

CHAPTER 13

'Why Market-Capitalism Favors Democracy'

Democracy and market-capitalism are like two persons bound in a tempestuous marriage that is riven by conflict and yet endures because neither partner wishes to separate from the other. To shift the simile to the botanical world, the two exist in a kind of antagonistic symbiosis.

Although the relation is extraordinarily complicated, from the profuse and constantly growing array of experiences with political and economic systems we can, I believe, draw five important conclusions. I offer two in this chapter, the other three in the next.

1. *Polyarchal democracy has endured only in countries with a predominantly market-capitalist economy; and it has never endured in a country with a predominantly nonmarket economy.*

Although I have limited this conclusion to polyarchal democracy, it also applies pretty well to the popular governments that developed in the city-states of Greece, Rome, and medieval Italy and to the evolution of representative institutions and the growth of citizen participation in northern Europe. But I'm going to bypass that history, some of which we encountered in Chapter 2, in order to focus exclusively on the institutions of modern representative democracy - that is, polyarchal democracy.

Here the record is amazingly unambiguous. Polyarchal democracy has existed *only* in countries with predominantly market-

capitalist economies and *never* (or at most briefly) in countries with predominantly nonmarket economies. Why is this so?

2. *This strict relation exists because certain basic features of market' capitalism make it favorable for democratic institutions. Conversely, some basic features of a predominantly nonmarket economy make it harmful to democratic prospects.*

In a market-capitalist economy, the economic entities are either individuals or enterprises (firms, farms, and whatnot) that are privately owned by individuals and groups, and not, for the most part, by the state. The main goal of these entities is economic gain in the form of wages, profits, interest, and rent. Those who manage the enterprises have no need to strive for broad, lofty, and ambiguous goals such as the general welfare or the public good. They can be guided solely by self-interested incentives. And because markets supply owners, managers, workers, and others with much of the crucial information they need, they can make their decisions without central direction. (This doesn't mean they can do without laws and regulations, which I'll come back to in the next chapter.)

Contrary to what our intuition might tell us, markets serve to coordinate and control the decisions of the economic entities. Historical experience shows pretty conclusively that a system in which countless economic decisions are made by innumerable independent but competing actors, each acting from rather narrow selfregarding interests and guided by the information supplied by markets, produces goods and services much more efficiently than any known alternative. What is more, it does so with a regularity and orderliness that is truly astonishing.

As a result, in the long run market-capitalism has typically led to economic growth; and economic growth is favorable to democracy. To begin with, by cutting acute poverty and improving living standards, economic growth helps to reduce social and political

conflicts. Furthermore, when economic conflicts do arise, growth provides more resources that are available for a mutually satisfactory settlement in which each side gains something. (In the absence of growth, economic conflicts, to use the language of game theory, become "zero-sum": what I gain you lose, what you gain I lose. So cooperation is useless.) Growth also provides individuals, groups, and governments with surplus resources to support education and thus to foster a literate and educated citizenry.

Market-capitalism is also favorable to democracy because of its social and political consequences. It creates a large middling stratum of property owners who typically seek education, autonomy, personal freedom, property rights, the rule of law, and participation in government. The middle classes, as Aristotle was the first to point out, are the natural allies of democratic ideas and institutions. Last, and perhaps most important, by decentralizing many economic decisions to relatively independent individuals and firms, a market capitalist economy avoids the need for a powerful, even authoritarian central government.

A nonmarket economy can exist where resources are scarce and economic decisions few and obvious. But in a more complex society, to avoid economic chaos and to provide at least a moderate standard of living, a substitute for the coordination and control provided by markets is necessary. The only feasible substitute is the government of the state. So whatever the formal legal ownership of enterprises might be in a nonmarket economy, their decisions are, in effect, made and controlled by the government. Without the coordination of the market, it necessarily becomes the government's task to allocate all scarce resources: capital, labor, machinery, land, buildings, consumer goods, dwellings, and the rest. To do so, the government needs a detailed and comprehensive central plan and thus government officials charged with making the plan, carrying it out, and seeing to its enforcement. These are prodigious tasks,

requiring staggering quantities of reliable information. To gain compliance with their directives, government officials must discover and apply appropriate incentives. These may run from rewards, both legal (such as salaries and bonuses) and illegal (for example, bribery), to coercion and punishment (such as execution for "economic crimes"). Except under rare and transitory conditions, which I'll come to in a moment, no government has proved up to the task.

