Chapter 5

Political Economy: How Democratic Is the Free Market Economy?

At first glance, democratic politics and free market economics seem to go together. The liberty to speak, to practice any religion or none at all, and to participate in politics has often come to be associated with the right to make as much money as we can, to succeed or fail according to our own merits in a free marketplace. Free enterprise seems as unintimidating as a yard sale or a bazaar, with many buyers and sellers, colorful haggling, and a variety of products from which to choose. In contrast, big, intrusive government, with its taxes, police, laws, and bureaucracy, appears to present the greatest threat to all these rights. The equation of democracy with free market capitalism seems, especially since the demise of communism, the best and now the only economic game in town. After all, aren't the most prosperous countries in the world also the most free from governmental control? And even if there are sometimes problems, what alternative do we have?

Upon closer inspection, though, the marriage between democracy and contemporary capitalism continues to be a contentious one. In Singapore and China, and arguably in many states of the former USSR, the rise of the market economy has certainly not led to political freedom; and in America, free enterprise capitalism and political democracy may exist at the same time, but their relationship is hardly cozy. Everywhere, free market capitalism seems to generate enormous wealth, but also wrenching instability and inequalities. *Political economy* is the study of the relationship between politics and economics in different countries around the globe. The two essays that follow ask what the roles of government, citizens, corporations, workers, and consumers actually are in America and also what they *should be* to best serve the public interest.

Perhaps the most important debate in political economy concerns the relationship among democracy, equality, and economic efficiency. Aristotle wrote that democracy could not tolerate extremes of wealth and poverty; large inequalities destroyed the spirit of self-sacrifice and fellowship necessary in a democracy. Politics became less the search for the common good than the single-minded pursuit of material interests by rich and poor alike. While the wealthy fell into luxury and decadence, the poor would sink into ignorance and envy.

For those who believe that economic equality and social equality are important for democratic politics, recent trends in America's political economy are indeed ominous. As we go to press, the economy is locked in a recession caused by greed and excessive risk-taking by the mortgage industry and Wall Street. Unemployment is hovering around 10 percent. The income and wealth gap has widened continually at the expense of what was once a very large and politically predominant middle class. In 2003, nearly half the national income went to just 20 percent of the population, and the top 20,000 income earners accumulated as much as the bottom 96 million. (The inequality debate is covered in Chapter 16.) Most U.S. wage earners face increased insecurity, as waves of corporate mergers, downsizing, outsourcing, and other "innovations" make companies leaner but also meaner. Is the free market really free? If it produces such results, can democracy survive such new extremes?

Many corporations and individuals as well as ordinary Americans defend such inequalities by pointing to the efficiency, growth, and technological innovation that are the products of the free enterprise system. They argue that it is better to divide a very large economic pie unequally than to have less pie to divide; they go on to say that many of the changes represent necessary and inevitable adjustments to the realities of the new global economy. The market, its many defenders claim, also preserves liberty by allowing each individual to compete fairly and consumers to choose among a wide range of new products. Free market economies are said to be meritocracies, rewarding the industrious with wealth and punishing the lazy with hardship. In George Gilder's words, "A successful economy depends on the proliferation of the rich, on creating a large class of risk-taking men who are willing to shun the easy channels of a comfortable life in order to create new enterprise, win huge profits, and invest them again."

The two essays that follow not only offer opposing views about the meanings of American democracy and capitalism; they also differ about the meaning of freedom, individual liberty, and equality. They disagree profoundly about what role government actually does play in relationship to the U.S. market economy as well as about what role it should play.

The first essay is excerpted from *Capitalism and Freedom,* by Nobel Prize-winner Milton Friedman, who died in 2006. It was originally written in 1962 and has since been reissued in many editions. Friedman describes himself as a "classic liberal" and tries to restore the original doctrine's political and moral meanings. Classic liberals like Friedman advocate maximum individual freedom in the face of government's tendency to tyrannize. The market economy, Friedman argues, "remov[es] the organization of economic activity from the control of political authority," thereby "eliminat[ing] this source of coercive power." Because liberty is synonymous with democracy, Friedman argues that government has only two legitimate roles: It must defend the national territory and act as an umpire, deciding the rules of the market "game" and interpreting them as necessary when free individuals compete with one another.

In the second essay, Samuel Bowles, Frank Roosevelt, and Richard Edwards deny Friedman's claim that market capitalism and small government go together. They argue that "the expansion of the role of government in the United States is not something that happened in *opposition* to capitalism" but something that happened "in *response* to the development of capitalism." Bowles, Roosevelt, and Edwards go on to claim that a capitalist market economy is hardly a meritocracy; political power and economic power are linked through biased rules. Unlike Friedman, they say that the marketplace concentrates both kinds of power. Hierarchical corporations determine the investments and life circumstances for workers and communities and severely limit the meaning and scope of democratic government and citizenship themselves. For these writers, growing economic inequality spells the effective denial of liberty to the many. Corporate power often buys undue political influence, whether through campaign contributions or corporate ownership of the mass media.

The authors of both essays base their arguments on a defense of democracy. While reading them, ask the following questions: How would Friedman have defended himself against the charge that the market economy produces corporations that exercise unchecked and undemocratic power? What would Bowles, Roosevelt, and Edwards say to Friedman's charge that government often poses a threat to individual freedom and choice and thus to democratic liberty? How do both essays deal with voters and citizens and their potential role in controlling the production and distribution of economic resources? How would the U.S. political economy change if each author had his way? How would it stay the same?

Capitalism and Freedom

MILTON FRIEDMAN

Introduction

The free man will ask neither what his country can do for him nor what he can do for his country.[1] He will ask rather "What can I and my compatriots do through government" to help us discharge our individual responsibilities, to

1. Friedman is referring to John F. Kennedy's 1961 inaugural address.

achieve our several goals and purposes, and above all, to protect our freedom? And he will accompany this question with another: How can we keep the government we create from becoming a Frankenstein that will destroy the very freedom we establish it to protect? Freedom is a rare and delicate plant. Our minds tell us, and history confirms, that the great threat to freedom is the concentration of power. Government is necessary to preserve our freedom, it is an instrument through which we can exercise our freedom; yet by concentrating power in political hands, it is also a threat to freedom. Even though the men who wield this power initially be of good will and even though they be not corrupted by the power they exercise, the power will both attract and form men of a different stamp.

How can we benefit from the promise of government while avoiding the threat to freedom? Two broad principles embodied in our Constitution give an answer that has preserved our freedom so far, though they have been violated repeatedly in practice while proclaimed as precept.

First, the scope of government must be limited. Its major function must be to protect our freedom both from the enemies outside our gates and from our fellow-citizens: to preserve law and order, to enforce private contracts, to foster competitive markets. Beyond this major function, government may enable us at times to accomplish jointly what we would find it more difficult or expensive to accomplish severally. However, any such use of government is fraught with danger. We should not and cannot avoid using government in this way. But there should be a clear and large balance of advantages before we do. By relying primarily on voluntary co-operation and private enterprise, in both economic and other activities, we can insure that the private sector is a check on the powers of the governmental sector and an effective protection of freedom of speech, of religion, and of thought.

