

CAPITALISM TODAY: TRIUMPHS AND CHALLENGES

Maurice Chevalier, the French entertainer, was asked on his 75th birthday his thoughts on reaching that advanced age. He replied, “I think it’s great, considering the alternative.” Capitalism, too—the most productive economic system known—is preferable to the alternatives. And unlike death, its excesses can be mitigated.

Ever since Adam Smith pointed out that the butcher and baker provide us with dinner, not from benevolence but from self-interest, it has been clear that, creativity and productivity are galvanized by incentives which harness the producers’ interests in a competitive society.

When the savings of prudent lenders were transformed into the investment capital of innovative entrepreneurs, Modern Capitalism was born, creating what Smith called *The Wealth of Nations*; prodigious growth in productivity followed.

The two sides of uncontrolled free markets were soon revealed, as baronial splendor accompanied Dickensian poverty, Rothschild’s chamber pot was admired while children worked 14-hour days in coal mines. Soaring economic booms and devastating busts occurred periodically, along with staggering differentials in wealth and income between those at the top and those at the bottom; monopolistic practices crushed the small business that Smith praised.

Eventually graduated income taxes and inheritance duties were imposed; government regulation modified the worst excesses of the free market; and the creation of trade unions gave labor effective bargaining power. Public services in health and education became available, with housing and income benefits for the poor and disabled.

Thanks to its open frontier, its political institutions, communal practices and philosophy of Calvinist self-reliance, America never developed an angry protesting proletariat like Europe. The ‘animal spirits’ of its entrepreneurs were seen as serving the public good.

Until recently, American public sentiment viewed the ground rules as fair and efficient, reflecting the goals of our Founding Fathers—liberty, equality, democracy.

Today, however, the public feels less free, less equal, and less in control than in the past. Opinion polls proclaim that respect for Congress, the Supreme Court, bankers and public school leaders is at an all-time low. As Robert Putnam, author of *Bowling Alone*, puts it, “a sense is abroad in the land that our national experiment in self-government is faltering.” When the full negative impact is felt on unskilled and semi-skilled employment because of automation, globalization and high-tech developments like robotics, three-dimensional printing and microtechnology, the strain on our ecosystem will be serious.

The realization that social mobility in America today lags behind that of other developed nations, the poor academic performance of our students compared to those of other countries and the decaying state of our national physical infrastructure are facts of life, as are the disparities in well-being between the 1% and the 99%. Worst of all may be our growing fear that life will not deal kindly with our children and grandchildren.

Belief in the legitimacy of the ‘ground rules’ is fundamental to the functioning of a stable society, and if we do not take steps now to restore that diminishing sense of legitimacy, we will pay a painful price in the future. The time has come to rethink our Social Contract, to reconsider the rights and responsibilities, privileges and obligations,

of who owes what to whom.

What Hobbes, Rousseau and Mill wrestled with must be reformulated to deal with the complexities of life today—to give incentives for creation and production without destructive imbalances.

Conflicting visions on that question abound. Tea Party types lacking compassion cite 2 Thessalonians 3:10 (“If any will not work, neither let him eat.”) while Occupy Wall Street types cite Keynes’ *Economic Possibilities of our Grandchildren*, which in turn quotes Matthew 6 on “the lilies of the field; they neither toil nor spin.” Machiavelli perpetually debates Dr. Pangloss.

In the real world, practical thinkers such as Arthur Okun produce volumes like *Equality and Efficiency—The Big Tradeoff*, which wrestle with commonsense compromises in society’s long term interest. What is the appropriate relationship between public goods and private, between present consumption and investment for future benefits? What are the rights and responsibilities of the old vs. the young, the present vs. generations to come?

As we await mature discussion on these issues from our political leaders and public intellectuals, the clock is ticking. If we do not resolve these issues, some charismatic demagogue, a latter-day Huey Long, may arrive first.

To forestall the possibility of social upheaval if public perception is that the ground rules no longer work, several topics must be addressed: A) Tax Reform; B) Entitlement Reform; C) Social Ineffectiveness and D) The Monetizing of Politics.

TAX REFORM

“Taxes are the price we pay for civilized society,” said Oliver Wendell Holmes, Jr. “Legalized robbery” is what the Tea Party’s platform calls any government revenue “more than is absolutely necessary.” A confused public votes for a dysfunctional Washington that is making ours a dysfunctional nation.

Full and frank discussion must be held about the appropriate level of graduated income taxes and graduated inheritance taxes; about

what constitutes a capital gain and how it should be taxed; about the rationale behind property tax exemption; about what should be “tax deductible,” and about what “loopholes” should be closed.

Important for discussion, on our national agenda should be the V.A.T. (Value Added Tax) that every other developed nation imposes—one that taxes “consumption,” not salaries or wages, returns on savings or investments, incentives for production, etc. With limited exemptions for food, clothing and rent, the V.A.T. is the most rational source of government revenue devised, and in America today it is rarely discussed. If the proceeds were designated for scientific research, an infrastructure bank and higher education, a V.A.T. would help the U.S. regain its leadership in the world. (The timing for the introduction of such a tax must await our economic recovery.)

