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Capitalism, Socialism, and Democracy

To most citizens of North America, democracy and capitalism are so closely tied that the idea of an alternative seems foolish; to many citizens of some countries in other parts of the world, it is self-evident that democracy and socialism are the only possible partners. In the United States the word *socialist* is so negative that using this word produces rejection of an idea without further discussion; in many countries the word *capitalist* has the same effect. To put it mildly, there is a lot of disagreement and misunderstanding concerning these two economic systems.

The discussion that follows is intended to clarify the meaning of *capitalism* and *socialism* and show why adherents of each claim to be the only true democrats. Thus the emphasis is on the arguments for and against capitalism and socialism as supportive of democracy. Both positive and negative arguments are presented, because in each case much of the argument for one alternative is based on the argument against the other. Both capitalism and socialism can be found combined with democratic and authoritarian political systems;[1] therefore, it is particularly important to understand how both advocates and critics see their relationship to democracy.

[1] There have been many studies of authoritarianism, going back to Theodor W. Adorno et al., *The Authoritarian Personality* (New York: Harper & Row, 1950).

Today democratic capitalism is perceived as having won the argument with socialism. With the collapse of the authoritarian socialism that we call *communism,* capitalists have a renewed confidence. Capitalism has returned to its roots in the free market, and many of its defenders contend that the problems capitalism encountered were due to a loss of faith in the free market rather than any inherent problem with the system. This resurrected belief in the free market makes the whole argument much simpler than it was when most capitalists supported what they called the *mixed economy;* but it also simplifies and focuses the attack on capitalism because the operations of the free market are the traditional point of attack.

The Principles of Democratic Capitalism

Traditional capitalism, often called *free market capitalism* or *laissez-faire capitalism,* is characterized by

- Private ownership of property
- No legal limit on the accumulation of property
- The free market—no government intervention in the economy
- The profit motive as the driving force
- Profit as the measure of efficiency

The fundamental position as stated by Adam Smith (1723–1790), the Scottish economist and moral philosopher who is generally thought of as the intellectual father of capitalism, is that human beings are most effectively motivated by self-interest.[2] In economic terms, this means that individuals should be free (the free market) to pursue their interests (profit). The result should be the most efficient economic system, and, therefore, everyone will benefit. Goods will be produced that sell as cheaply as possible because, if they aren't, someone else will step in and replace the current manufacturer. Jobs will be created by entrepreneurs searching for a way to make a profit. The entire economy will be stimulated and grow, thus producing a higher standard of living for everyone, as long as the entrepreneur is free to operate and can make a sufficient profit. Workers can choose to spend their money on consumer goods or, by saving, enter the competition by going into business for themselves. Some will fail, some will succeed, and some will succeed beyond all expectations. All commentators agree that capitalism tends to increase production: even Karl Marx (1818–83), the founder of communism, said this. But critics of capitalism like Marx argue that the costs are too high.

The Mixed Economy In the twentieth century some changes were made in capitalism. First, in the culmination of a trend that began in the late nineteenth

[2] For an extensive history of the development of capitalism, see Fernand Braudel, *Civilization and Capitalism, 15th–18th Century,* 3 vols. (New York: Harper & Row, 1982–1984).

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Adam Smith (1723–90) is best known as the author of *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), better known under the short title *The Wealth of Nations*. In *The Wealth of Nations* he presented a history of economics in Europe, a description of manufacturing in his day, and, most important, a set of recommendations. The key argument is that individuals, each pursuing his or her own self-interest, will produce the greatest benefits for everyone. He applied this idea to the operations of the economic system and thereby became famous for providing the moral justification for and part of the intellectual foundation of capitalism.

century, government regulation of the economy was accepted. Regulation came about because the English economist John Maynard Keynes (1883–1946) had argued, and generally convinced other economists, that depressions could be avoided by regulating the economy, specifically by using public expenditure to pump money into the economy and soak up excess unemployment. By doing this, prosperity for all without serious fluctuations—the so-called boom-and-bust cycle—could be virtually guaranteed.

Second, during the Great Depression banks closed, causing the loss of people's life savings, and pensions disappeared along with the companies that had provided them. These events left many people without the financial support they had counted on for their old age. As a direct result, government-administered retirement systems were established in most Western countries. In the United States this was the beginning of the social security system, which was initially designed to be self-supporting (monies paid in by employees and employers would accumulate and be paid out on retirement). The expansion of the program to most of the population, the expansion of benefits, and the rapid increase in the number of people who not only lived long enough to retire but then lived a long time after retirement combined to undermine the financial base of the system.