The second broad principle is that government power must be dispersed. If government is to exercise power, better in the county than in the state, better in the state than in Washington. If I do not like what my local community does, be it in sewage disposal, or zoning, or schools, I can move to another local community, and though few may take this step, the mere possibility acts as a check. If I do not like what my state does, I can move to another. If I do not like what Washington imposes, I have few alternatives in this world of jealous nations. . . .

Government can never duplicate the variety and diversity of individual action. At any moment in time, by imposing uniform standards in housing, or nutrition, or clothing, government could undoubtedly improve the level of living of many individuals; by imposing uniform standards in schooling, road construction, or sanitation, central government could undoubtedly improve the level of performance in many local areas and perhaps even on the average of all communities. But in the process, government would replace progress by stagnation, it would substitute uniform mediocrity for the variety essential for that experimentation which can bring tomorrow's laggards above today's mean. . . .

The Relation between Economic Freedom and Political Freedom

It is widely believed that politics and economics are separate and largely unconnected; that individual freedom is a political problem and material welfare an economic problem; and that any kind of political arrangements can be combined with any kind of economic arrangements.... The thesis of this chapter is ... that there is an intimate connection between economics and politics, that only certain combinations of political and economic arrangements are possible, and that in particular, a society which is socialist cannot also be democratic, in the sense of guaranteeing individual freedom.

Economic arrangements play a dual role in the promotion of a free society. On the one hand, freedom in economic arrangements is itself a component of freedom broadly understood, so economic freedom is an end in itself. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.

The first of these roles of economic freedom needs special emphasis because intellectuals in particular have a strong bias against regarding this aspect of freedom as important. They tend to express contempt for what they regard as material aspects of life, and to regard their own pursuit of allegedly higher values as on a different plane of significance and as deserving of special attention. For most citizens of the country, however, if not for the intellectual, the direct importance of economic freedom is at least comparable in significance to the indirect importance of economic freedom as a means to political freedom....

Viewed as a means to the end of political freedom, economic arrangements are important because of their effect on the concentration or dispersion of power. 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.

Historical evidence speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organize the bulk of economic activity.

Because we live in a largely free society, we tend to forget how limited is the span of time and the part of the globe for which there has ever been anything like political freedom: the typical state of mankind is tyranny, servitude, and misery. The nineteenth century and early twentieth century in the Western world stand out as striking exceptions to the general trend of historical development. Political freedom in this instance clearly came along with the free market and the development of capitalist institutions. So also did political freedom in the golden age of Greece and in the early days of the Roman era.

History suggests only that capitalism is a necessary condition for political freedom. Clearly it is not a sufficient condition. Fascist Italy and Fascist Spain, Germany at various times in the last seventy years, Japan before World Wars I and II, tzarist Russia in the decades before World War I—are all societies that cannot conceivably be described as politically free. Yet, in each, private enterprise was the dominant form of economic organization. It is therefore clearly possible to have economic arrangements that are fundamentally capitalist and political arrangements that are not free.

Even in those societies, the citizenry had a good deal more freedom than citizens of a modern totalitarian state.[2] … Even in Russia under the Tzars, it was possible for some citizens, under some circumstances, to change their jobs without getting permission from political authority because capitalism and the existence of private property provided some check to the centralized power of the state….

Historical evidence by itself can never be convincing. Perhaps it was sheer coincidence that the expansion of freedom occurred at the same time as the development of capitalist and market institutions. Why should there be a connection? What are the logical links between economic and political freedom? In discussing these questions we shall consider first the market as a direct component of freedom, and then the indirect relation between market arrangements and political freedom. A by-product will be an outline of the ideal economic arrangements for a free society.

As liberals, we take freedom of the individual, or perhaps the family, as our ultimate goal in judging social arrangements. Freedom as a value in this sense has to do with the interrelations among people; it has no meaning whatsoever to a Robinson Crusoe on an isolated island…. Robinson Crusoe on his island is subject to "constraint," he has limited "power," and he has only a limited number of alternatives, but there is no problem of freedom in the sense that is relevant to our discussion. Similarly, in a society freedom has nothing to say about what an individual does with his freedom; it is not an all-embracing ethic. Indeed, a major aim of the liberal is to leave the ethical problem for the individual to wrestle with. The "really" important ethical problems are those that face an individual in a free society—what he should do with his freedom. There are thus two sets of values that a liberal will emphasize—the values that are relevant to relations among people, which is the context in which he assigns first priority to freedom; and the values that are relevant to the individual in the exercise of his freedom, which is the realm of individual ethics and philosophy.

The liberal conceives of men as imperfect beings. He regards the problem of social organization to be as much a negative problem of preventing "bad" people from doing harm as of enabling "good" people to do good; and, of course, "bad" and "good" people may be the same people, depending on who is judging them.

The basic problem of social organization is how to co-ordinate the economic activities of large numbers of people. Even in relatively backward societies, extensive division of labor and specialization of function is required to make effective use of available resources. In advanced societies, the scale on which co-ordination is needed, to take full advantage of the opportunities offered by

2. A totalitarian state is a political order in which state power is held by a single political party, with no political rights accorded to individuals. Friedman here is referring to the former Soviet Union and to other communist countries.

modern science and technology, is enormously greater. Literally millions of people are involved in providing one another with their daily bread, let alone with their yearly automobiles. The challenge to the believer in liberty is to reconcile this widespread interdependence with individual freedom.

Fundamentally, there are only two ways of co-ordinating the economic activities of millions. One is central direction involving the use of coercion—the technique of the army and of the modern totalitarian state. The other is voluntary co-operation of individuals—the technique of the market place.

The possibility of co-ordination through voluntary co-operation rests on the elementary—yet frequently denied—proposition that both parties to an economic transaction benefit from it, *provided the transaction is bilaterally voluntary and informed.*

Exchange can therefore bring about co-ordination without coercion. A working model of a society organized through voluntary exchange is a *free private enterprise exchange economy*—what we have been calling competitive capitalism.

In its simplest form, such a society consists of a number of independent households—a collection of Robinson Crusoes, as it were. Each household uses the resources it controls to produce goods and services that it exchanges for goods and services produced by other households, on terms mutually acceptable to the two parties to the bargain. It is thereby enabled to satisfy its wants indirectly by producing goods and services for others, rather than directly by producing goods for its own immediate use. The incentive for adopting this indirect route is, of course, the increased product made possible by division of labor and specialization of function. Since the household always has the alternative of producing directly for itself, it need not enter into any exchange unless it benefits from it. Hence, no exchange will take place unless both parties do benefit from it. Co-operation is thereby achieved without coercion.

Specialization of function and division of labor would not go far if the ultimate productive unit were the household. In a modern society, we have gone much further. We have introduced enterprises which are intermediaries between individuals in their capacities as suppliers of service and as purchasers of goods. And similarly, specialization of function and division of labor could not go very far if we had to continue to rely on the barter of product for product. In consequence, money has been introduced as a means of facilitating exchange, and of enabling the acts of purchase and of sale to be separated into two parts.