It is not the inefficiencies of a centrally planned economy, however, that are most injurious to democratic prospects. It is the economy's social and political consequences. A centrally planned economy puts the resources of the entire economy at the disposal of government leaders. To foresee the likely consequences of that fantastic political windfall, we might recall the aphorism that "power corrupts and absolute power corrupts absolutely." A centrally planned economy issues an outright invitation to government leaders, written in bold letters: *You are free to use all these economic resources to consolidate and maintain your power!*

Political leaders would have to have superhuman powers of self-denial to resist this temptation. Alas, the melancholy record of history is clear: rulers with access to the enormous resources provided by a centrally planned economy have all confirmed the wisdom of the aphorism. To be sure, leaders may use their despotism for good ends or bad. History records some of both - though overall, I think, despots have achieved considerably more ill than good. In any case, centrally planned economies have always been closely associated with authoritarian regimes.

SOME QUALIFICATIONS

Although the two conclusions are valid, they need several qualifications. For one thing, economic growth is not unique to democratic

countries, nor is economic stagnation unique to nondemocratic nations. Indeed, there appears to be no correlation between economic growth and a country's type of government or regime.

Moreover, although democracy has existed only in countries with a market-capitalist economy, market-capitalism has existed in nondemocratic countries. In several of these - Taiwan and South Korea in particular - the factors I mentioned earlier that tend to accompany economic growth and a market economy in turn helped to bring about democratization. In these two countries authoritarian leaders, whose policies helped to stimulate the development of a successful market economy, export industries, economic growth, and a large, educated middle class, also unwittingly planted the seeds of their own destruction. Thus although market-capitalism and economic growth are favorable to democracy, in the long run they may be far less favorable, indeed downright unfavorable for nondemocratic regimes. Consequently, the denouement of a momentous historical drama to be played out during the twenty-first century will reveal whether China's nondemocratic regime can withstand the democratizing forces generated by market-capitalism.

A market-capitalist economy need not exist, however, only in its familiar twentieth-century urban-industrial or postindustrial form. It may also be - or at least has been - agricultural. As we saw in Chapter 2, during the nineteenth century the basic democratic institutions, with the exception of female suffrage, developed in several countries - the United States, Canada, New Zealand, and Australia - that were predominantly agricultural. In 1790, the first year of the American republic under its new (and still continuing) constitution, out of a total population of just under four million persons, only 5 percent lived in places with more than twenty-five hundred inhabitants; the remaining 95 percent lived in rural areas, mainly on farms. By 1820, when the political institutions of (white male) polyarchal democracy were already solidly established, in a

population of fewer than ten million people, more than nine out of ten still lived in rural areas. On the eve of the Civil War in 1860, when the country had more than thirty million inhabitants, eight of ten Americans lived in rural areas. The America that Alexis de Tocqueville described in *Democracy in America* was agrarian, not industrial. The economic enterprises of that agrarian society were, of course, principally farms, owned and managed by individual farmers and their families. Much of what they produced was used for their own consumption.

The important point, however, is that the economy was highly decentralized (more, indeed, than it was to become with industrialization); it gave political leaders little access to its resources; and it created a large middle class of free farmers. Thus it was highly favorable for democratic development. Indeed, in Thomas Jefferson's vision of the Republic, the necessary foundation for democracy was an agrarian society consisting of independent farmers.

Are these preindustrial origins of several of the oldest democracies irrelevant to countries in the postindustrial era? No. That body of experience reinforces a crucial point: whatever its dominant activity, a decentralized economy that helps to create a nation of independent citizens is highly favorable for the development and maintenance of democratic institutions.

A moment ago I mentioned "rare and transitory conditions" under which governments have efficiently managed central planning. What is more, the governments were democratic. These were the wartime governments of Britain and the United States during World War I and even more emphatically during World War II. But in these cases, the planning and allocation of resources had a clearly defined goal, which was to insure that military needs were met along with a basic supply of goods and services for civilians. The war aims were widely supported. Though some black markets developed, they were not so extensive as to diminish the effectiveness

of the centralized system for allocating resources and controlling prices. Finally, the system was dismantled after peace arrived. As a result, political leaders were deprived of the opportunities they would have enjoyed for exploiting their dominant economic role for political purposes.

