

8 THE THEORY OF CAPITALISM

THE ECONOMICS OF CAPITALISM

We think it may be useful to summarize the theory of Capitalism, in this concluding chapter on the idea of the capitalist revolution, before we turn to the practical program by which it can be accomplished. That theory involves more than the economics of the production and distribution of wealth. It involves basic considerations of political economy, concerning government's role in relation to the economy as a whole. It also involves some fundamental ethical judgments about wealth in relation to more important goods, and about subsistence work in relation to more important activities.

The economics of Capitalism has been sufficiently discussed in the preceding pages to require only the briefest summary here. The following points are its essential elements:

1. The industrial production of wealth, in which capital is responsible for the major portion of the wealth produced, and labor for only a small fraction of it.
2. The private ownership of capital, together with the widest possible diffusion of such ownership among the households of the economy.

3. The production of wealth by the voluntary association and cooperation of private owners of the factors of production (*i.e.*, private owners of labor power and private owners of capital) in which most of the persons involved will function as capitalists as well as workers.
4. The distribution of the wealth produced in accordance with the property rights of the persons engaged in its production, with the extent of the distributive shares accorded the various participants, determined by the extent of their contribution as that is evaluated through supply and demand under conditions of free competition.
5. The progressive reduction of the labor force (*i.e.*, the number engaged in mechanical labor) with the progressive automation of industrial production; and a steady increase in the employment of men in leisure work, or in subsistence work that is not mechanical in quality.
6. The maintenance of a generally high standard of living by means of earned incomes consisting of wages established under freely competitive conditions and the earnings of capital shares (the latter being especially important in those cases in which competitively set wages do not constitute a viable income).
7. The creation of widely diffused mass purchasing power as a means of supporting mass production, without an artificial expansion of production for the mere sake of providing employment, whether or not the wealth produced is desired.
8. The promotion and adoption of every technological advance that will result in a more efficient industrial production of wealth, accompanied by a progressive diminution in the amount of subsistence work needed for its production.

Certain widely prevalent errors have prevented, and may still prevent, those who are concerned with the economic problems of our society from understanding the theory of Capitalism as outlined above. It may be therapeutic to call attention to the most insidious of these fallacies in current economic thought, which are to

be found not only in the writings of avowed socialists but also in the writings of the leading apologists for our present mixed capitalism. They can be briefly summarized as follows:

1. The failure to recognize capital instruments as active producers of wealth in the same sense that men doing subsistence work are active producers of wealth.
2. The consequent false distinction between being an active participant in the production of wealth through one's own labor and being a passive participant in its production through one's capital.
3. The further consequent notion that income derived from the productive use of capital is not earned in the same sense as is income derived from the productive use of labor power, together with the notion that property in capital, being passive, should not be accorded the same rights as property in labor.
4. The illusion that mechanical labor becomes increasingly productive in proportion as the whole industrial economy becomes increasingly productive through the introduction of more and more efficient capital instruments, together with a consequent blindness to the fact that mechanical labor in an advanced industrial economy such as ours produces a very small portion of our wealth (probably 10 percent or less).
5. The failure to realize that in our present economy property rights in capital have been substantially eroded, together with self-deception in the belief that our economy respects the rights of private property in capital.
6. The failure to recognize that diffusion of economic power is impossible without diffusion of private ownership of capital and without full respect for the rights of such ownership, together with the failure to see that effective private ownership of capital, widely diffused, is the only institution in a free society capable of containing and limiting the necessarily centralized political power of modern governments.