Despite the important role of enterprises and of money in our actual economy, and despite the numerous and complex problems they raise, the central characteristic of the market technique of achieving co-ordination is fully displayed in the simple exchange economy that contains neither enterprises nor money. As in that simple model, so in the complex enterprise and money-exchange economy, co-operation is strictly individual and voluntary *provided*: (a) that enterprises are private, so that the ultimate contracting parties are individuals and (b) that individuals are effectively free to enter or not to enter into any particular exchange, so that every transaction is strictly voluntary....

So long as effective freedom of exchange is maintained, the central feature of the market organization of economic activity is that it prevents one person from interfering with another in respect of most of his activities. The consumer is protected from coercion by the seller because of the presence of other sellers with whom he can deal. The seller is protected from coercion by the consumer because of other consumers to whom he can sell. The employee is protected from coercion by the employer because of other employers for whom he can work, and so on. And the market does this impersonally and without centralized authority.

Indeed, a major source of objection to a free economy is precisely that it does this task so well. It gives people what they want instead of what a particular group thinks they ought to want. Underlying most arguments against the free market is a lack of belief in freedom itself.

The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the "rules of the game" and as an umpire to interpret and enforce the rules decided on. What the market does is to reduce greatly the range of issues that must be decided through political means, and thereby to minimize the extent to which government need participate directly in the game. The characteristic feature of action through political channels is that it tends to require or enforce substantial conformity. The great advantage of the market, on the other hand, is that it permits wide diversity. It is, in political terms, a system of proportional representation. Each man can vote, as it were, for the color of tie he wants and get it; he does not have to see what color the majority wants and then, if he is in the minority, submit.

It is this feature of the market that we refer to when we say that the market provides economic freedom. But this characteristic also has implications that go far beyond the narrowly economic. Political freedom means the absence of coercion of a man by his fellow men. The fundamental threat to freedom is power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power cannot be eliminated—a system of checks and balances. By removing the organization of economic activity from the control of political authority, the market eliminates this source of coercive power. It enables economic strength to be a check to political power rather than a reinforcement.

Economic power can be widely dispersed. There is no law of conservation which forces the growth of new centers of economic strength to be at the expense of existing centers. Political power, on the other hand, is more difficult to decentralize. There can be numerous small independent governments. But it is far more difficult to maintain numerous equipotent small centers of political power in a single large government than it is to have numerous centers of economic strength in a single large economy. There can be many millionaires in one large economy. But can there be more than one really outstanding leader, one person on whom the energies and enthusiasms of his countrymen are centered? If the central government gains power, it is likely to be at the expense of local governments. There seems to be something like a fixed total of political power to be distributed. Consequently, if economic power is joined to political power, concentration seems almost inevitable. On the other hand, if economic power is kept in separate hands from political power, it can serve as a check and a counter to political power….

In a capitalist society, it is only necessary to convince a few wealthy people to get funds to launch any idea, however strange, and there are many such persons, many independent foci of support. And, indeed, it is not even necessary to persuade people or financial institutions with available funds of the soundness of the ideas to be propagated. It is only necessary to persuade them that the propagation can be financially successful; that the newspaper or magazine or book or other venture will be profitable. The competitive publisher, for example, cannot afford to publish only writing with which he personally agrees; his touchstone must be the likelihood that the market will be large enough to yield a satisfactory return on his investment….

The Role of Government in a Free Society

… From this standpoint, the role of the market is that it permits unanimity without conformity.… On the other hand, the characteristic feature of action through explicitly political channels is that it tends to require or to enforce substantial conformity.… The typical issue must be decided "yes" or "no"; at most, provision can be made for a fairly limited number of alternatives….

The use of political channels, while inevitable, tends to strain the social cohesion essential for a stable society. The strain is least if agreement for joint action need be reached only on a limited range of issues on which people in any event have common views. Every extension of the range of issues for which explicit agreement is sought strains further the delicate threads that hold society together. If it goes so far as to touch an issue on which men feel deeply yet differently, it may well disrupt the society. Fundamental differences in basic values can seldom if ever be resolved at the ballot box; ultimately they can only be decided, though not resolved, by conflict. The religious and civil wars of history are a bloody testament to this judgment.

The widespread use of the market reduces the strain on the social fabric by rendering conformity unnecessary with respect to any activities it encompasses. The wider the range of activities covered by the market, the fewer are the issues on which explicitly political decisions are required and hence on which it is necessary to achieve agreement. In turn, the fewer the issues on which agreement is necessary, the greater is the likelihood of getting agreement while maintaining a free society….

Government as Rule-Maker and Umpire

… Just as a good game requires acceptance by the players both of the rules and of the umpire to interpret and enforce them, so a good society requires that its members agree on the general conditions that will govern relations among them, on some means of arbitrating different interpretations of these conditions, and on some device for enforcing compliance with the generally accepted rules.… In both games and society also, no set of rules can prevail unless most participants most of the time conform to them without external sanctions; unless that is, there is a broad underlying social consensus. But we cannot rely on custom or on this consensus alone to interpret and to enforce the rules; we need an umpire. These then are the basic roles of government in a free society: to provide a means whereby we can modify the rules, to mediate differences among us on the meaning of the rules, and to enforce compliance with the rules on the part of those few who would otherwise not play the game.

The need for government in these respects arises because absolute freedom is impossible. However attractive anarchy may be as a philosophy, it is not feasible in a world of imperfect men. Men's freedoms can conflict, and when they do, one man's freedom must be limited to preserve another's—as a Supreme Court Justice once put it, "My freedom to move my fist must be limited by the proximity of your chin."…

Action through Government on Grounds of Technical Monopoly and Neighborhood Effects

The role of government … is to do something that the market cannot do for itself, namely, to determine, arbitrate, and enforce the rules of the game. We may also want to do through government some things that might conceivably be done through the market but that technical or similar conditions render it difficult to do in that way. These all reduce to cases in which strictly voluntary exchange is either exceedingly costly or practically impossible. There are two general classes of such cases: monopoly and similar market imperfections, and neighborhood effects.

Exchange is truly voluntary only when nearly equivalent alternatives exist. Monopoly implies the absence of alternatives and thereby inhibits effective freedom of exchange. In practice, monopoly frequently, if not generally, arises from government support or from collusive agreements among individuals. With respect to these, the problem is either to avoid governmental fostering of monopoly or to stimulate the effective enforcement of rules such as those embodied in our anti-trust laws. However, monopoly may also arise because it is technically efficient to have a single producer or enterprise. I venture to suggest that such cases are more limited than is supposed but they unquestionably do arise….

A second general class of cases in which strictly voluntary exchange is impossible arises when actions of individuals have effects on other individuals for which it is not feasible to charge or recompense them. This is the problem of "neighborhood effects." An obvious example is the pollution of a stream. The man who pollutes a stream is in effect forcing others to exchange good water for bad. These others might be willing to make the exchange at a price. But it is not feasible for them, acting individually, to avoid the exchange or to enforce appropriate compensation….

