Welfare-Corporate Capitalism And Market Socialism: Economic Systems For The 21st Century?

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In this paper I examine the main features and consequences of six economic systems. Two are the theories of a pure capitalist system and a pure socialist system. Another two are the actual performances of pure capitalist and pure socialist systems. The last two systems are a welfare-corporate capitalist system and a market socialist system. These last two are systems that we now enjoy or suffer depending on your point of view, and variations on them are what the future is likely to bring. Our understanding of these two systems is served by first considering the other four, which is how I organize the paper.

A second theme that runs throughout this paper is the long-run trade-off between growth and security in economic development. One of the most widely-accepted if not universally - accepted propositions in finance is that return is desirable and risk is undesirable. Hence, shares are priced so that the expected return increases as the return′s variance or risk increases. Reflection on my dividend growth model led me to believe that growth is risky. In short, growth stocks are risky. Two of my former doctoral students, David Fewings and Robert Whaley found theoretical and empirical evidence in support of this hypothesis. They found correlation between beta and growth.

I was able to get Fewings′s work published in a book,[2] but beyond that we ran into a wall. In the neo-classical theory of finance, there is absolutely no association between growth and risk, and it proved impossible to publish in the establishment literature any work that explored this hypothesis further. In fact, neo-classical economics in general sees no connection between growth and insecurity. Growth is an unmixed blessing, and the inequality, insecurity and other undesirable consequences cannot be allowed to question the growth imperative. Nonetheless, I decided to explore the long-run trade-off between growth and security in economic development. This paper is the result of that investigation.

I. Pure Capitalist and Socialist Systems

The two main distinguishing features of a pure capitalist system are a) private ownership of the means of production, and b) reliance on markets for the administration of the economy. By contrast, a pure socialist system has a) public ownership of the means of production, and b) reliance on a bureaucracy to administer the economy. Neo-classical, that is establishment

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[2]See David R. Fewings, *Corporate Growth and Common Stock Risk* (Greenwich Connecticut: JAI Press, 1979).

economists, have constructed a theory of a perfectly competitive capitalist system that is a utopia. Everyone is free to buy, produce and work at whatever she wants. All wage and profit rates are fair. There is no unemployment, insecurity, etc. Similarly, establishment socialist economists in the former Soviet Union have constructed the theory of a pure socialist system that also is a utopia.

Both groups of economists recognise that the real world falls short of their respective utopias. Neo-classical economists tell us that the gap is due to market imperfections. In doing so they offer us a more attractive vision of the future than the great theologians. The latter, with few exceptions, recognise that human imperfections make a heaven on earth practically impossible, but neo-classical economists assure us that heaven on earth requires only that we overcome market imperfections. I presume that the establishment economists in the former Soviet Union claimed that their utopia required only that imperfections in the bureaucracy be overcome. Neither pure system has existed in practice for any length of time, and neither is a viable option for the future. Both have proven to be closer to hell than to a heaven on earth. To see why that is so, and to understand what options we really have, we must look at each of the systems we have within the context of their historical development.

II. Evolution of Actual Capitalist Systems

European capitalism had its origins in feudal society. Feudalism there arose in the centuries following the fall of the Roman Empire, in order to provide security against the raids of marauding tribes. Tribalism was the alternative economic system at the time. The typical feudal manor was a closed system that also provided economic security through its technology of production and social arrangements. However, the agricultural surplus that increased with the progress of feudal society was realized most effectively through the rise of capitalism. That is, the surplus was converted to armaments, jewellery and other manufactures through sale to the towns with their market economy. The towns in turn financed the rise of national monarchs and eventually nation states; in other words, the progress of feudal society required the relative growth of capitalism. The contradictions in this process transformed, corrupted and ultimately destroyed feudal society. It culminated in the transition to capitalism between the 15th and 18th centuries, a unique and remarkable event, since that transition did not take place under roughly similar circumstances in other places. One striking example is 17th Century China.[3]

Capitalism is a very effective engine of economic growth, but it is also a terrible engine of economic insecurity, and without high growth the insecurity is intolerable. This insecurity was moderated during the transition from feudalism to capitalism, both by the growth made possible by the transition, and by the cushion provided by the underlying feudal society. The transition was completed in Great Britain by about 1850, and by that date the country was to come as