7. Recognition of the importance of effective and adequate capital formation, without recognition of the necessity of a progressively broader diffusion of its private ownership.
8. Blindness to the fact that a massive concentration of capital property in a minute proportion of the households in an industrial economy bars the way to an effective participation by all households in the production of wealth, together with consequent blindness to the fact that the economic security thus achieved by a few households is destructive of economic security for the rest.
9. The failure to recognize that it is the maldistribution of participation in production, through excessive concentration in the ownership of capital, that is the basic cause of the economic dislocations or periodic “depressions” in an industrial economy based on private property in capital and labor.
10. The mistaken belief that full employment and a laboristic distribution of wealth are indispensable to the creation of a widely diffused purchasing power adequate for the consumption of the wealth an industrial society is able to produce, and which is therefore necessary to prevent “depressions.”
11. The false notion that labor-saving devices create employment; *i.e.*, the fallacy of supposing that technological advances are compatible with a policy of full employment in subsistence work, which often takes the form of concealing their incompatibility by an orgy of artificially stimulated overproduction.
12. Self-deception with regard to the fact that corporate managers or executives are subsistence workers in exactly the same sense as are all other employees of industrial corporations, differing from these others only in the degree of importance and creativeness of their work, together with the mistaken belief that the corporate managers or executives are the “real capitalists” in our society, in contradistinction to the “mere owners” of the capital that the corporation employs.

The correction or elimination of these errors and fallacies would open the door to a sound understanding of the economics

of Capitalism. That, in fact, is almost impossible as long as these currently prevalent mistakes persist.

THE POLITICS OF CAPITALISM

As a political economy, Capitalism is not to be confused with the so-called *laissez-faire* system of an absolutely self-regulating market. It does not rest on the utterly mistaken belief that if only government will keep its hands completely off the economy, the operation of natural economic laws will result in economic prosperity, general economic welfare, and justice, as well as freedom, for all.

As with regard to the economics of Capitalism, so with regard to the politics of Capitalism, a number of widely held beliefs prevent the truth from being seen. The most obfuscating of these beliefs relate to the economic function of competition. It is believed, for example, that free competition uninhibited by governmental regulation or interference will function as an automatic regulator of economic activity. It is also believed that free competition will provide full employment and that it will automatically sustain itself.

The repeated and widespread demonstrations that competition does not provide full employment, and that it normally and naturally tends to destroy itself, should by now have discredited these doctrinaire *laissez-faire* beliefs. But unfortunately they still persist in certain quarters. It is unfortunate also that so much of the virtue claimed in the past for free competition was based on the illusion that it would provide full employment and that it would perpetuate itself because, as a consequence, when these beliefs are discredited, the true functions of free competition are often discredited with them.⁶⁷

⁶⁷ A thorough analysis of the functions of free competition will be presented in *Capitalism*. In a brief summary of that analysis, we would like to emphasize the following points: that free competition in all the markets of the economy (other than those in the field of the technically unavoidable public utilities) will determine for the common good of the society (a) what items of wealth will be pro-

As a political economy, Capitalism recognizes that free competition does not and cannot provide full employment, and further, that full employment itself is an undesirable objective and that the means of achieving it are equally undesirable. Insisting that, in the absence of freely competitive markets whereby economic values can be objectively and impartially determined, the whole conception of a just economy becomes hollow, Capitalism also recognizes that the most assiduous efforts of government to regulate the economy are required to preserve free competition in all markets against the inherent propensity of free competition to destroy itself. Under Capitalism, therefore, the government has the obligation to maintain free competition in all the markets of the economy.

Far from being a system of *laissez-faire*, Capitalism is a political economy in which the maximum freedom of the participants in economic activity is achieved by government regulation *consistent with the economic principles of Capitalism* and, especially, with its principles of justice. The absence of proper economic regulations can no more create a free economy than the absence of social regulations can create a free society.

It is the duty of government to promote Capitalism by giving the fullest protection to private property, not only property in consumer goods but also and principally property in the instruments of production, whether capital or labor power. In the case of property in capital instruments, the aim of government should be to make such property effective as a source of earned income. To do this, it must protect the rights of capitalists to receive the full re-

duced and in what quantities; (b) the technological manner of their production; (c) the identity of the producers, *i.e.*, the owners of labor and the owners of capital; (d) when items of wealth shall be produced and where; (e) the value of the contribution of each participant in production; and (f) the value of goods and services in all stages of production and at all times following the completion of their production.

turn from the wealth produced by the shares of capital that they own. In addition, government should surround the economic status of the capitalist as stockholder with legal protections and privileges analogous to those it has conferred on the political status of the citizen, and for an analogous reason; namely, in order to make the capitalist, like the citizen, a man who can exert legal power in the control of his own affairs.