Parks are an interesting example because they illustrate the difference between cases that can and cases that cannot be justified by neighborhood effects, and because almost everyone at first sight regards the conduct of national parks as obviously a valid function of government. In fact, however, neighborhood effects may justify a city park; they do not justify a national park, like Yellowstone National Park or the Grand Canyon. What is the fundamental difference between the two? For the city park, it is extremely difficult to identify the people who benefit from it and to charge them for the benefits which they receive. If there is a park in the middle of the city, the houses on all sides get the benefit of the open space, and people who walk through it or by it also benefit. To maintain toll collectors at the gates or to impose annual charges per window overlooking the park would be very expensive and difficult. The entrances to a national park like Yellowstone, on the other hand, are few; most of the people who come stay for a considerable period of time and it is perfectly feasible to set up toll gates and collect admission charges. This is indeed now done, though the charges do not cover the whole costs. If the public wants this kind of an activity enough to pay for it, private enterprises will have every incentive to provide such parks. And, of course, there are many private enterprises of this nature now in existence. I cannot myself conjure up any neighborhood effects or important monopoly effects that would justify governmental activity in this area.

Considerations like those I have treated under the heading of neighborhood effects have been used to rationalize almost every conceivable intervention. In many instances, however, this rationalization is special pleading rather than a legitimate application of the concept of neighborhood effects. Neighborhood effects cut both ways. They can be a reason for limiting the activities of government as well as for expanding them….

Action through Government on Paternalistic Grounds

Freedom is a tenable objective only for responsible individuals. We do not believe in freedom for madmen or children. The necessity of drawing a line between responsible individuals and others is inescapable, yet it means that there is an essential ambiguity in our ultimate objective of freedom. Paternalism is inescapable for those whom we designate as not responsible.

The clearest case, perhaps, is that of madmen. We are willing neither to permit them freedom nor to shoot them. It would be nice if we could rely on voluntary activities of individuals to house and care for the madmen. But I think we cannot rule out the possibility that such charitable activities will be inadequate, if only because of the neighborhood effect involved in the fact that I benefit if another man contributes to the care of the insane. For this reason, we may be willing to arrange for their care through government.

Children offer a more difficult case. The ultimate operative unit in our society is the family, not the individual. Yet the acceptance of the family as the unit rests in considerable part on expediency rather than principle. We believe that parents are generally best able to protect their children and to provide for their development into responsible individuals for whom freedom is appropriate. But we do not believe in the freedom of parents to do what they will with other people. The children are responsible individuals in embryo, and a believer in freedom believes in protecting their ultimate rights.

To put this in a different and what may seem a more callous way, children are at one and the same time consumer goods and potentially responsible members of society. The freedom of individuals to use their economic resources as they want includes the freedom to use them to have children—to buy, as it were, the services of children as a particular form of consumption. But once this choice is exercised, the children have a value in and of themselves and have a freedom of their own that is not simply an extension of the freedom of the parents.

The paternalistic ground for governmental activity is in many ways the most troublesome to a liberal; for it involves the acceptance of a principle—that some shall decide for others—which he finds objectionable in most applications and which he rightly regards as a hallmark of his chief intellectual opponents, the proponents of collectivism in one or another of its guises, whether it be communism, socialism, or a welfare state. Yet there is no use pretending that problems are simpler than in fact they are. There is no avoiding the need for some measure of paternalism….

Conclusion

A government which maintained law and order, defined property rights, served as a means whereby we could modify property rights and other rules of the economic game, adjudicated disputes about the interpretation of the rules, enforced contracts, promoted competition, provided a monetary framework, engaged in activities to counter technical monopolies and to overcome neighborhood effects widely regarded as sufficiently important to justify government intervention, and which supplemented private charity and the private family in protecting the irresponsible, whether madman or child—such a government would clearly have important functions to perform. The consistent liberal is not an anarchist….

Is it an accident that so many of the governmental reforms of recent decades have gone awry, that the bright hopes have turned to ashes? Is it simply because the programs are faulty in detail?

I believe the answer is clearly in the negative. The central defect of these measures is that they seek through government to force people to act against their own immediate interests in order to promote a supposedly general interest. They seek to resolve what is supposedly a conflict of interest, or a difference in view about interests, not by establishing a framework that will eliminate the conflict, or by persuading people to have different interests, but by forcing people to act against their own interest. They substitute the values of outsiders for the values of participants; either some telling others what is good for them, or the government taking from some to benefit others. These measures are therefore countered by one of the strongest and most creative forces known to man—the attempt by millions of individuals to promote their own interests, to live their lives by their own values. This is the major reason why the measures have so often had the opposite of the effects intended. It is also one of the major strengths of a free society and explains why governmental regulation does not strangle it.

Corporate Capitalism Hurts American Democracy

SAMUEL BOWLES, FRANK ROOSEVELT, AND RICHARD EDWARDS

A capitalist economy operates on the basis of a set of principles—rules of the game—designed to organize commodity production for profit using wage labor and privately owned capital goods. Governments, on the other hand, are organized according to different principles, a different set of rules. These rules make possible collective action, and involve a compulsory relationship between citizens and their government. Governments—or government leaders—act on behalf of the entire population of a nation, and their actions can be enforced on all of its residents.

The principles of democratic government are very different from those that govern the capitalist economy. Generally, the employees of a corporation do not elect its leaders—the management—and neither does the community in which the corporation is located. In fact, corporate leaders are not elected at all in the sense that is usually attached to the word *election*. The people who own the corporation select them, with each owner having as many votes as the number of shares of stock he or she owns. Similarly, freedom of speech and other civil liberties guaranteed in the political sphere are often limited in the workplace. Many businesses enforce dress codes, and employees are generally not free to post information such as appeals from labor unions.

These two sets of rules—the rules of democratic government and the rules of a capitalist economy—exist side by side in our society. Both affect the economy, and they each conflict. Why has government grown and what does it have to do with the capitalist economy? Do citizens or capitalists have power in politics? Below, we address these questions.

The Expansion of Government Economic Activity

During the past century, the economic importance of the government has grown dramatically. Because its role has expanded qualitatively as well as quantitatively, and because not all government activities are equally important in relation to the economy, there is no single measure by which the expansion of the government's role can be adequately gauged. Measured in dollars, however, federal, state, and local government spending in the United States increased from 7.7 percent of the total output of the economy in 1902 to 31 percent of it in 2002.

In the United States, increases in military, Social Security, and health-related programs in the twentieth century led to substantial growth of expenditures at the level of the federal government. Expansion of such direct services as public schools, municipal hospitals, and police and fire protection led to even more rapid growth of employment at the state and local levels.

Although government expenditures at all levels in the United States increased greatly during the past century, the sum of such expenditures, as a share of the nation's total output of goods and services, is smaller than the comparable percentages of national output spent by governments in other advanced capitalist countries.

The reasons for the increased economic importance of the government are much debated. Some people see growing government as a triumph by the ordinary citizen over the self-serving interests of business. Others see the growth as a triumph of the bureaucratic mentality, which assumes that if there is a problem its solution must take the form of a government program. Still others see big government and the free market economy as opposites.