If we put these wartime systems to one side, centrally directed economies have existed only in countries where the leaders were fundamentally antidemocratic. Thus we cannot easily untangle the undemocratic consequences of the economic order from the undemocratic consequences of leaders' beliefs. Lenin and Stalin were so hostile to democracy that with or without a centrally directed economy, they would have prevented democratic institutions from developing. The centrally directed economy simply made their task easier by providing them with greater resources for inflicting their will on others.

Strictly speaking, then, the historical experiment that combines democratic institutions with a centrally directed peacetime economy has never been tried. I for one hope that it never will. The likely consequences are, I believe, fully foreseeable. And they bode ill for democracy.

Yet even if market-capitalism is far more favorable to democratic institutions than any nonmarket economy that has so far existed, it also has some profoundly unfavorable consequences. We examine these in the next chapter.

CHAPTER 14

Why Market-Capitalism Harms Democracy

If we approach market capitalism from a democratic point of view we discover, when we look closely, that it has two faces. Like the emblem of the Greek god Janus, they face in opposite directions. One, a friendly face, points toward democracy. The other, a hostile face, points the other way.

3. *Democracy and market-capitalism are locked in a persistent conflict in which each modifies and limits the other.*

By 1840, a market economy with self-regulating markets in labor, land, and money had been fully installed in Britain. Market capitalism had triumphed over its enemies on all fronts: not only in economic theory and practice but in politics, law, ideas, philosophy, and ideology as well. Its opponents, so it appeared, were completely routed. Yet in a country where people have a voice, as they had in England even in those predemocratic times, such a complete victory could not endure. As it always does, market-capitalism brought gains for some; but as it always does, it also brought harm to others.

Though suffrage was highly restricted, the other political institutions of representative government were largely in place. And in due time - in 1867 and again in 1884 - suffrage was expanded; after 1884 most males could vote. Thus the political system provided opportunities for the effective expression of opposition to unregulated market-capitalism. Turning for help to political and governmental leaders, those who felt themselves injured by unregulated market

sought protection. Opponents of laissez-faire economics found effective expression of their grievances through political leaders, movements, parties, programs, ideas, philosophies, ideologies, books, journals, and, most important, votes and elections. The newly formed Labour Party focused on the plight of the working classes.

Although some opponents proposed only to regulate market-capitalism, others wished to abolish it outright. And some compromised: let's regulate it now, they said, and eliminate it later. Those who proposed to abolish capitalism never achieved their goals. Those who demanded government intervention and regulation often did.

As in Britain, so, too, in Western Europe and the other English-speaking countries. In any country where governments could be influenced by popular movements of discontent, laissez-faire could not be sustained. Market-capitalism without government intervention and regulation was impossible in a democratic country for at least two reasons.

First, the basic institutions of market-capitalism themselves require extensive government intervention and regulation. Competitive markets, ownership of economic entities, enforcing contracts, preventing monopolies, protecting property rights - these and many other aspects of market capitalism depend wholly on laws, policies, orders, and other actions carried out by governments. A market economy is not, and cannot be, completely self-regulating.

Second, without government intervention and regulation a market economy inevitably inflicts serious harm on some persons: and those who are harmed or expect to be harmed will demand government intervention. Economic actors motivated by self-interest have little incentive for taking the good of others into account; on the contrary, they have powerful incentives for ignoring the good of others if by doing so they themselves stand to gain. Conscience is

easily quieted by that seductive justification for inflicting harm on others: "If I don't do it, others will. If I don't allow my factory to discharge its wastes into the river and its smoke into the air, others will. If I don't sell my products even if they may be unsafe, others will. If I don't... others will." In a more or less competitive economy, it is virtually certain that, in fact, others will.

When harm results from decisions determined by unregulated competition and markets, questions are bound to arise. Can the harm be eliminated or reduced? If so, can this be achieved without excessive cost to the benefits? When the harm accrues to some persons and the benefits to others, as is usually the case, how are we to judge what is desirable? What is the best solution? Or if not the best, at least an acceptable solution? How should these decisions be made, and by whom? How and by what means are the decisions to be enforced?

It is obvious that these are not just economic questions. They are also moral and political questions. In a democratic country citizens searching for answers will inevitably gravitate toward politics and government. The most easily accessible candidate for intervening in a market economy in order to alter an otherwise harmful outcome, and the most effective, is... the government of the state.

Whether discontented citizens succeed in getting the government to intervene depends, of course, on many things, including the relative political strengths of the antagonists. However, the historical record is clear: in all democratic countries,* the harm produced by, or expected from, unregulated markets has induced governments to intervene in order to alter an outcome that would otherwise cause damage to some citizens.