On the same principle—that people should be protected from radical shifts in economic fortune—other programs were added. Countries varied in the speed and extent of expansion of such governmental intervention in the economy; the United States was probably the slowest economically developed democracy to add programs, and it added far fewer than most. In the United States most programs were established in the so-called War on Poverty during the presidency (1963–69) of Lyndon Johnson (1908–73). These programs were then greatly expanded during the presidency (1969–74) of Richard Nixon (1913–94).

The argument for regulation goes as follows:

- The amount of property and money held by individuals directly affects the amount of money they spend.
- The amount individuals spend directly affects the amount any industry can produce.
- The amount industry can produce affects the number of people it can hire.
- The number of people industry can hire again affects the amount of money available to be spent by individuals for the products of industry.
- The number of products industry can produce affects its profit.

In this way, some limitation on the amount of property or money that can be held by any individual helps rather than deters the entire capitalist system because it forces the money to circulate more widely. Thus even some strong supporters of capitalism argue for some regulation.

Democratic capitalism originated in the West, and that area has provided the model for many countries; but alternative models are available. The best-known alternative occurs in Asia. In Japan an attempt was made to avoid the continual conflict between owners or managers and workers that has characterized the West and that still exists in some countries. The largest Japanese corporations used to provide what were, in essence, lifetime contracts for workers. In return they expected the workers to have a real identification with the corporation. Some such contracts still exist, but the practice is no longer standard. In other Asian countries, like Singapore, a free market was combined with an authoritarian political system that, although democratic, regulated many details of daily life. There was a period in which the economies of many Asian countries grew rapidly; however, currently most of them are strong and stable but not growing.

A number of Western countries are trying to replace the conflict or adversary model of industrial relations that has dominated democratic capitalism with a model that sees management and labor as dependent on each other for success. Germany, the most successful Western industrial democratic capitalist country, has a system that gives a great deal of power to unions as a means of avoiding conflict. Continuing attempts to modify that relationship have so far had only limited success, but Germany is still experiencing difficulties integrating the former German Democratic Republic (East Germany) into the German economy, and the expansion of the European Union means that lower-wage countries are readily available as competition.

Avoiding conflict is also one goal of the corporatist or neocorporatist theory of democracy described in the previous chapter. Corporatists want workers and employers to join with government in ensuring the smooth running of the economy.

The Return to the Free Market As has already been mentioned, capitalists have turned against the mixed-economy model and reasserted the primacy of

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the free market. During the 1980s and 1990s, most Western countries dismantled at least some government regulation, cut back assistance and pension programs, and privatized parts of the economy that had been publicly owned or operated. But many programs have proved immensely popular with citizens and politically difficult or impossible to eliminate. Still, the extent of economic regulation has clearly dropped throughout the world of democratic capitalism.

Capitalism and Democracy

For capitalists, democracy requires capitalism because, they believe, it supports the central democratic value of freedom. Capitalists believe that freedom is based on private property, and capitalism, by stressing private property, makes economic freedom central. Capitalists also believe that economic freedom is a primary support for political liberty. Economic freedom means that everyone is free to enter the marketplace, accumulate property without limit, and use that property as they choose. Capitalists see two potential sources of control that must be blocked—monopolies and government. Monopolies, they believe, will always be temporary if the free market is allowed to operate; therefore, the real problem is government.

Free market capitalists argue that any government regulation destroys the basis for the capitalist system and, hence, individualism and liberty. The defenders of some government regulation (but not control) of the economy say that the absence of government regulation itself destroys the democratic capitalistic system because a few people can control the economy, and even the government, through monopolies. Other bad effects of a lack of government regulation are sometimes mentioned, but the development of monopolies is the most important politically.

Monopolies The problem of monopolies was illustrated in the United States during the first growth of industrialism and particularly the great expansion of the railroads. Such men as J. P. Morgan (1837–1913) virtually controlled the American economy and thereby the American government. This monopolistic tendency, some capitalists argue, destroys the capitalist system by radically limiting competition. The system is not competitive when only a few companies can set prices. Under such circumstances few people with new ideas or approaches are able to try them out: it is not talent that succeeds in such a system but the monopolist's will. This situation does not fit the traditional myth of the capitalist system in which the clerk becomes corporation president by hard work. The clerk of a monopolist might become a business president someday, but not necessarily by hard work. The key to success would be the whim of the monopolist.