But there is a more persuasive explanation for the increasing role of government in economic life: **The survival and workability of capitalism as an economic system has required the government to grow.** The ceaseless search for extra profits and the ensuing social, technical, and other changes … have created conditions that have led to demands for a more active government. These demands, as we will see, have come as often from businesspeople as from workers, as often from the Chamber of Commerce as from the AFL-CIO, as often from Republicans as from Democrats. The expansion of the role of government in the United States is not something that happened in *opposition* to capitalism; rather, it is something that has happened in *response* to the development of capitalism. In what specific ways did this expansion occur?

Economic Concentration

Much of the growth of governmental economic activity can be explained by the growth of large corporations and the decline of small producers. The enormous power of modern corporations in the United States has allowed their owners to lobby the government for favors and to influence the formation of public opinion. Thus, big business is able to induce the government to do things that enhance profit making. Examples of this would include subsidies for the nuclear power industry and exorbitant purchases of military hardware. U.S. corporate leaders have also supported the expansion of government regulation in those many situations in which they wanted protection from competitive pressures that might lower profits. Examples of such situations include regulation of the quality of meat and other food to prevent competition from companies that would lower the quality of such products. In addition, consumers and workers have supported the expansion of the economic role of the government, in part to protect themselves from the power of the giant corporations. Passage of the Sherman Antitrust Act (1890), the Clean Air Act (1970), and the Consumer Product Safety Act (1973) are examples of this.

International Expansion

The increasingly global reach of large American corporations has contributed to the development of a conception of "U.S. interests" around the world. As corporations expanded from national to international businesses, they changed from wanting the government to impose tariffs to keep out goods made abroad to insisting that the government protect U.S. investments around the world. They have promoted the development of an increasingly expensive military establishment to defend these interests. Preparations for war and the payment of interest on the national debt—much of which was borrowed to pay for past wars—have accounted for much of the growth in federal expenditures. Capitalism did not invent war, but the degree of international economic interdependence and rivalry produced by the expansion of capitalism did make *world* wars more likely. After World War II, high levels of military expenditure became a permanent feature of the U.S. economy. In 2002 military expenditures amounted to nearly one-half of the "discretionary spending" part of the U.S. federal budget—the part not already committed to paying for "entitlements" such as Social Security and Medicare. In the aftermath of the terrorist attack on the World Trade Center in 2001 the role of government has increased still further with the creation of the Department of Homeland Security and with the government now empowered to monitor private individuals' e-mail communications and to bypass some of the rights of privacy that Americans had long taken for granted.

Economic Instability

The increasing instability of the economy, marked by periods of severe unemployment and dramatized by the worldwide Great Depression of the 1930s, has been another reason for the growing economic importance of the government. The stabilization of the U.S. economy was a major objective of the businessmen who promoted the formation of the Federal Reserve System in 1913 and the Securities and Exchange Commission in 1935. An even more significant impetus for governmental intervention was the persistence of the Great Depression until military expenditures brought about full employment at the beginning of World War II. During the depressed 1930s, radical political movements of both the left and the right spread around the world generating political instability as people responded in different ways to the failure of capitalist economies to provide for their livelihoods.

In many countries, broad coalitions of employers and workers pushed the government to take greater responsibility for maintaining economic growth, profits, and employment through its activities as a macroeconomic regulator. Immediately following World War II, organizations such as the Committee for Economic Development in the United States were successful in gaining congressional passage of the Employment Act of 1946. This legislation committed the U.S. federal government, at least in principle, to insuring that there would be adequate job opportunities for everyone in the labor force.

The post–World War II growth of total government expenditures has increased the ability of the government to stabilize employment. Some government programs (such as unemployment insurance) act as built-in stabilizers that automatically raise government spending when the economy slows down, thus helping to maintain enough total demand to avoid severe recessions. Other more deliberate macroeconomic regulation such as new tax policies or changes in the rate of interest may also counteract the economy's tendency to provide too few jobs. Except during the Korean War, the Vietnam War, and the late 1990s, however, such policies have not succeeded in bringing about full employment in the United States. In part this is because, despite the Employment Act of 1946, the elimination of unemployment has never actually been the objective of the government's macroeconomic regulation. Alben Barkley, a U.S. senator at the time of its passage, drew attention to the inadequacy of the Full Employment Act by saying that the new law "promised anyone needing a job the right to go out and look for one."

Income Support

During the Great Depression, many Americans became convinced that those unable to make an adequate living should be supported, at least at some minimal level, by the government. Government programs to support poor people replaced informal support systems and private charity, both because people who fell on hard times could no longer count on their families or neighbors to tide them over and because private charities did not have sufficient funds to take care of them. In the 1930s unemployment compensation, general relief, and Social Security were established. With the numerical growth and political mobilization of the aged population and of single parent families during the 1960s and early 1970s, benefits and beneficiaries expanded.

In recent years, however, the idea of government support for those in need has come under serious attack from political forces on the right. From the early 1970s through the 1990s, the expansion of income support programs was halted and, in some cases, reversed. In the 1990s, for example, the average weekly unemployment insurance benefit payment was lower in real terms (corrected for inflation) than it had been twenty years earlier.

With the 1996 "welfare reform" legislation passed by the Republican-dominated Congress and signed into law by President Clinton, the federal role in maintaining income support through Aid to Families with Dependent Children (AFDC) was eliminated altogether. Under the Temporary Assistance to Needy Families (TANF) legislation, blocks of aid were granted to states, which then became solely responsible for providing relief. From 1996 to 2002 welfare rolls were further cut back by new regulations requiring all able-bodied former recipients to work at menial jobs in order to qualify for aid. It is too soon to judge whether this recent curtailment of federal support will have beneficial or harmful economic consequences for America's neediest citizens over the long term.

Changing Patterns of Family Life

The combination in the late 1960s of a slowdown in the growth of real wages and an upsurge of women's demands for equality had the effect of altering relationships between women and men both in the household and in the economy as a whole. The two developments have made it less likely that men will be the sole "breadwinners" while their wives stay home to take care of the children, cook the meals, and clean the house. In 1900, only 20 percent of American women worked outside the home; by 2000, the percentage of women between the ages of 25 and 64 in the paid labor force had increased to 73.5 percent.

In the face of wage stagnation from the late 1960s to the mid-1990s, more and more families found that they needed to have both husband and wife in the paid labor force in order to support their living standards. At the same time, the women's movement changed people's consciousness in ways that led at least some men to take more responsibility for household tasks and allowed many more women to take full-time jobs and have careers. Of course these changes have been accompanied by an increasing commodification of household tasks: more children are now taken care of in daycare centers or by paid "nannies," more meals are eaten out or ordered in, and more housecleaning is done by paid "help."

Increases in the labor force participation of women and the broader changes in society's gender roles became yet another set of factors making for expansion of the government's role in the economy. To break down barriers to women's equality in the workplace, new laws and new enforcement activities were required. In the United States, the Civil Rights Act of 1964 created the Equal Employment Opportunity Commission (EEOC) to secure the rights of women as well as members of minority groups to equal opportunities in the workplace. To help both women and men combine paid work with family responsibilities, the U.S. Congress passed and President Clinton signed the 1993 Family and Medical Leave Act. Although compliance with these laws has been less than perfect, they are both significant in bringing U.S. policies closer to those in other advanced industrial nations.