In a country famous for its commitment to market-capitalism,

[*And in many nondemocratic countries as well. But our concern here is with the relation between democracy and market-capitalism.]

the United States, national, state, and local governments intervene in the economy in ways too numerous to list. Here are just a few examples:

- . unemployment insurance;
- . old age annuities;
- . fiscal policy to avoid inflation and economic recession;
- . safety: food, drugs, airlines, railroads, highways, streets;
- . public health, control of infectious diseases, compulsory vaccination of school children;
- . health insurance;
- . education;
- . the sale of stocks, bonds, and other securities;
- . zoning: business, residential, and so on;
- . setting building standards;
- . insuring market-competition, preventing monopolies, and other restraints on trade;
- . imposing and reducing tariffs and quotas on imports;
- . licensing physicians, dentists, lawyers, accountants; and other professional persons;
- . establishing and maintaining state and national parks, recreation areas, and wilderness areas;
- . regulating business firms to prevent or repair environmental damage; and belatedly,
- . regulating the sale of tobacco products in order to reduce the frequency of addiction, cancer, and other malign effects.

And so on. And on, and on.

To sum up: It no democratic country does a market-capitalist economy exist (nor in all likelihood can it exist for long) without extensive government regulation and intervention to alter its harmful effects.

Yet if the existence in a country of democratic political institutions significantly affects the operation of market-capitalism, the existence of market-capitalism in a country greatly affects the operation of democratic political institutions. The causal arrow, so to speak, goes both ways: from politics to economics and from economics to politics.

4. *Because market capitalism inevitably creates inequalities, it limits the democratic potential of polyarchal democracy by generating inequalities in the distribution of political resources.*

Words About Words

Political resources include everything to which a person or a group has access that they can use to influence, directly or indirectly, the conduct of other persons. Varying with time and place, an enormous number of aspects of human society can be converted into political resources: physical force, weapons, money, wealth, goods and services, productive resources, income, status, honor, respect, affection, charisma, prestige, information, knowledge, education, communication, communications media, organizations, position, legal standing, control over doctrine and beliefs, votes, and many others. At one theoretical limit, a political resource might be distributed equally, as with votes in democratic countries. At the other theoretical limit, it might be concentrated in the hands of one person or group. And the possible distributions between equality and total concentration are infinite.

Most of the resources I just listed are everywhere distributed in highly unequal fashion. Although market-capitalism is not the only cause, it is important in causing an unequal distribution of many key resources: wealth, income, status, prestige, information, organization, education, knowledge....

Because of inequalities in political resources, some citizens gain significantly more influence than others over the government's policies, decisions, and actions. These violations, alas, are not trivial. Consequently, citizens are not political equals - far from it-and thus the moral foundation of democracy, political equality among citizens, is seriously violated.

5. Market-capitalism greatly favors the development of democracy up to the level of polyarchal democracy. But because of its adverse consequences for political equality, it is unfavorable to the development of democracy beyond the level of polyarchy.

For the reasons advanced earlier, market-capitalism is a powerful solvent of authoritarian regimes. When it transforms a society from landlords and peasants to employers, employees, and workers; from uneducated rural masses barely capable of surviving, and often not even that, to a country of literate, moderately securer urbanized inhabitants; from the monopolization of almost all resources by a small elite, oligarchy, or ruling class to a much wider dispersion of resources; from a system in which the many can do little to prevent the domination of government by a few to a system in which the many can effectively combine their resources (not least their votes) and thereby influence the government to act in their favor - when it helps to bring about these changes, as it often has and will continue to do in many countries with developing economies, it serves as a vehicle for a revolutionary transformation of society and politics.

When authoritarian governments in less modernized countries undertake to develop a dynamic market economy, then, they are likely to sew the seeds of their own ultimate destruction.

But once society and politics are transformed by market-capitalism and democratic institutions are in place, the outlook fundamentally changes. Now the inequalities in resources that market-capitalism churns out produce serious political inequalities among citizens.

Whether and how the marriage of polyarchical democracy to market-capitalism can be made more favorable to the further democratization of polyarchy is a profoundly difficult question for which there are no easy answers, and certainly no brief ones. The relation between a country's democratic political system and its nondemocratic economic system has presented a formidable and persistent challenge to democratic goals and practices throughout the twentieth century. That challenge will surely continue in the twenty-first century.