[3]This transition from feudalism to proprietor capitalism, and its evolution to the welfare-corporate capitalism we have today is described in greater detail in the last chapter of M.J. Gordon, *Finance Investment and Macroeconomics: The Neoclassical and a Post-Keynesian Solution* (Aldershot, England.: Elgar, 1994).

close as it ever was to having a pure competitive capitalist system. Feudalism was gone and the welfare state had not been established. About 1850, Charles Dickens's novels and Karl Marx's Capital, each in its own way, described the consequences of that system for the mass of the people. Marx drew his information from the reports of parliamentary committees on child labor, the employment of women, and the housing and health of the people. These reports warned that unless drastic corrective action was taken, the British working class would be physically destroyed by the competitive capitalist system that was in place.

Over the years 1850 to 1950, the leading capitalist countries suffered both the privation and insecurity of fluctuations in employment and output, and periodic wars of increasing scale. However, the dominant story was the rise of the welfare state, the extraordinary growth in prosperity for both capitalist and worker, and the phenomenal growth in the managerial and professional middle class. The private arrangements to find economic security proved to be unsatisfactory, and social security was found in numerous ways, including pension plans, unemployment compensation, socialized medicine and public housing. Progressive taxation and full employment expenditure policies, undertaken to increase aggregate demand, were among the other features of the welfare state.

Toward the end of this period, the theoretical rationale for the welfare state and its related developments were discovered by the great economist, John M. Keynes. The formal recognition and acceptance of the welfare state, due to Keynes, made the years 1945 to 1970 a golden age in capitalist development. It was a period of stability and growth, rising expectations and their realization.

III. The Modern Corporation and Welfare-Corporate Capitalism

The 1970's, however, inaugurated a reversal in the rise of the welfare state. The leading capitalist countries have since experienced various combinations of high unemployment rates, high inflation rates, unprecedented government deficits, and increasing inequality. The experience of the third world countries and the countries of the former Soviet Union has been far worse. Now more than ever, the rich get richer and the poor get poorer. The progress of technology seems to contribute more to ravishing the environment than protecting it, particularly in the third world. The internationalization of real and financial capital proceeds at a breathtaking pace, and the ability of national governments to manage their economies in the interest of their people declines correspondingly. The buzz words are globalization, downsizing and the end of work.

The causal factor in all of these developments has been the rise of the modern corporation. The 18th and 19th century enterprises of Adam Smith and Karl Marx had the factory and its offices located in the same or in adjoining buildings. Over the last century the progress in travel, transportation, communication, data processing and in the practice of management have resulted in the global corporation. It participates in all of the world's important markets, while moving production almost at will from one low wage country to another in order to minimize production cost.

Perhaps more important, the primary if not the sole activity of the enterprises of the

18th and 19th century was production. The modern corporation, by contrast, engages primarily in a wide range of non-production activities in pursuit of monopoly power. These activities include research and development for the purpose of improving existing products, discovering new products and reducing production costs. They include selling and advertising to increase sales and the mark up of price over production costs. They include labor relations to persuade or intimidate workers to produce more or accept lower wages. They include political contributions, lobbying and corruption of government officials in order to obtain natural resources on favourable terms and other favours of government. They include the employment of lawyers, accountants and financiers to avoid and evade taxes and to influence tax legislation. I could go on. These activities may be harmless apart from their cost and their consequences for the distribution of income. They may be beneficial or they may be malignant in their consequences for society. Regardless, what they all have in common is the pursuit of the profits to be gained from monopoly power.

The importance of these monopoly activities is illustrated quite dramatically by looking at the financial statements of Microsoft, a leading high technology company. For the year ending in June 1997, it had sales revenue of $11,358 million, while the labor and material cost of producing the products sold was only $1,085 million. The cost of research and development was $1,925 million, while sales and marketing expenses were almost 50% larger at $2,856 million. General and administration expenses came to $362 million, and income before deducting income taxes was $5,314 million. Notice that the labor and material cost of producing the output sold during the year was less than 10% of the value of the goods sold, while the expenditures to maintain and increase its monopoly power came to 45% of sales revenue, and profits amounted to 47% of sales revenue. The profit of over $5 billion was earned with an investment in inventory, equipment and buildings of less than $2 billion. The market value of Microsoft's common stock was over $160 billion, reflecting the extraordinary growth opportunities created by its monopoly power.