However, citizens in Japan and many Western nations have long had rights to government-funded childcare, to health care for children as well as adults, and to paid parental leave as well as generous required vacation time. In contrast, the U.S. government has been reluctant to formulate comprehensive policies for the support of families, the only exception being for families at or below the poverty line.

Still, the passage of the U.S. Family and Medical Leave Act in 1993 was at least a small step in the direction of governmental support for working families. The Act requires that all workers in firms with more than fifty employees be allowed to take up to twelve weeks of unpaid leave at the time of the birth or adoption of a child or when an ill family member needs to be cared for. Both women and men are covered by the Act. Although their leave is unpaid, employees retain their health benefits while they are on leave and are assured of an equivalent position within their firm when they return to work. What both the Equal Employment Opportunity Commission and the Family and Medical Leave Act do, then, is to assign greater responsibility to the U.S. government for regulating relationships between employers and their employees.

Public Safety

Many groups have demanded that government mediate the conflict between profitability and public safety. While competition generally pushes firms to develop the most profitable technology, the resulting technological advancements do not always result in net benefits to society. The pharmaceutical industry provides an example of the danger of leaving economic decision making solely up to firms seeking to maximize their profits. Certain drugs may be very profitable for the companies, but their side effects, though often complicated and long delayed, may ultimately be damaging to people's health. The chemical industry offers another example of the conflict between profit making and public safety. Some highly profitable production processes in this industry may cause brain damage, sterility, or cancer in the workers who run them; such effects may become known only after many years of exposure….

Environmental Protection

Another issue that has aroused public demands for governmental intervention is the growing need to protect the natural environment from the effects of industrial production. Our natural surroundings—our land, fresh water, air, and oceans—are not only being used, they are being used up or contaminated as corporations compete to produce goods more cheaply. Historically, there have been no prices charged for the use—or misuse—of air and water, and the result has been the pollution of the elements that sustain life. In many cases the most profitable way of disposing of wastes—even very hazardous ones—has been simply to throw them away, using our natural environment as a free dumping ground. Incidents such as the burning of Ohio's Cuyahoga River in 1969, the poisoning of the Love Canal residential area outside of Buffalo in the 1970s, and the 1989 Exxon *Valdez* oil spill off the coast of Alaska have dramatized the need for more adequate controls. The creation of the Environmental Protection Agency and the passage of the Clean Air Act and the Water Pollution Control Act in the early 1970s were important steps in this direction.

Discrimination

Over the last three decades people have come to realize that the unrestricted exercise of private property rights can result in racial and sexual discrimination against both customers and workers. The lunch-counter sit-ins that set off the civil rights movement in the early 1960s brought the issue into sharp relief: should the owners of restaurants and lunch counters have the right to do whatever they please with their property, even if it involves the exclusion of black customers? Or do black people have a right to be treated equally in public places? Since 1964 the U.S. Civil Rights Commission has brought suits against companies, unions, and other institutions to force them to abandon discriminatory practices.

Many of the causes of expanded government economic activity discussed above may be understood as responses to particular aspects of the accumulation process of the capitalist economy. Thus the growth of government regulation has been as much a part of capitalist economic development as the growth of investment or the growth of technology.

But if government has had to grow to repair the problems and hardships caused by the development of the economy, it does not follow that such growth has always succeeded in meeting human needs. It is debatable whether people are today more secure economically than they were a hundred years ago, or better protected from the arbitrary power of giant corporations, or less susceptible to environmental or natural disaster, or less likely to encounter health hazards in their workplace or in their food. Many of the political battles during the last century have been about the extent to which the government can or should be called on to solve social problems caused by economic forces beyond the control of individuals.

Just as we should not overrate the impact of the government's economic activities, we should not exaggerate their extent. Government employment, including the military, is only 15 percent of the total labor force, and of greater significance is the fact that the most important determinant of the future course of the economy—investment—is still almost entirely in private hands....

Government and Corporate Profits

While there is much controversy over the amount of government participation in the economy, the more essential question might be the ways in which government activity and taxation policy affect corporate profits. In general, when it comes to governmental intervention and the corporate profit rate, the power of ordinary citizens and workers is often sacrificed to the needs and political power of large companies and their biggest shareholders. Government can have a huge impact on both the pre-tax profit rate and, through taxation, on how much the after-tax profit rate of corporations rewards shareholders.

Government can improve corporate profits through relatively noncontroversial means, such as promoting research. Yet most other activities provide benefits to some groups and classes and harm others. Consider work regulations and the minimum hourly wage; minimal work regulation and a low minimum wage—both current policies—provide a higher profit rate by cutting corners with safety and by causing higher levels of job insecurity. Current policies permit employers to pay relatively low wages compared to other wealthy countries, speed up work, and obtain other concessions from workers without the time and expense of bargaining with them. These measures are all contrary to what workers generally want—higher wages, safer and less stressful working conditions, and more job opportunities....

Businesses themselves may have contradictory goals for government. Each firm is not so concerned about the economy-wide profit rate as it is about its own profit rate. Thus businesses are often ready to urge the government to adopt policies that will raise their own profit rates even though such policies may push down the profit rates of other businesses. Individual firms lobby the government to reduce their own taxes, to obtain subsidies, or to be allowed to set high prices for their output. Big oil companies benefit enormously from tax credits for foreign royalties paid. The Boeing Corporation has regularly obtained support through government-subsidized cheap credit for the company's foreign customers. Companies in the oil industry were quite happy when the government lifted its controls on oil prices, permitting the price of oil (a raw material input for most other companies) to go up, not down. The oil companies' support of decontrol seemed unaffected by the fact that this policy inflicted big losses on the auto industry, whose high-profit gas guzzlers fell from favor among consumers as gasoline prices rose. Most businesses would be happy to promote government policies that would allow them to pay their own workers less while forcing other firms to pay more. In all these ways, businesses lobby for special benefits that are often in conflict with policies to raise the general profit rate.

Workers, too, have divided interests concerning what the government should do, although often for quite different reasons. Workers in the automobile industry, for example, may want government policies to limit imports of cars produced elsewhere; other workers may want to save money by purchasing a cheaper automobile made in, say, Japan. To take another example, unions that have mainly white male members may be less enthusiastic about government programs designed to secure equal employment opportunities for women and minority workers than unions with substantial minority and female memberships.

Our understanding of government policy is further complicated by the fact that employers and workers are not the only players in the game. Government leaders have their own objectives and face their own constraints. Most of all, they must find ways of getting reelected or reappointed. Such concerns may necessitate appealing to large numbers of voters, an objective that itself may require a combination of two strategies: adopting policies that are in the interest of a majority of voters, and instituting policies that appeal to individuals who can make substantial financial contributions to election campaigns. Only a combination of these strategies would improve one's chance of being reelected: politicians who faithfully serve the interests of the majority but cannot finance election campaigns are just as surely losers as the ones who too blatantly favor the few at the expense of the many.