Where competition is the instrument of just evaluation, and hence of justice in the distribution of wealth, monopoly is an instrument of power whereby some men can impose their arbitrary will on others. Furthermore, a diffused ownership of capital property would thrive on a truly competitive system, whereas monopoly in all its forms facilitates every tendency toward concentrated ownership of capital. Our present antitrust laws are conceptually inadequate to foster free competition and to prevent all forms of monopoly.

In addition to giving full protection to the rights of private property and to safeguarding free competition against its own inherent tendencies toward monopoly, government should positively promote Capitalism by regulations designed to provide every household with the opportunity to contribute to production, either through the ownership of capital or through the ownership of labor, or through both, in ways that will justly enable each household to earn a viable distributive share of the wealth produced.

Government is under an obligation to make it possible at all times for each and every consumer unit or household to participate in the production of wealth to an extent sufficient for earning a viable income. If a capitalistic form of distribution is observed, this of necessity requires that, since the wealth is largely produced by capital, it must also be largely distributed in the form of returns to the owners of capital. As the burden of production shifts from labor to capital, an increasing number of the households in the economy must, therefore, become owners of capital.

There will always be millions of workers employed in an industrial economy. Nevertheless, if the contribution of an individual

household toward the production of wealth is exclusively by labor and if, when objectively and justly evaluated through free competition, what such labor earns is less than sufficient to provide a decent standard of living for that household, then the opportunity must be given it to enlarge its participation in production through becoming an owner of capital.

Under mixed capitalism, with its unjust laboristic form of distribution, our government pursues the objective of general economic welfare by a policy of full employment. Under Capitalism, with a just capitalistic form of distribution, the government would pursue the objective of securing everyone's natural right to earn a viable income by a policy of ensuring everyone's effective participation in production—by means of capital if labor alone does not suffice.

We have just indicated the positive duties of government in regulating the economy for the purpose of promoting and preserving Capitalism. In addition, government must, of course, regulate economic activities, as it must regulate all other activities in society, with an eye to preventing some men from inflicting injury on others. Such things as adulteration of products, unfair practices, or fraud in business transactions, should be no less subject to proscriptive regulation than embezzlement and highway robbery.

The role of government in relation to the economy has a negative as well as a positive side. To promote Capitalism, there are certain things government should not do, and these are as important as the things it should do. Government should not own and operate capital property except in those rare instances, such as public highways, in which private ownership is unworkable. With the exception just noted, government should not engage in the production of wealth; and, consequently, it should avoid engaging in the distribution or redistribution of wealth incidental to engaging in its production.

Finally, the theory of Capitalism as a political economy calls for a thorough re-examination and, probably, reformation of two

quasi-political institutions—the stock corporation and the labor union. These two institutions are themselves the inevitable by-products of an industrial or capitalist mode of production.

In an industrial system of production the capital required for large-scale enterprises is of such magnitude as to require joint stock holdings and shared ownership; and with every stage of technological advance, it has become more and more necessary for the stock corporation, with a large number of nonoperating owners of the shares of its stock, to replace the solitary capitalist who both owned all the capital involved and managed the operation himself.

For a quite different reason the factory system of production, during the hundred years or more when primitive capitalism prevailed, necessitated the formation of labor unions in order to give those who could participate in production only by labor sufficient power to cope with the enormous power wielded by the few in whose hands the ownership of capital was concentrated.

Over a hundred years ago, de Tocqueville saw in the rise of these new forms of voluntary association the emergence of what he called “secondary agencies of government.” These, he thought, might serve to prevent the concentration of all political and economic power in the hands of the State, as in a sense the feudal lords of the ancient regime, functioning as secondary agencies of government, prevented all political and economic power from being concentrated in the sovereignty of the king. The corporation and the union might thus prevent the mass society, which was just emerging and which he called “democracy,” from degenerating into the tyranny of the totalitarian state.⁶⁸

Soviet Russia, in which there are neither stock corporations nor labor unions, confirms de Tocqueville’s brilliant insight into the conditions under which a mass society with an industrial economy would experience the tyranny of the totalitarian state. But de Tocqueville did not foresee the role that corporations and labor unions would play as opposing centers of power in the economic conflicts

⁶⁸ See *Democracy in America*, Second Part, Book IV, Chs. 5-6.

of mixed capitalism; nor did he foresee the difficulties that democratic governments would face in controlling these quasi-political institutions, some with more economic power at their disposal than most of the cities or states that constitute subordinate units of government in the federal organization of our political society.