Microsoft is only a somewhat extreme example of the costs incurred and the profits generated in the pursuit of monopoly power by the large modern corporation. The measure of monopoly power, called the *degree of monopoly*, is the ratio of value added to the wages of production workers. Value added is sales volume, less the cost of the materials used in production. The Annual Survey of Manufactures of the U.S. Bureau of Census collects these data. Over the years 1899 to 1949, the degree of monopoly in the manufacturing sector of the US economy fluctuated in a narrow range around 2.5. Over the years 1949 to 1994, it rose dramatically to 5.2. In 1994, production cost accounted for only twenty cents of every dollar of profit. Profit on capital and the cost of monopoly activities absorbed the other eighty cents.

The system we now live in may be called welfare-corporate capitalism. Under it, the role of the state in providing for the welfare of the population is gradually diminishing, while the role of the corporation in generating growth, monopoly profits, inequality and unemployment is expanding. It is to be hoped that this process is cyclical and not secular, and a desirable balance between the two forces can be achieved. Recent election results in England, Germany and elsewhere suggest that is what the people want.

IV. Market Socialism: The Chinese Model

Let us now consider the historical development of market socialism in China. For over 100 years prior to 1949, when a socialist government came to power in China, rule by imperialist foreign governments and provincial warlords had reduced the country to a state of poverty, corruption, violence and degradation that defied description. Over the next five years, the new government moved rapidly towards a pure socialist system. Ownership of practically all wealth was transferred to the government, and a bureaucracy determined the production and distribution of output. These changes accomplished wonders in terms of equality of income, full employment, and improvements in education, health care and other services. Production of basic commodities such as grain, cloth and steel also increased dramatically.

However, the progress that took place under this centralized bureaucratic system made further progress increasingly difficult. A modern economy requires hundreds -- no, thousands of different types of steel, and even greater variety in cloth, food, and other classes of products. Growth and technological progress required change. A central bureaucracy could not possibly acquire all of the information needed to administer the economy effectively. This was particularly true under the primitive state of Chinese technology in travel, communication, data processing and enterprise management. It also could not bring about a high rate of technological progress, since central control required that workers and managers do only what they were told to do: the freedom and motivation to improve, innovate, or work harder would disrupt the system. The Great Leap Forward and the Cultural Revolution were disastrous attempts to catch up with the West within the framework of a pure socialist system.

In 1978 China decided to expand the role of the market in administering the economy without giving up government ownership. It also decided to acquire technology and to some degree capital from the West through joint ventures, wholly owned foreign companies and private enterprise. What were the consequences of this decision?[4]

In agriculture, the use but not the ownership of the land has been privatized. In this way each peasant family cannot be separated from the income from its plot of land. The security of state ownership was combined with the material incentives of the market, and the result was spectacular. Prior to 1978 the growth rate in agricultural production was about 2.1% per annum, little more than the population growth rate. Since then the growth rate has been over 6.0%, and now all but a small fraction of the Chinese people eat well. In addition, the movement of peasants to the city has only been as fast as they could be absorbed without undue hardship.

The high infrastructure investment and low productivity of urban industry made it unprofitable to expand urban industry at a higher rate than the natural growth rate in the urban

[4]The consequences are described in greater detail in M.J. Gordon, "China's Path to Market Socialism." *Challenge: The Magazine of Economic Affairs*. (Jan/Feb. 1992). pp 53-56, and in Myron J. Gordon, Yue Li, and Zhilong Tian, "The Future of Market Socialism in China" in Donald Brean, ed. *Taxation in Modern China*. (England: Routledge, 1998).

population. Consequently industry was brought to the countryside. Employment in township and village enterprises rose form 22 million in 1978 to 135 million in 1996. The quality and quantity of the output have improved correspondingly. In bringing industry to the countryside Deng Xiaoping succeeded where Mahatma Gandhi and Mao Zedong failed. Now more than half the families in the countryside have income from township and village enterprises or urban employment in addition to farm income. The increased prosperity of the peasant families near the big cities and along the coastal plain has been stunning.

