and development. That does miss Bill Gates and small fry .com entrepreneurs. But more accurately, he foresaw a growing critical attitude developing with increasing affluence towards results of corporate dominance. This would gradually lead--in one of his scenarios--to a take-over of corporate management by a broad coalition of stakeholders. For Schumpeter, whether or not such managed capitalism is called "socialism" or not was purely a matter of taste. The dynamism of capitalism would be progressively "burdened", "fettered" and "regulated." Inherent frictions and deadlocks of such a mixed order might well generate a leap to "an outright socialist solution" and "complete planning as the lesser of possible evils" (Elliott, 1973). Schumpeter offered few details on how such an arrangement would actually work, but he doubted the sustainability of capitalist institutions and correctly anticipated that challenges to the system would be more intellectual and rational than class-based.

5. The Future

So Schumpeter gives us one vision of the future: bureaucratized capitalism dominated by command and control methods of government, leavened by participation of various public interest groups. This would be a less dynamic capitalism in terms of GDP growth to be sure, but it would address--however incompletely and crudely--the growing latent demand for non-market goods.

Let us explore a little how stakeholder capitalism might work. Such a capitalism could be a corporatist arrangement where environmentalists, minorities and labor would share power with management and stockholders. Stakeholders, in the most democratic variant, would elect boards or directors, perhaps with a proviso regarding minimal representation. In a less democratic version, a single interest--say environmentalists--would hold majority if not overweening power in the corporation. Thus, for example, the Green Party representative might maintain Party discipline in the enterprise by being sure that the party line was carried out. This begins to sound like the Soviet economy without central planning.

In either variant, profit or market share could not remain the sole or principal measure of managerial success, since doing right for the environment (or for the Green Party or labor or any other represented interest) would often mean violating efficiency (profitability) standards. Thus both of these arrangements imply the need for comprehensive subsidization (excising of "surplus" profit). This too looks Soviet.

While corporate governance could be more or less democratic and inclusive, relationships between enterprises can be more or less market-oriented. In the most market-friendly variant (call it "logo capitalism"), all latent willingness to pay for environmental values is realized through an extensive labeling system. Consumers will have good if not perfect information on whatever they buy (human labor conditions, participation, women's rights, biodiversity, etc.). In this market friendly solution, enterprise objectives can be couched in relatively simple terms of market share or profitability since prices will reflect non-market values. Of course this solution will not resolve the issues or free-riding or equity.

My guess is that our capitalism of 20-30 years hence will resemble that of today more than stakeholder capitalism. Partly, this view is based on objective considerations, in particular the difficulty of designing institutions that can reasonably efficiently and effectively monitor attributes that matter to consumers. Measurement can easily become intractable or economically unfeasible, as, for example in the matter of identifying the contribution of each polluter to total pollution and charging accordingly. But the barriers to institutional design are not so much technical as incentive-based. It was not technology that ultimately prevented the Soviets from implemented "perfect computation" but the disincentives to management for providing accurate information that foiled the attempt. Designing incentive-compatible institutions at the enterprise level where a welter or interests are represented is also a formidable task.

A final difficulty of both visions is politics. Corporations are far from defenseless after all. Even market-friendly eco labeling efforts in Europe have floundered on deliberate corporate obstructionism as much as technical problems (West 1996). Thus I think the future will bring more of the same, with market-friendly solutions making some inroads in the way non-market goods are produced and allocated but with no major change. Given performance of U.S. capitalism over the past decade and broad political acceptance of the system, that is not a pessimistic conjecture.

References

Elliot, John E., *Comparative Economic Systems*. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1973.

European Bank for Reconstruction and Development (EBRD), *Transition Report, 1999.*

Feige, Edgar L. Underground Activity and Institutional Change: Productive, Protective and Predatory Behavior in Transition Economies, in *Transforming Post- Communist Political Economies,* Joan M. Nelson, *et al.*, eds. Washington D.C.:: National Academy Press, 21-34, 1997.

Heilbroner, Robert, Analysis and Vision in the History of Economic Thought, *Journal of Economic Literature,* 28 (September), 1097-1114, 1990.

North, Douglas C. *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press, 1990.

West, Karen, Ecolabels: The Industrialization of Environmental Standards, *The Ecologist,* 25 (January/February), 16-20, 1965.