In the American tradition, it has long been a maxim of government that it is not power as such, but irresponsible or uncontrollable power which endangers freedom. The giant corporations which now exist and the giant labor union which has just come into existence represent enormous concentrations of power which have not as yet been made fully responsible for the use they make of their power. The most difficult task that government faces, in effecting the transition from our present mixed capitalism, is to tame and harness the power of these creatures of capitalism and, by making them responsible in the discharge of the limited functions they should perform, make them serve Capitalism and democracy, or at least prevent them from despoiling either.⁶⁹

The problem of the labor union under Capitalism is different from the problem of the corporation. Under Capitalism, the labor union will obviously not be needed as an instrument of power to effect a laboristic distribution of wealth. This was the function it performed in the transition from primitive to mixed capitalism, and is still performing. But to say that the labor union will not be needed to perform this function in a justly organized economy, with diffused ownership of capital and a capitalistic distribution of wealth, is not to say that there will then be no socially useful service for it to undertake. Voluntary associations of capitalist workers, operating through democratic processes of self-government, may serve their own members and the whole society by functioning as agencies for the economic education of the newly made capitalists, and as instruments for the protection of their property rights.

⁶⁹ On this subject, see the discussion of the corporation by Scott Buchanan in his *Essay on Politics*, New York, 1953; Ch. IV.

The problem of the corporation is largely one of restoring shareholders to their full powers and rights as the owners of capital and the employers of management. At present, the stockholder is almost disfranchised by the usurpation of economic power by management and boards of directors. This is aggravated by the prevailing shibboleth that the "passive" nonoperating shareholder should be quite content to abdicate the power and rights which go with this property, in favor of the "active" nonowning managers of the enterprise. This amounts to saying that it is to his own interest to relinquish his hold on his property for the sake of obtaining such returns as management, in its superior wisdom, thinks fit.

The theory of Capitalism calls for a radical reformation of the relation of the owners of capital to operating management. It envisages making corporations responsible, by making them compete for new capital in the open market instead of allowing them to withhold a large part of each year's capital earnings and to use that wealth, without the shareholders' consent, for further capitalization. It maintains that a full annual distribution of the wealth produced by the capital of mature corporations, *i.e.*, the distribution of the net income of such corporations to their stockholders, is indispensable to the restoration of the full rights of private property in the most important productive assets of our economy, as well as to the reduction of concentration of ownership and the elimination of a major source of market monopoly.

This proposition is absolutely essential to the practical program for creating Capitalism as the ideally just economy and the economic substructure for the justice and freedom of democracy. We will discuss its practical implications in Chapter Eleven, which treats of the modern corporation in the transition to Capitalism. For the present, no more need be said than that in the political economy of Capitalism the legal reconstitution of the corporation, as well as its effective regulation, is one of the primary positive tasks of government.

THE ETHICS OF CAPITALISM

Democracy and Capitalism are in themselves intrinsically desirable for the justice and freedom they establish as the essential conditions of a truly classless society. But establishing the conditions of such an ideal society will be a hollow triumph unless the human beings who live under such conditions put them to good use. Whether or not they will depends largely on whether our society, through the liberal education of all its members or through other means, can achieve a moral and intellectual revolution—one which leads human beings to put good institutions to good use.⁷⁰

That revolution is needed to reverse two tendencies that are almost universal in our society. Each expresses a wrong order of values. Each, therefore, springs from the same basic error in ethics—the error of mistaking a means for an end.

