The Hidden Effects of Free-Market Capitalism

TURBO CAPITALISM

WINNERS AND LOSERS IN THE GLOBAL ECONOMY

EDWARD LUTTWAK

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Edward Luttwak

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To my wife Dalya

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PREFACE

Perhaps it is because I am the son of an innovative capitalist manufacturer, and an entrepreneur on my own account, that I deeply believe both in the virtues of capitalism and in the need to impose some measure of control over its workings.

With the possible exception of nuclear weapons, capitalism is the most powerful of human inventions. As true an expression of the restless soul of European civilization as the urge to discover, create and conquer, capitalism has now spread to almost every part of the world. Traditional economies guided by unchanging practices, communist economies directed by bureaucrats, closed economies commanded by rulers or magnates have all been swept away, surviving only in isolated backwaters. Nothing can equal the unique ability of capitalism to convert simple human greed into infinitely varied productive energies. No purposeful central administration can pursue both efficiency and innovation as successfully as the relentless competition for profit and wealth unleashed by capitalism. No disciplined scheme can coordinate tasks and apportion supplies as harmoniously as the utterly spontaneous workings of capitalist markets, which need no scheme or discipline at all.

By displacing set work-routines or planned outputs with the ever-changing competitive production of goods and services; by replacing giving and taking among the entitled with buying and selling among people who might as well be perfect strangers and often are, capitalism transforms both ends of every traditional, bureaucratic, or patrimonial economy it conquers. With that, inevitably, much else is also transformed, from the ways of politics and government to private habits and personal tastes, from the patterns of family life to the very landscape of town and country.

Even Russia's very new and much-resisted capitalism has been strong enough to refashion the grimly monumental Moscow of Soviet days with shiny office towers, countless new shops, and restaurants and cafés and bars that illuminate the night of once-dark and somber streets. Less visibly, storeroom clerks have become the owners of shops and even international traders. Bureaucrats, party officials, secret policemen, scientists and all sorts of other state employees have become bankers, merchants, managers or even billionaire tycoons, often after an interval as traffickers, smugglers or even gangsters. This has changed mentalities, tastes and political preferences radically, sometimes more than once in very few years.

Even their poor and tentative rural capitalism has been strong enough to transform the Mayan villages of the emerald-green highlands of Guatemala. They now have shops and therefore shopkeepers, whose outlook must differ from their fellow Mayans who still live by cultivating the land. The tiny family plots, once apportioned by ancestral custom, are increasingly bought and sold for hard cash, allowing some villagers to enlarge their holdings while others are left landless. Once, the better or luckier tiller of the soil had the honor of giving or lending food to the hungry; now he sells his surplus for money – giving him a far greater incentive to work harder to grow more, though fewer grateful friends. Before, all were united in periodic misery or minimal abundance according to the vagaries of harvests, and all their mud and wattle dwellings looked the same; now concrete-block walls and corrugated-iron roofs proclaim that some have much more than others.

An economic force as strong as capitalism can only be controlled, if at all, by the counter-force of political power. But I do not believe that the Russian or Mayan or any other emerging capitalism should be controlled. If anything, they should be encouraged in every way. The relatively poor Russians, the miserably poor Mayans, and all in between that capitalism might uplift to a decent existence, have no other possible remedy. That is not true, however, of the mostly impersonal corporate and financial capitalism of the more affluent countries, where all other aims – social, political and even cultural – need not be sacrificed for a bit more efficiency, slightly more wealth – especially wealth so unevenly distributed.

True, there is nothing sinister or wicked about the aims of today's more advanced forms of capitalism. Profit and expansion are the proper ambitions of any capitalism. Much is wrong, however, about some of the methods which have now become routine. Abrupt mass firings are preferred to gentler retirements that may cost only slightly more or even less – because they drive up share prices, if only for a day of quick gains by the managers themselves. Plants that may sustain entire communities are closed without warning for the same reason, perhaps with no real effort to improve their efficiency instead. Rapid gain displaces larger, long-term benefits because managers are impatient to move on to the next and greater corporate slot, while there is less and less long-term ownership.

In the process, individual lives, families, communities, even entire regions are disrupted, sometimes wrecked. Hard statistics show that dismissed employees lose more than their jobs, often having their lives shortened by stress and humiliation, sometimes losing their marriages as well as mortgaged homes. Even booming economies are littered with ghost towns, or ghostly neighbourhoods that have lost their main or only source of jobs and income. Unstable jobs, even if truly well-paid, are not qualitatively the same as stable, career jobs; they only sustain immediate consumption, not the building-up of lives.