The most important effect of monopoly, viewed from the perspective of democracy, is that the monopolist can control the government. Such control severely restricts the degree to which democracy can exist because it might even negate the effect of popular participation in political decision making.[3]

[3] For a different view, see Gabriel Kolko, *The Triumph of Conservatism: A Reinterpretation of American History, 1900–1916* (New York: Free Press, 1963).

President Dwight D. Eisenhower (1890–1969, president 1953–61), in his farewell address, warned the American people about a military–industrial complex that he contended was close to ruling the United States through informal channels. Eisenhower was concerned about the close relationship between the military and the large industries that produced military goods under contract to the Pentagon. He was also concerned with the fact that many high-ranking officers "retired" after twenty years in the military to take jobs in the industries with which they had negotiated contracts and with which their former colleagues would be negotiating future contracts. He believed that these relationships and the growth of the sector of the economy providing goods to the military were leading to a dangerous concentration of economic and political power. This could happen even more readily under a monopolistic system.[4]

Many capitalists believe that the competitive pressures of a truly free market will prevent the development of monopolies. They also believe that any monopoly that develops will not last long because of the same pressures. One reason monopolies are expected to collapse is that their dominance of the market will reduce their incentive to innovate or take risks. In these circumstances, people with new ideas and the risk-taking capitalist mentality will bring new goods to the market and undermine the power of the monopoly.

Economic Freedom Thus even within capitalism the desired extent of economic freedom is the subject of debate. The basic premise is that capitalism allows more freedom for the individual than does any other economic system. Any individual with sufficient interest and funds can buy stock in any number of companies. Stockholders become part owners of a company and can, if time and money permit, participate in some decisions of the company at annual meetings, although this opportunity is limited for the small shareholder.

In addition, there are those like Milton Friedman (b. 1912) who argue that capitalism provides greater political freedom than any other system. "The kind of economic organization that provides economic freedom directly, namely, competitive capitalism, also promotes political freedom because it separates economic power from political power and in this way enables the one to offset the other."[5] This separation can be compared to a checks-and-balances system such as that in the U.S. Constitution. Government power is limited by centers of economic power that also limit one another. These centers of economic power are in turn limited by government, which is also subject to regular elections. If both economic and political power are centralized in government, there is no check on the activities of government except through the vote.

The individual is free to enter the economic system subject to some government regulation and some limitation due to the existence of many large

[4] Some critics argue that this happened some time ago. See, for example, Paul A. Baran and Paul M. Sweezy, *Monopoly Capital: An Essay on the American Economic and Social Order* (New York: Monthly Review Press, 1966).

[5] Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), 9.

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corporations. The individual succeeds or fails depending on his or her willingness to work hard and the desire of the consumer, manipulated to some extent by advertising, to buy the product. This is economic freedom and shows the relationship of capitalism to equality of opportunity. Every person should be able to become a capitalist and have the potential to get rich.

Equality of Opportunity To the extent that capitalists support equality, they mean equality of opportunity, and equality of opportunity was one motivation behind the development of a welfare system designed to ensure that everyone can participate in the system. This concern is not based solely on humanitarian ends but also on the recognition that people who cannot provide for themselves can be a burden on society and a waste of potential human resources. In addition, welfare programs have been concerned with the aged, who have contributed to society but who need help to provide for retirement when many costs, such as medical bills, tend to rise while incomes decline.

Criticism of Democratic Capitalism

Critics of capitalism focus on the extremes of wealth and poverty, the power over the political process that such wealth gives its owners, and the extreme inequality between employer and employee that exists under capitalism. Some of these points have also bothered defenders of capitalism. Other criticisms attack the institution of private property, the free market, and the profit motive.

Results There are two related issues in the criticism of capitalism's results—power and poverty. The power issue can be framed generally by asking how much power one person should have in a democratic society. Great wealth gives potential power in a political system, and critics assert that such wealth makes rule by the people impossible. Defenders of capitalism argue either that this is a nonissue (the rich are a minority, and the majority can always defeat them) or that limited regulation can solve the problem. But the essence of the argument is that the benefits of capitalism outweigh any danger.

Great wealth appears to accompany extreme poverty. Critics of capitalism say that such extremes are inevitable in a capitalist system and are wrong. No one should be condemned to a life of poverty so that a few individuals can be rich. Defenders of capitalism reply either that poverty is the fault of the poor (they have not worked hard enough) or that poverty will be overcome through the economic growth that capitalism makes possible.

