

Why isn't capitalism working?

Lawrence Summers

Americans have traditionally been the most enthusiastic champions of capitalism. Yet a recent American public opinion survey found that just 50 per cent of people had a positive opinion of capitalism while 40 per cent did not. The disillusionment was particularly marked among young people 18-29, African Americans and Hispanics, those with incomes under 30,000 dollar and self-described Democrats.

Three elections in a row in the US have been bloodbaths by recent standards for incumbents, with the left side doing well in 2006 and 2008 and the right winning comprehensively in 2010. With the rise of the Tea Party on the right, and the Occupy movement on the left, this suggests far more is up for grabs than usual in this election year.

So how justified is disillusionment with market capitalism? This depends on the answer to two critical questions. Do today's problems inhere in today's form of market capitalism or are they subject to more direct solution? Are there imaginable better alternatives?

The spread of stagnation and abnormal unemployment from Japan to the rest of the industrialised world does raise doubts about capitalism's efficacy as a promoter of employment and rising living standards for a broad middle class. This problem is genuine. Few would confidently bet that the US or Europe will see a return to full employment as previously defined within the next 5 years. The economies of both are likely to be constrained by demand for a long time.

But does this reflect an inherent flaw in capitalism or, as Keynes suggested, a 'magneto' problem (like the failure of a car alternator) that can be addressed with proper fiscal and monetary policies,

and which will not benefit from large scale structural measures? I believe the evidence overwhelmingly supports the latter. Efforts to reform capitalism are more likely to divert from the steps needed to promote demand than to contribute to putting people back to work. I suspect that if and when macroeconomic policies are appropriately adjusted, much of the contemporary concern will fade away.

That said, sharp increases in unemployment beyond the business cycle — one in six American men between 25 and 54 are likely to be out of work even after the US economy recovers — along with dramatic rises in the share of income going to the top 1 and even the top .01 per cent of the population and declining social mobility do raise serious questions about the fairness of capitalism. The problem is real and profound and seems very unlikely to correct itself untended. Unlike cyclical concerns there is no obvious solution at hand. Indeed the observation that even Chinese manufacturing employment appears well below the level of 15 years ago suggests that the problem's roots lie deep with the evolution of technology.

The agricultural economy gave way to the industrial economy because progress enabled demands for food to be met by only a small fraction of the population, freeing large numbers of people to work outside agriculture. The same process is underway today with respect to manufacturing and a substantial range of services reducing employment prospects for most citizens. At the same time, just as in the early days of the industrial era, the combination of substantial dislocations and greater ability to produce at scale is enabling a lucky few to acquire great fortunes.

The nature of the transformation is highlighted by the 50-fold change in the relative price of a

television set of a constant quality and a day in a hospital over the last generation. While it is often observed that wages for median workers have stagnated, this obscures an important aspect of what is occurring. Measured via items such as appliances or clothing or telephone service where productivity growth has been rapid, wages have actually risen rapidly over the last generation. The problem is that they have stagnated or fallen measured relative to the price of housing, health care, food and energy or education. As fewer and fewer people are needed to meet the population's demand for goods like appliances and clothing, it is natural that more and more people work in producing goods like health care and education where outcomes are manifestly unsatisfactory. Indeed as the economist Michael Spence has documented, a process of this kind is underway; essentially all employment growth in the U.S. over the last generation has come in non-traded goods.

The difficulty is that in many of these areas the traditional case for market capitalism is weaker. It is surely not an accident that in almost every society the production of health care and education is much more involved with the public sector than the production of manufactured goods. There is an imperative to move workers from activities like producing steel to activities like taking care of the aged. At the same time there is the imperative of shrinking or least slowing the growth of the public sector.

This brings us to the charge that the governments of industrial market capitalist societies are bankrupt. Even as market outcomes seem increasingly unsatisfactory, budget pressures have constrained the ability of the public sector to respond. How and when — and not whether — basic programmes of social protection will be cut back, is now back on the table. The basic solvency of too many capitalist states seems in question.

Again the problems are very real. While I believe more than most that the US government will be

able to borrow on very attractive terms for a long time, if as I fear private borrowing remains depressed, there is no denying that the current path of planned spending and planned revenue collection are inconsistent. And Europe is teaching us that markets can take significant fiscal problems and make them catastrophic by becoming too alarmed too rapidly.

At one level the answer here is simply to insist on more political will and courage. But at a deeper level, citizens of the industrial world who believe that they live in progressive societies are right to wonder why increasingly affluent societies need to roll back levels of social protection. Paradoxically, the answer lies in the very success of capitalism which has made the opportunity-cost of an individual teaching or nursing or administering that much more expensive.

When outcomes are unsatisfactory, as they surely are at present, there is always a debate between those who believe that the current course needs to be pursued with increased vigour and those who argue for a radical change in direction. That debate is somewhat beside the point in the case of market capitalism. Where it has been applied it has been an enormous success. The challenge for the next generation is that while that success will increasingly be taken for granted and indeed will become an increasing source of frustration in these pinched times, its success cannot be matched outside the market's natural domain. It is not so much the most capitalist parts of the contemporary economy but the least — those concerned with health, education and social protection — that are in most need of reinvention.

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