Few corporations would risk damaging the natural environment nowadays, for fear of harsh penalties. But many damage the human environment, suffering no penalties at all. It is perfectly true, however, that corporations are only responsible to their shareholders – fashionable talk of 'stakeholders' having no real substance after all. Corporations are not moral entities. They exist to earn profits, and so it should be. It is or should be the task of governments alone to control capitalism on behalf of the citizens they are supposed to equally represent. It is or should be the highest priority of governments to find ways of keeping the disruptions of capitalism within tolerable bounds, without sapping capitalism's marvellous creative energies.

In my student days at the London School of Economics during the early 1960s, and for almost two decades thereafter, the opposite problem existed: an excess of control over private-enterprise capitalism. Its competitive drive for constant improvement and growth, its unmatched ability to generate wealth potentially for all, were obstructed almost everywhere in the supposedly capitalist world. Private-enterprise capitalism was completely excluded from some of the most important industries in many countries. And capitalism itself was prohibited in the vast expanse under communist rule from East Berlin to the China coast.

In France, Italy and Spain especially, but also in Great Britain and elsewhere in Western Europe as well as in Australia, New Zealand, South Africa and much of non-communist Asia, there was much pervasive obstruction as well as outright exclusion. A great many industries described as basic, or strategic, or more poetically as 'the commanding heights', were dominated or totally monopolized by state-owned firms managed by bureaucrats or, worse, political appointees. Iron and steel, coalmining, aviation and most military production were prime candidates, but in almost all of those countries, electricity supply, telephone and telegraph services, railways, airlines, intercity bus fleets, and local mass transport were also under public ownership, national, regional or municipal. In some, private capitalism was displaced in yet more industries as varied as shipbuilding, chemicals and commercial banking, or even ice-cream production.

In the United States, there was little public ownership, but much public regulation – and very detailed too, with prices or tariffs set to the last cent by Federal, State or local commissions, boards and agencies for each service or product. Capitalist competition was totally excluded from regulated monopolies starting with Ma Bell, the country's only major telephone company. And it was severely restricted in a long list of other industries, from airlines along with all other inter-state transport, to Savings & Loan Associations, to natural gas output and pipeline delivery, and final distribution to factories and homes – with specified prices set from above for each gasfield, each transit, each locality, each class of user. If one adds the Pentagon's supervision of then vast military industries, and the Department of Agriculture's intrusive control of the largest of all industries, it can be seen that Americans were much more eager to celebrate private-enterprise capitalism than to allow its unfettered practice.

All this detailed regulatory control was meant to stabilize industries and employment, which was also a key purpose of outright public ownership as practiced in Europe and beyond. In Japan and eventually Korea and other East Asian countries, yet another way of controlling capitalism was found, not to stabilize industries at all but rather to force-feed and guide their fastest possible growth. This 'developmental' capitalism was privately owned but subsidized, assisted and *very* closely directed by powerful economic ministries.

Each non-communist country that did allow free enterprise in some spheres thus established its own version of controlled capitalism. And there was a spontaneous tendency for public ownership, market regulation and purposeful bureaucratic direction to increase over time. Larger firms, sometimes complete industries in trouble, were taken under the wing of government to protect employment, thus increasing public ownership. It became normal to subsidize money-losing state enterprises for years on end. Regulators and bureaucrats naturally tend to over-regulate and micro-manage if allowed to get away with it, which they often were. The only contrary tendency was the slow liberalization of international trade and foreign-exchange controls.

Capitalism was thus becoming distinctly over-controlled by the late 1970s. All too many corporations left in private but managerial hands naturally adapted to the political environment by themselves becoming more and more bureaucratic and politicized, a process in itself harmful to creative innovation, and even to plain hard work. Yet in most countries controlled capitalism was only on the verge of decline at the time, or perhaps only beginning to approach the culminating point of useful control beyond which decline would start.

But controlled capitalism had not been a failure overall. On the contrary, it had been a truly colossal success. From the end of the Second World War until the mid-1970s the American and European economies were uplifted by many years of rapid growth, bringing affluence from the relatively few to almost all. Japan famously grew even faster, though limiting its standard of living somewhat to invest in yet more growth. Nevertheless there too, as in entire regions of Europe, ancestral poverty gave way to a steadily increasing prosperity.