The story with regard to urban state enterprises is mixed. Total output has grown impressively, but about half the enterprises by number suffer losses that are absorbed by the state. One reason is their failure to modernize. Another is that redundant workers and poor managers are dismissed only as fast as they can be absorbed elsewhere in the economy. These enterprises, as well as the profitable ones, continue to pay generous pensions and other benefits. Policies to curtail or make profitable these enterprises are being developed slowly and carefully. It has not been found possible to transform the equipment, technology and management of *all* of Chinese industry in one generation.[5] Consequently, joint ventures and private enterprises grow faster and lead the way in importing foreign technology.

In aggregate, the prosperity of the urban as well as the rural population is increasing at an impressive rate. Civil rights as well as human rights have also improved significantly over these years. China is still a poor country, and its people do not have the civil rights that exist in wealthy capitalist countries. Furthermore, the inequality of income, crime, prostitution and corruption that we find in capitalist market systems have also increased considerably. However, their levels do not approach what we observe in Indonesia, India, Egypt, Brazil and other large Third World countries or in the former Soviet Union. Most important, China does not have the widespread grinding poverty and the private and unofficial violence against the poor that exists in so many countries.

What is going on in China may, as some claim, be nothing more than a transition to capitalism, so that within 25 years China will be a capitalist country that enjoys the blessing of the United States. It is also possible that China and some other countries will find market socialism an attractive long-run alternative to welfare-corporate capitalism. It is to be hoped that this great social experiment can continue without being aborted by foreign intervention.

V. The Future

The previous pages make clear that I now can see nothing beyond welfare-corporate capitalism and market socialism as the economic systems through which the world order will

[5]Periodically, the government announces that it will accelerate the elimination of unprofitable enterprises, even at the cost of large scale unemployment. During the last few years, workers at unprofitable enterprises have faced sharper reductions in compensation in order to encourage progress. However, there is little increase in the outright unemployment experienced in third world capitalist countries. Few of the unprofitable companies are actually driven into bankruptcy.

evolve over the next century. However, the path each of these systems will follow is by no means certain. With respect to welfare-corporate capitalism, welfare and not the corporation must become the prime concern. We see in Southeast Asia, Russia and other countries of the former Soviet Union and practically all of South America, as well as Africa, the terrible consequences of the subordination of national governments and their concern for the welfare of their people to multinational corporations. Even some establishment economists now recognize that the complete international mobility of real and financial capital must be restricted.[6] Far more is needed. The participation of multinational corporations in the markets of a country and in the extraction of its natural resources must be controlled by that country in its national interest. The failure of a country to pursue its national interest wisely and efficiently is no justification for submitting to the sovereignty of foreign corporations. They invariably support corrupt and inefficient governments in the Third World.

Our concern for the environment and the quality of life is also served by subordinating the corporation to national welfare and control. We have seen how the modern corporation is driven by a growth imperative. The inequality, unemployment and greed fostered by that growth imperative imposes it on the countries in which they operate and overrides concern for the environment and quality of life.

China, no less than the countries of the West, perhaps even more so, is subject to a growth imperative. Its growth over the past twenty years has been the highest among the large and important countries, and the consequences for the environment have not been good. These developments raise a number of questions. Has China gone too far in sacrificing the socialist concern for equality, security and the quality of life? Is the subordination of all other concerns to growth the inevitable consequence of *market* socialism, or are there other explanations? The answers to these questions may become clearer only with the passage of time. In this connection, it should be noted that concern for national independence and security may contribute materially to China's desire for growth. When China looks abroad, it sees large U.S. military bases in South Korea, Japan, Okinawa, and the Philippines. It sees the U.S. cultivate relations with Taiwan, Vietnam and other countries of the region. It hears powerful voices in the U.S. shed crocodile tears about human rights in China and call for the "liberation" of Taiwan and Tibet from Chinese oppression. China's leaders may see economic development as a means for maintaining national independence and security.

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[6]The Chief Economist of the World Bank was among the economists who have come out for restrictions on capital mobility. See Joseph Stiglitz, *More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus*, (World Institute for Development Economics Research, United Nations University, Helsinki, 1998.) However, he has been forced to resign that position.