Another form of taxation—called Pigovian after Arthur Pigou—is my second favorite; it decreases “negative externalities.” Examples are taxes on polluting fuels, alcoholic beverages, smoking tobacco, congestion pricing on traffic, ‘recreational drugs,’ if they are ever legalized, etc. As Pat Moynihan suggested, it could be reflected in severe taxes on hand guns, bullets, on ammunition of all sorts.

ENTITLEMENT REFORM

That no one in America today should starve, go naked, be homeless or walk around with infectious disease is universally accepted. That no one should be illiterate is open to debate, but most would agree. Beyond that, opinions vary.

If a Leonardo da Vinci, Isaac Newton or Marie Curie were born in an isolated Ozark or Appalachian Mountain hollow to an unmarried, semi-literate teenage mother, many would say that it is in society’s best interest to see that child’s talent blossom, at public cost if necessary. Others, contemplating the problems of Greece in 2013, might not.

Orlando Shaw of Nashville, Tennessee, has fathered 22 children by 14 different mothers; Desmond Hatchett of Knoxville, Tennessee, has fathered 30 children by 11 different mothers. Some Orthodox

Jews and Mormon groups produce more children than they can support. Society's obligations to the father, to the various mothers and to each of the children merit discussion.

There are those (and I am one) who believe it is in society's interest for education to be a "free good," available to all from pre-K to graduate school. "Equality of opportunity for all" and first-rate "public goods" (parks, museums, etc.)—are essential; after that—let's talk. If the aggregate benefits available to an unemployed worker are greater than those to the employed, disincentives are obvious.

SOCIAL INEFFECTIVENESS

A free market economy requires regulation to avoid chaos. Proper regulation can guide and encourage the good and impede and discourage the bad.

Government regulations today reflect the power of trade union influence or corporate arm-twisting, the legalized bribery of campaign contributions or the impact of K-Street lobbyists.

Transparency in proposing legislation; transparency in its drafting and its appearance in regulations; transparency in the interpretation and imposition of regulations; and transparency in debate over when outdated regulations should expire—merit discussion.

Regulations to protect the family farm when there are no family farms distort U.S. agriculture; regulations to protect the worst public school teachers from being fired harm our school children; regulations that permit government workers' overtime payments to distort lifetime pensions will bankrupt U.S. cities. Let the sun shine on our strangling regulations and clear up the sickness!

THE MONETIZING OF POLITICS

At the root of much of what ails the U.S. today is legalized corruption of politicians, stemming from the cost of election. Congressmen are widely seen as for sale —at one time to trade unions, then to large corporations, today to rich private individuals.

John McCain describes the American political system as “an elaborate influence-peddling scheme in which both parties conspire to stay in office by selling the country to the highest bidder.” Lobbying by oil, pharmaceutical, insurance, television, banking and other industries generates billions of dollars of questionable federal subsidies, along with other advantages that should not be “for sale.” Pandering to government employee unions has saddled us with unfunded liabilities that will haunt our children.

Other democratic societies have avoided the ‘monetizing of politics’ and we should study their electoral practices.

Providing free television time to political candidates; limiting the length of campaigns; revoking the corrosive impact of “Citizens United” (the worst U.S. Supreme Court decision since Dred Scott) which equates free speech with money and personal civil rights with corporate rights are important first steps. Another, of course, is focusing attention on the pernicious practice of gerrymandering. Some 400 of the 435 seats in the House of Representatives are all but impossible for an opposing party to contest.

The public disdains Congress but takes no steps to improve it, and shows its level of interest in politics by appallingly low voter turnouts.

CONCLUSION:

Has capitalism failed? No, but our political will to control it has. Is democracy failing? No, but its success requires the continuous attention of honorable and public-spirited citizens who think long term as well as short term, for “we, us, our” as well as “I, me, mine.”

Our society’s strengths represent the best of the democratic process, of free market capitalism, of the right of each “to do his own thing” so long as it harms no one else. I, for one, accept the concept of “American exceptionalism.” But our weaknesses are apparent, as obstructionist political leaders increasingly apply parliamentary practices in a constitutional system not designed for them.

Where are our “public intellectuals” demanding leadership that puts the long term public good over short term partisan advantage,

that consider the moral as well as the expedient?

Which economists today remember that Adam Smith also wrote *The Theory of Moral Sentiments*? Which political scientists recall that when de Tocqueville coined the phrase “individualism” to describe American society he also praised our community spirit of cooperation and civic involvement?

How many of our political leaders have demonstrated the character and competence to merit our respect? Where is today’s “trust-busting” Teddy Roosevelt to rein in the “malefactors of great wealth?” Where is today’s FDR, to propose a fresh “New Deal” to provide for all our citizens, while rewarding the creators, the risk-takers, the hard-working, the productive?

If we do not find them soon, we will have demagogues instead.

*Finance Seminar
September 18, 2013*