In the late 1970s the tendency to control capitalism was abruptly reversed. Ideology and fashion were important in dismantling the American system of regulations. Well-funded lobbying by interested parties eager to profit from deregulation was also important, perhaps more so. The consequences for separate industries were debated, not always in any depth. In each case, efficiency gains could be shown, and that was that. There was no serious national debate about the social desirability of deregulation as such, no attempt at an assessment of the combined impact on American society of all the separate deregulations.

In Europe ideology and fashion were also at work to diminish public ownership; in Europe, too, there was the very plausible expectation of more economic efficiency under private ownership. But in many cases it was the turning-away from decades of debt-growth and inflationary policies that forced the issue. Governments that accumulated public debt and printed money with abandon could always borrow or print a little more to cover the losses of money-losing state enterprises. Once deflationary policies became the norm, however, real money was needed – any subsidy paid out increasingly meant that some other government spending would have to be cut, including the kind of spending that wins votes.

Each country started dismantling controlled capitalism in its own way, at its own rate, for its own reasons, industry by industry. As each internationally competitive industry was unleashed in the United States or elsewhere, its gain in efficiency undercut prices or increased quality, or both, forcing the pace of decontrol for that same industry in other countries. Thus no country could stop the process by keeping its own controlled capitalism intact within its boundaries without paying an ever-increasing economic price. France did it, and paid. Japan did it, and it is paying very heavily at this time, in spite of the formidable efficiency of a few export industries that were never controlled, or only a little.

There was certainly no common forum where a broad international debate of the combined social and political and even cultural repercussions of dismantling controlled capitalism could be conducted. Even less could there be a joint international assessment of the consequences for each country and all. Economic efficiency would increase, to be sure. But what of societal inefficiencies? Yet there appear to be many, from regional impoverishment in a few cases, to almost universal community decline, family instability, and the resulting increase in the prevalence of crime. Hence the hard questions were never even asked, as successive privatizations and deregulations and globalizations were decided, releasing the unchecked powers of today's turbo-capitalism.

This book raises a few of those questions.

June 1998

Edward Luttwak
Chevy Chase, Maryland

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In this incisive critical analysis of today's free-market capitalism, Edward Luttwak shows how it is vastly different from the controlled capitalism that flourished so successfully from 1945 to the 1980s. Turbo-capitalism is private enterprise liberated from government regulation, unchecked by effective trade unions, unfettered by concerns for employees or investment restrictions, and unhindered by taxation. It promises a dynamic, expanding economy and new wealth.

The winners—the architects and acrobats of techno-organizational change—become much richer; the losers, the majority, become relatively or absolutely poorer and are forced by downsizing to take the traditional jobs of the underclass, more and more of whom end up in prison. Edward Luttwak challenges the conventional wisdom that jobs lost in old industries will be replaced by jobs in new ones. If General Motors fires you, Microsoft will not hire you; instead you'll be working in 'services,' often poorly paid.

Led by the United States, closely followed by Britain, turbo-capitalism is spreading fast throughout Europe, Asia, and the rest of the world (only in France and Japan is there any resistance) without the two great forces that check its enormous power in the United States: a powerful legal system and the stringent rules of American calvinism. Acknowledging the great efficiency of turbo-capitalism, Luttwak provides no solutions but describes in powerful detail the major societal upheavals and inequities it causes and the broad dissatisfaction and anxiety that may result. He suggests this is a high price to pay for this great dilemma of our times.

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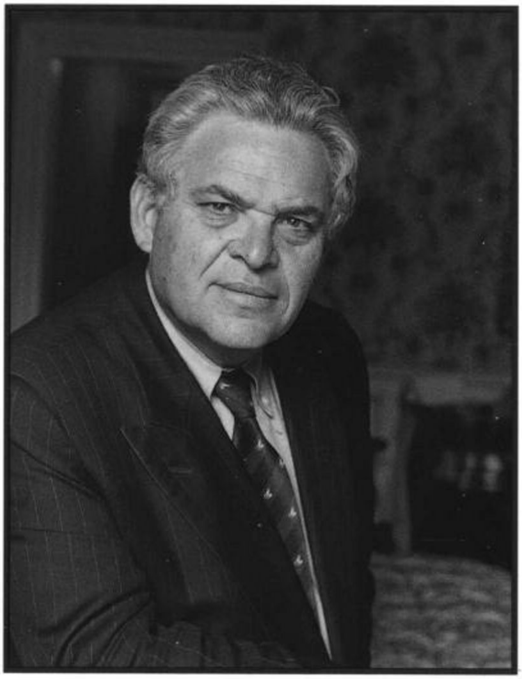