Most defenders of capitalism, and in the United States most people, believe the power of an employer over an employee to be simply in the nature of things. But critics of capitalism see this exercise of power as undemocratic and demeaning to the worker. In addition, many people believe that the power relationship between employer and worker fosters undemocratic attitudes, leading to authoritarianism in the employer and servility in the worker. This was clearly the case in Britain in the nineteenth and early twentieth centuries.

Private Property Critics of capitalism state that the private control of property used to manufacture and distribute goods is wrong because it gives a great deal of power to a few people. Today the power of private property is obvious as many companies relocate their operations for various reasons. Critics contend that such factors as the effect on a community, the well-being of employees, and the economic strength of a country should be taken into account in economic decision making. They usually argue that the creation of the value of property is social, not private—that is, it is created by groups of people working together, including those who invest, those who manage, and those who labor, all working within a structure of legal rules. Therefore social effects should outweigh other factors in decision making. Capitalists respond that if wealth is to be produced, they must consider their competitive situation first in any decision. Giving social factors precedence would make capitalists uncompetitive and ultimately force them out of business to the detriment of all concerned.

The Profit Motive Capitalists believe that the profit motive drives people to succeed and create wealth; their critics argue that even if that idea is true, it is wrong. They assert that the competition fostered is personally and socially unhealthy. Capitalists reply that competition is natural and healthy, both personally and socially, and that it is the major source of effort and excellence.

The Free Market Critics of capitalism argue that there is no such thing as a free market and that the whole point of business activity is to control or dominate the market, not compete freely in it. They also say that the free market, to the extent there is one, is inefficient. Capitalists, of course, state that there either is a free market or could be one in most circumstances and that it is the only truly efficient mechanism for producing and distributing goods.

As can be seen, the disagreements are fundamental. They will come up frequently in succeeding pages, particularly because the same issues are often involved in the discussion of socialism.

The Problem of Welfare

In the mid-1990s, politicians in most developed democracies came to the conclusion that the systems designed to provide assistance to the poor had developed fundamental problems and were keeping people out of jobs rather than helping them until they were in a position to enter or reenter the job market. Bolstered by a strong economy and a low unemployment rate, so-called welfare-to-work programs were implemented to force people into the job market by setting dates at which their welfare payments would stop. In the United States the states came up with a wide variety of such programs with different dates for the cutoff, different job training programs, and various incentives to get a job and disincentives to stay on welfare. Initially these programs were huge successes, with large numbers of welfare recipients entering or reentering the workforce and welfare rolls dropping dramatically. Two problems emerged—one expected, the other not planned

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for. The first is that some people on welfare have serious health problems (both mental and physical) or other issues that make it difficult to get or keep a job. The second problem is that the economy is no longer as strong, and many people recently hired off the welfare rolls are being fired, not through any fault in their job performance but because companies are cutting back.

end of the reading assignment

DEMOCRATIC SOCIALISM

Socialism in all forms is currently under attack, and many democratic socialists are dropping the label because many communists now call themselves democratic socialists. Particularly in Eastern Europe, it is difficult to know what a current political label really means. Democratic socialists are in this position because communism, which they criticized, is a form of socialism and has failed. Thus democratic socialists, while not giving up their beliefs, do not want to be falsely identified with communism and are unsure what to call themselves. *Social democracy* is the most common new label and allows for the incorporation of some elements of the market into democratic socialist theory.

The Principles of Democratic Socialism

Democratic socialism can be characterized as follows:

- Much property held by the public through a democratically elected government, including most major industries, utilities, and the transportation system
- A limit on the accumulation of private property
- Governmental regulation of the economy
- Extensive publicly financed assistance and pension programs
- Social costs and the provision of services added to purely financial considerations as the measure of efficiency

Socialism has a long history, which some advocates like to trace back to biblical sources. It is more accurate to see socialism as originating in response to the excesses of early industrial capitalism; but many socialists, particularly those calling themselves Christian socialists, found their inspiration in the New Testament.

Still, the origins of contemporary democratic socialism are best located in the early to mid-nineteenth century writings of the so-called utopian socialists, Robert Owen (1771–1858), Charles Fourier (1772–1837), Claude-Henri Saint-Simon (1760–1825), and Étienne Cabet (1788–1856). All these writers proposed village communities combining industrial and agricultural production and owned, in varying ways, by the inhabitants themselves. Thus the essence of early socialism was public ownership of the means of production. These theorists all also included varying forms of democratic political decision making, but they all distrusted the ability of people raised under capitalism to understand what was in their own best interest.