Government leaders, like businesspeople, may thus find that their objectives work at cross-purposes. To gain favor with business, government leaders may want to cut taxes on profits or high incomes. But raising other taxes to maintain sufficient government revenues may incur the wrath of the broader electorate. And with lower taxes all around, it may be impossible for government leaders to offer public services that are considered essential by a majority of voters.

The three-way tug of war among government leaders, citizens (including workers), and business executives is illustrated, in the following section, by the problem of macroeconomic regulation of the unemployment rate....

The Limits of Democratic Control of the Capitalist Economy

If government has often grown in response to the needs of the capitalist economy, might the economic powers of government be used instead to achieve economic growth that would benefit everyone? Can the citizens of a democratic society control the economy in ways that will promote their own well-being?

… The ability of voters—even large majorities of them—to alter the course of economic events is quite limited as long as the economy remains capitalist.

To understand the limits on government, think of our economy as a game in which there are two different sets of rules. One set of rules—the rules of a capitalist economy—confers power and privilege on those who own and control the capital goods used in production, particularly on the owners and managers of the largest corporations. The other set of rules—the rules of democratic government—confers substantial power on the electorate, that is, on the majority of adult citizens. Thus our social system gives rise to two types of power: the *power of capital* and the *power of the citizenry*.

Those powers are often at loggerheads, as when citizens want to restrict the power of capitalists to sell dangerous or environmentally destructive products. In most such conflicts, capitalists have immense and often overwhelming advantages, despite the fact that the owners of businesses (and particularly the owners of large businesses) are greatly outnumbered in the political arena. There are three explanations for their political power—one obvious, the other two not so obvious.

One reason capitalists have a significant amount of political power is that economic resources can often be translated *directly* into political power. Businesses or wealthy individuals can contribute to political campaigns; they can buy advertisements to alter public opinion; they can hire lawyers, expert witnesses, and others to influence the detailed drafting and implementation of legislation; and they can use their economic resources in other ways—engaging in outright bribery, for example—to influence the political system. In all these ways corporate control of economic resources makes it possible for businesspeople to influence government officials and economic policies.

A second reason for the disproportionate political power of business leaders is more indirect. The owners of today's media conglomerates control the TV stations, newspapers, publishing houses, and other capital goods used in the media that shape public opinion. Even "public" radio and TV now depend heavily on corporate contributions. The constitutional rights to freedom of speech and of the press (which includes TV and radio) guarantee that people can say, and journalists can write, whatever they please. However, the private ownership of the capital goods used in the TV industry, for example, guarantees that what is broadcast is in the end controlled by corporate leaders—either the owners of the stations or the owners of the major corporations that buy the advertising for the programs. These are people who generally have little interest in promoting citizen power because increases in such power may jeopardize their profits.

A third way in which money brings power has to do with the fact that capitalists control investment and therefore can influence what happens in the economy of any particular area. If businesspeople see an area as having a bad investment climate, meaning that they may have difficulty making profits there, they will not invest in that area but will choose instead to invest somewhere else (if they invest at all). If they do not invest in a particular area, the result will be unemployment, economic stagnation, and probably a decline in living standards. This explains why political leaders in particular areas are apt to be easily influenced by the demands of business leaders. If the former do not go along with the wishes of the latter, the population of the area will suffer economic hardships and, placing at least part of the blame for their difficulties on their political leaders, will vote the incumbents out in the next election.

Something like the same process plays a role in the political business cycle. When there has been a long expansion, government leaders are usually willing to go along with the demands of business leaders to bring about a recession that will raise the rate of unemployment. Why is this? It is because, in this situation, government officials can anticipate that business leaders will blame them for any decline in profit rates that might result from increases in the power of workers. If the profit rate was in fact threatened, business leaders would not only withhold their investment, thereby causing economic hardships that would lead people to express their anger in the next election; they would also deny the current political leaders the financial support the latter would need in order to finance a reelection campaign.

When business leaders refuse to invest in a particular area, whether it is a locality, an area such as a state in the United States, or an entire nation, the area will experience what is referred to as a *capital strike.* When workers strike, they refuse to do their part in the economy: they do not work. When capitalists strike, they also refuse to do their part: they do not invest. But here the similarity between the strikes of workers and those of capitalists ends. When workers strike they must organize themselves so that they all strike together. A single worker cannot go on strike (that would be called quitting). By contrast, when capital goes on strike, no coordination is needed.... Each corporation routinely studies the economic and other conditions relevant to its decision to invest. If the executives of the corporation do not like what they see, they will not invest. Nobody organizes a capital strike. Such strikes happen through the independent decisions of corporate leaders. If things look bad to a significant number of corporations, the effect of their combined withholding of investment will be large enough to change the economic conditions of a whole area.

The potential for a capital strike severely limits what citizen power can accomplish when citizen power conflicts with the power of capital. A hypothetical scenario will make this clear. It is currently the policy in the United States that unemployed workers are entitled to receive unemployment insurance checks for 26 weeks after they lose their jobs. But imagine what would happen if the government of a particular state—let's call it "Anystate, USA"—were to decide to provide longer-lasting unemployment benefits so that workers could continue to receive unemployment insurance checks as long as they are unemployed. And let's say that these payments are financed by heavy taxes on the profits of firms that pollute the environment. If a majority of Anystate's citizens support these policies, the state government will adopt them, paying the additional benefits to unemployed workers and collecting the "pollution taxes" to pay for them.

Now imagine that you are the chief executive officer (CEO) of a large multinational corporation—let's call it "MNC Enterprises, Inc."—that employs large numbers of workers in Anystate. Assume that you are considering investing in Anystate, say, by building a new plant there. Not only will you worry about the potential taxes (applicable to any production process that pollutes the environment); you will also be uncertain, first, about how much power you will have over your employees and, second, about how hard they will work, knowing that they are entitled to receive unemployment insurance checks for a long period if you fire them.

You may even ask yourself what the citizenry will vote for next—and you will certainly think twice before investing in Anystate, not necessarily because you personally do not like the new laws, but because your profit rate, both before and after taxes, would most likely be lower in Anystate than it might be elsewhere. Not only would a low profit rate make it difficult for MNC Enterprises to maintain its competitive position relative to other corporations; it would also have additional consequences. Once it became known that the company's profit rate was falling, the price of the company's stock in the stock market would fall. This, in turn, might cause the stockholders to sell their shares, putting more downward pressure on the price of the stock. It is also possible that the Board of Directors of the company, in response to its poor "performance," would begin thinking about replacing you with a new CEO. Anticipating all this, you will probably put any new plant somewhere else, perhaps in a state that actively advertises its favorable investment climate.

Quite independently, other businesspeople will, no doubt, come to the same conclusion. Some may even close plants or offices in Anystate and move them elsewhere. The cumulative effect of these independently made decisions will be increasing unemployment and lower incomes for the people of Anystate.

The hard times may bring on a state financial crisis. As unemployment increases, state expenditures on unemployment insurance will rise, as will the costs of other income support programs. As people's incomes fall, the state's tax revenues will also fall, and a deficit will appear in the state's budget. (Most states are required by their state constitutions to balance their budgets.)