EDWARD LUTTWAK, born in 1942 in Transylvania and educated in Italy, England, and the United States, is a well-known strategist, consultant, and writer. Originally focused on military issues, he has broadened the application of strategy to economic issues, introducing the new concept of 'geo-economics,' and now to social issues as well. His books, which have been translated into fourteen languages, include *Coup d'Etat* (1968), *The Grand Strategy of the Roman Empire* (1978), *The Pentagon and the Art of War* (1985), *Strategy: The Logic of War and Peace* (1987), and *The Endangered American Dream* (1993). He is Senior Fellow at the Center for Strategic and International Studies in Washington, D.C.

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Winners and Losers

On penalty of suffering high unemployment and indeed long-term decline, the entire world is urgently being summoned to imitate the new ways of work and wealth of the American economy. New they certainly are. It was not until the end of the 1970s that today's roaring turbo-capitalism was unleashed by the abolition of anti-competition laws and regulations left over from the 1930s, by the technological innovations thus allowed, by the privatization of whatever could be privatized, and by the removal of most import barriers.

For individual Americans, the results have been spectacular, one way or another. Tens of thousands of acrobatic entrepreneurs and mere corporate managers, hundreds of thousands of bold or just lucky investors, have become multi-millionaires, billionaires or even multi-billionaires. Because many prefer to believe that great enrichment is justified by great personal achievement, the computer pioneers from Microsoft's Bill Gates down to ordinary software centi-millionaires are forever being cited as typical of the new ultra-rich. But many prospered hugely in newly deregulated industries from natural gas to commercial banking, simply by taking what was offered to them once restrictions were lifted. Others still did very well yet more easily in plain old trades, just by floating on a rising stock-market tide.

High achievement is rewarded, but so is mediocrity, given an indulgent board of directors. Lawrence Coss, chief executive officer of Green Tree Financial, concurrently appeared on two different 1997

Business Week rankings of US corporate chiefs: one for the highest earners of 1996 – he was number one at $102,449,000, or $280,682 per day including weekends and vacations – and one for the least effective in raising shareholder value.[1]

Some sixty million less enterprising Americans who were once paid rather well for routine work in unionized factories and corporate offices must now in effect compete every day with the labor-saving technologies which could replace them, and even with cheaper foreign labor. To keep their now perpetually insecure jobs, they and their unions have had to accept stagnant or even declining earnings and fringe benefits. By January 1997, with unemployment falling below 5 per cent in high boom times and emerging labor shortages here and there, the Chairman of the Federal Reserve, Alan Greenspan, worried aloud that this implicit bargain (job security for low inflation) would come to an end, bringing higher wages – not a worthy aim, but instead a dreadful prospect for America's official slayer of the dragon inflation. His fears were misplaced. Having increased by a mere 2.7 per cent – less than inflation – and thus fallen in real terms during the recovery year 1995, total pay and benefits increased by only 2.9 per cent even in the boom year 1996, and then by 3 per cent at the peak of the boom in 1997, only then finally gaining a fraction over inflation.[2]

Others among the sixty million less fortunate Americans have failed to keep or find industrial or office jobs, thus being driven into poorly paid selling, serving, guarding, handling, laboring and cleaning jobs. In so doing, the downwardly mobile have claimed for themselves all the traditional occupations of the underclass, whose non-workers in turn account for most of the 1.8 million people behind bars at the last count.[3] Another 3.7 million were on probation or parole awaiting trial, so that the criminalized total of 5.5 million accounts for 2.8 per cent of the adult population of the United States, twice the proportion of 1980 when turbo-capitalism was just getting started.

The causal link between turbo-capitalism and crime passes through the accelerated technical and structural changes that have eliminated

[1] As measured by stock price at year-end 1996, plus reinvested dividends over 1994–96 minus the year-end 1993 stock price. Jennifer Reingold, 'Executive pay' (annual survey), *Business Week*, 21 April 1997.

[2] Bureau of Labor Statistics, Employment Cost Index, quarterly releases, 1995, 1996, 1997. Re Greenspan: Robert D. Hershey, Jr, 'Pay report is noninflationary, relieving markets (for a while)', *New York Times*, 29 January 1997, page D1.

[3] Mid-year 1997. US Department of Justice, Bureau of Justice Statistics, *Correction Statistics*.