One is our tendency under a mixed economy to glorify toil or subsistence work for its own sake. We look upon economic activity as an end rather than as a means. We express this attitude by the way in which we subordinate to economic activity the much more important and difficult creative activities that lie outside the sphere of the production of wealth—the activities of politics, religion, the fine arts, pure science, philosophy, teaching, etc. We express this misguided tendency in our disdain for men who, with adequate income from capital property, do not continue to engage in one or another form of subsistence work. We express it when we speak of the cessation of subsistence work as “retirement,” as though when

⁷⁰ The moral and intellectual virtues that are needed to make a man a sound and responsible capitalist are of no higher order than those required for intelligent and responsible citizenship. If liberal education ever becomes adequate to the task that confronts it in a society in which citizenship is conferred on all, and in which all need to be helped by education to become good citizens, it will also be able to help all who have become capitalists to acquire the virtues a good capitalist should have.

the task of providing enough wealth for economic security is completed, the main purpose of human life has been accomplished.

The other tendency is found in our substitution of the pursuit of wealth for the pursuit of happiness. We regard wealth as if it were a good without qualification or without limit--the more of it the better, no matter how it is used. We forget that the acquisition of wealth by a household is only a means to an end, a means which is well-used only when it provides the members of a household with such physical comfort and security as is necessary to enable them to live good human lives. We, therefore, fail to recognize that the amount of wealth that any household needs is strictly limited, and that the amount in excess of reasonable needs which it can put to good use is relatively slight. In short, we give to wealth, which is at best a means of human development, the unlimited and unqualified goodness that belongs only to the end we should pursue--the fullest perfection of ourselves as human beings.

These two tendencies run counter to the direction which the capitalist revolution must take.

The elevation of economic activity to a place it should not have in human life or, worse, the treatment of subsistence work as if it were intrinsically virtuous, instead of merely compulsory, blinds men to the moral significance of Capitalism's insistence that the ideal is not the full employment of men in the labor of producing wealth, but the full enjoyment by men of the liberal activities or leisure work that machine-produced wealth can make possible for all.

A revolution that seeks to make all men capitalists loses its moral point if men feel they can retain their self-respect only through earning their living by labor, instead of feeling that they are doing much more for themselves and their society by effectively and fully using its machine-slaves in order to devote a substantial portion of their time and energies to liberal pursuits and to the work of civilization. Unless an early release from the compulsion of subsistence work for all ranks of labor, managerial and technical as well as mechanical, is regarded, not as retirement, be-

ing shelved, or going off on a permanent vacation, but as a promotion or graduation to better employments, Capitalism offers a dreadful prospect instead of an inspiring challenge.

The attitude which looks upon the acquisition of wealth as a competitive game to be indulged in for the pleasure it affords,⁷¹ or the attitude which looks upon the accumulation of wealth—without limit—as a morally acceptable measure of human achievement, must necessarily lead men to reject the proposition that the individual acquisition and accumulation of wealth should serve the things that wealth itself is needed to support.

Rejecting this proposition, they are also likely to reject the proposal that individual accumulations of capital should not be permitted to grow beyond the point at which they necessarily exclude other households from adequately participating in the production of wealth. The feeling that their individual liberty would be infringed by such limitation will make them deaf to the clearest proof that justice requires it. Since the principles of economic justice are essential to Capitalism, and since it regards nothing that justice demands as an encroachment on freedom, the program of Capitalism cannot avoid meeting strong emotional resistance in some quarters of contemporary society.

It is our hope that such resistance can be overcome by enlightened self-interest, if by nothing else. Beyond that, it is our deeper hope that liberal education can alter the attitudes and even reverse the tendencies which turn men away from or against the goals of the capitalist revolution.

If that revolution were to take place through the pressure of circumstances and without moral commitment to its aims and principles, the result would be a society whose economic and political institutions were morally better than its human beings. An industrial economy which persists in the maldistribution of capital, its most productive factor, or which cannot find a way of checking inflation, may contain the seeds of its own destruction; but that is

⁷¹ On this point, see Frank Knight's essay, "The Ethics of Competition," in a volume of essays which bears that title (New York, 1935).

as nothing compared with the human havoc and corruption engendered in a society which is ideally suited to the best in human nature but for which men have not made themselves fit.

Even the best institutions do not operate automatically for the benefit of mankind. Their ultimate result is no better than the ethical goals or ideals men set themselves and discipline themselves to seek. Freedom gives men the opportunity to live well, and justice makes that opportunity equal for all. But neither guarantees that men will avail themselves of it for the highest development of which each is capable.