But the problems have only just begun. In order to spend more money than taxes are currently bringing in, the state government will be forced to raise taxes further or to borrow money from banks or individuals willing to make loans to the state or buy bonds (IOUs) issued by the state government. Because of the decline in Anystate's economy, the banks cannot be sure that their loans will be paid back promptly or that they will ever be paid back. If they agree to lend money to the state, they will do so only at high interest rates (to cover the risk of lending to the state). Similarly, investors will be willing to buy the state's newly issued bonds only if they are guaranteed high rates of interest. If the loans are granted and the bonds are bought, the state will have more money to finance its current expenditure, but its fundamental problems will only be put off. They will return with greater intensity when the high interest charges have to be paid, adding to the other demands on state revenues. The resulting vicious cycle, now evident in many U.S. states, is called a *state fiscal crisis*.

There are two likely outcomes. First, with repayment increasingly uncertain, the banks may refuse further loans until the state government changes its policy. If the state government is on the verge of bankruptcy—which means breaking contracts with state employees and not paying wages or bills—the bank's policy recommendations may be quite persuasive. Second, the sovereign citizens of Anystate may decide to elect a new government, in order to have the laws revoked. In either case the new laws will be repealed.

Our example was for a single state, but in fact the process we have outlined could well occur in any state or even in any nation. After all, MNC Enterprises did not have to locate any of its factories in the United States.

Let's go back over our "Anystate" example. Were the citizens' voting rights or civil liberties violated? No. Did capitalists collude to deliberately undermine citizen power? No, they acted independently and in competition with each other. Did they use campaign contributions or lobbyists to influence government officials or elections? They might have but they did not need to.

Did the citizens exercise control over the economy? That is a much harder question. The capitalist economy certainly imposed limits on what they could do. The citizens could vote for any policy they wanted, but they could not force businesses to invest in Anystate, and that fact severely limited the political outcomes.

Where did they go wrong? The example could have turned out very differently.

One course the citizens of Anystate could have followed would have been to limit their expectations; they could have instructed their government to concentrate only on those programs that would benefit citizens but at the same time *raise*—or at least not lower—the profit rates of companies in the state. In other words, they might have accepted from the outset the fact that they were not "sovereign" in economic matters. This would have allowed them to make the best of a less-than-ideal situation.

Thus, for example, the citizens might have concentrated solely on eliminating the forms of air pollution that push down property values by reducing profits in recreation businesses. They might have designed programs to give economic security to the elderly, but not to current workers. They might have tried to increase employment and equality of opportunity by giving all children more business-oriented schooling. And they might have voted to finance these programs by taxes that did not affect profits. If they had adopted any or all of these policies, many Anystate citizens would have benefited, and those who were adversely affected might not have been in a position to block the adoption of them. Specifically, capitalists might have looked favorably or at least indifferently at such policies and might not have brought about economic decline in the state by withholding or withdrawing their investments.

Again, our Anystate example is hypothetical, but it is in fact similar to a process that actually occurred in Wisconsin early in the twentieth century. Wisconsin was a leader in trying out programs to make the most of citizen power while operating within the limits of a capitalist economy. Moreover, the federal government and a number of state and local governments now engage in many beneficial economic activities that also fit this description. Providing for social needs within the general framework of a capitalist economy has been the aim of European nations such as Sweden and Austria, where social democratic governments have been in power during much of the last century. As beneficial as these programs have been, however, they are severely limited by the fact that many of the ways to improve living standards and the quality of life sooner or later also threaten the rate of profit.

There is yet another course that Anystate citizens could have followed, which, if not likely, is at least conceivable. When MNC Enterprises (or other companies) decided to close down their operations in Anystate, the plants could have been bought by their local communities, by their workers, or by the state government itself. When a business leaves a community, what it takes with it, usually, is just its money. The plant, equipment and machinery—not to mention the workers—are left behind. If a way could be found to purchase the firm and sell its output, there is no reason why the workers who held jobs in the MNC Enterprises plant could not continue working there. They could do this by forming a community-owned enterprise, a worker-owned firm, or some other type of democratic organization.

We may conclude from our Anystate example that citizen power is severely limited in its ability to alter fundamental economic policies. These limits can only be overcome if citizens commit themselves to altering the rules of a capitalist economy…. The rules of a capitalist economy are not the same as those of democratic government. To achieve a democratic *society*—not just a democratic *government*—decision making in the economy, as well as in the government, would have to be made accountable to a majority of its participants.

Discussion Questions

1. Friedman stresses that the market economy is made up of *voluntary exchanges*. No one is forced to buy a particular product or to work for a particular company. What would Bowles, Roosevelt, and Edwards say about Friedman's argument?
2. There is a substantial amount of income inequality in the United States. As long as all citizens still maintain equal political rights, is such inequality necessarily harmful to democracy? Where would you draw the line between acceptable and unacceptable levels of economic inequality in a democracy?
3. Friedman argues that the free market promotes individual liberty. Yet many citizens in democratic countries use their liberty to support government programs that limit and regulate the scope and power of the marketplace itself. How might Friedman have responded to this reality?
4. "If you work hard and play the rules, *anyone*, regardless of race, religion, educational or class background, can achieve the American Dream." Agree or disagree. Be sure to define what you mean by the American Dream.

Suggested Readings and Internet Resources

How democratic is the U.S. capitalist system? What are and what should be the roles of government and democratic citizens in the creation and distribution of economic resources? How "free" is our market system and how "equal" its citizens? Two excellent introductions to the answers of these questions are Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New Haven, Conn.: Yale University Press, 1984), and Charles Lindblom, *The Market System: What It Is, How It Works, and What to Make of It* (New Haven, Conn.: Yale University Press, 2002). In a highly accessible book written with his wife, Rose Friedman, Milton Friedman defends free market capitalism: *Free to Choose: A Personal Statement* (San Diego, Calif.: Harcourt, 1980). For a mainstream account of a new, healthy globalized economy, see Thomas Friedman, *The Lexus and the Olive Tree* (New York: Anchor Books, 2000). *New York Times* Pulitzer-Prize-winning journalist David Cay Johnston documents how the wealthy distort the rules in *Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super Rich—and Cheat Everybody Else* (New York: Penguin, 2003).

The Policy Action Network
www.movingideas.org
This is the best site for extensive data on and analyses of current economic policy issues from a liberal perspective. Click on the internal links to the Economic Policy Institute or the Center on Budget and Policy Priorities for an analysis of current issues, or use the topic search engine. This site is sponsored by *0*, a liberal opinion magazine.

The Heritage Foundation
www.heritage.org
This site contains economic news and policy prescriptions from the premier right-wing think tank, as well as good links to other conservative foundations and public policy lobbies.

The Left Business Observer
www.leftbusinessobserver.com
A spirited, iconoclastic newsletter by corporate critic Doug Henwood, this website has interesting statistics and many links to unconventional left- and right-wing websites.

The Cato Institute
www.cato.org
Here are speeches, research, and opinion from the leading libertarian think tank in the United States. This site provides economic data and opinion supportive of privatization of now-public functions, from Social Security to environmental protection and education.