



The Future of Capitalism

How Today's Economic Forces Shape Tomorrow's World

by Lester C. Thurow

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384 pages

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Take-Aways

- Capitalism has no rival on the world economic stage. No other economic system competes with it.
- Despite its success, evidence shows that something has gone wrong with capitalism.
- Since the 1960s, the rate of world economic growth has steadily slowed from 5% annually to 2%.
- Five underlying forces influence the direction of the world economy.
- One sign of trouble: The growing imbalance in equal distribution of income.
- In the 1980s, in the U.S., 64% of all earning increases were paid to the top 1% of the workforce.
- The '70s and '80s marked the first time in U.S. history that workers' real wages declined throughout two consecutive decades.
- The war on inflation is outdated, yet governments continue to restrain job growth to keep wages down.
- The fight against inflation is a war that should have ended, but didn't.
- Capitalism won't implode. But unless something is done about its inequalities and imbalances, it is likely to stagnate.

Rating (10 is best)

Overall	Applicability	Innovation	Style
9	7	10	8

Relevance

What You Will Learn

In this Abstract, you will learn: 1) What is going wrong with capitalism; 2) How it is affecting you and your wages; and 3) How capitalism's fate fits a global perspective.

Recommendation

This is a particularly important book for two types of people to read: those who believe economic instability and inequality will lead capitalism to implode (they're wrong); and those who believe the economic engine of capitalism is running just fine, especially in the United States, and simply needs to be left alone by meddling do-gooders, thank you (they are wrong too). Neither view is realistic. Lester C. Thurow is quite well suited to explain why. He is practically a brand name on national television, known for making more sense of the economy than anyone could possibly expect from a dean at MIT. Although Thurow wrote this book in 1996, the trade deficit, the skewed distribution of revenue and the disparity between rich and poor continue to demonstrate the validity of his conclusion that fewer and fewer can get more and more for only so long. *getAbstract.com* highly recommends his insightful analysis, wishing only that Thurow proposed deeper solutions for the problems he so ably diagnosed.

Abstract

The New Economic Game

With the advent of the industrial revolution, success came to be defined as an increase in a society's material standard of living. Given that definition, capitalism is, in fact, the only successful economic system in the world. Its competitors lie strewn upon the boneyard of defunct notions such as fascism, socialism and communism.

Despite its success, something is clanking inside the thrumming engine of capitalism and it doesn't sound good. That grinding noise is the sound of the world economy decelerating from an inflation-adjusted annual growth rate of 5% in the 1960s, to 3.6% growth per year in the 1970s, to 2.8% in the 1980s, to just 2% in the first half of the 1990s.

Another interesting note: while the U.S. economy generated 38 million net new jobs from 1973 to 1994, western Europe failed to create a single net new job during the same time period. Yet even in the U.S., something is awry. In the 1980s, 64% of all earnings gains went to the top 1% of the workforce, raising serious questions about the long-term stability of the social and economic structure.

Historically, dominant social systems without competitors — ancient Egypt, imperial Rome, Europe's feudal Dark Ages, China's Middle Kingdom — all lost their ability to adapt. They could not keep pace with changes in technology and in the marketplace of ideas.

Tectonic Economics

To understand what's taking place economically, borrow a concept from geology: tectonic plates, those slow-moving foundations of the earth that carry great power even when hidden from obvious view. The five economic tectonic plates are:

1. The end of communism — One third of humanity and one quarter of the landmass of the world has now joined the capitalistic universe.

"No one knows how to run successful economics on any other principles. The market, and the market alone, rules."

"As we watch, the world's economic topography alters."

“The unipolar economic world dominated by the United States is over, a multipolar world has arrived.”

“Human culture and human values are for the first time being shaped by a profit-maximizing electronic media.”

“TV and the movies have replaced the family in generating values.”

2. Brain power rules — Today’s economy is dominated by man-made brain power industries, such as software, and these companies can thrive in any location because they are not tied to specific natural resources, such as coal or petroleum.
3. New demographics — The world population is growing larger, getting older and moving from poor countries to rich countries.
4. The global economy — Today, anything can be made anywhere and sold anywhere else. The world’s economy is growing increasingly interconnected.
5. No super power — No world super power will be able to make and enforce the rules of the economic game in the twenty-first century, a significant difference from the past.

Mapping the World’s Economic Surface

To continue the geological analogy, what would the world look like if the distribution of income and wealth were the equivalent of the earth’s crust? Stability was king in the 1950s and 1960s, but suddenly in 1968 the earth’s crust began to shift, and unequal distribution of wealth began to rise. That surge in inequality intensified; by the early 1990s, inequalities were rising in every category, including occupation, education and gender. Fewer people were getting more of the pie. By the 1980s, a staggering 64% of all earnings by males went to the top 1%. When measuring income, rather than earnings, the numbers were even more drastic. The top 1% absorbed 90% of income gains. For example, CEO salaries doubled and then tripled. The result has been the “winner take all” society. Nor were female earnings exempt from the trend — they simply followed after a 10- to 15-year time lag.

Falling real wages present another ugly reality. The trend toward a drop in inflation-corrected real wages began in 1973. In the ‘80s and ‘90s, only the top 20% of the workforce experienced real wage gains. From 1973 to 1992, men’s wages dropped 23% in the bottom quintile of the workforce, and 21% in the next lowest quintile. The percentage of workers with health insurance decreased from 69% to 61%. Never before in American history had real wages fallen for two straight decades.

Shopping for Insight

For a picture of the U.S. economy, follow the condition of its leading retail stores. Most stores positioned in the middle of the economic market, such as Sears, Macy’s and Gimbels suffered economic difficulties. Upscale stores, such as Bloomingdale’s and Nordstrom’s, and downscale stores, such as Wal-Mart, have done well. Plenty of customers inhabit the lowest and highest ends of the scale, but the large group in the middle is being squeezed out. No country — other than nations in the midst of revolution, civil war or military defeat — has experienced such a skewed distribution of wealth as the U.S. in the past 20 years.

The War on Inflation

The fight to restrain inflation is one of the hallmarks of the past 25 years. Inflation marked the ‘70s and ‘80s, beginning with the expenses of the Vietnam War and shooting up sharply with the oil shock of the OPEC embargo. The response to inflation was to combine higher interest rates with tighter fiscal policies, either raising taxes or decreasing government spending. This would push up the unemployment rate, force wages down and, thereby, keep corporate costs relatively stable. To counteract inflation, world growth was slowed from 5% in the first half of the ‘60s to about 2%. Current Federal Reserve Board policy seeks to limit U.S. economic growth to 2.5%. Anything above that level is considered inflationary.

“The average American teenager watches 21 hours of TV per week while spending five minutes per week alone with his or her father and 20 minutes alone with his or her mother.”

“In a very real sense the global economy has become physically embodied in our ports, airports and telecommunications systems. But most important, it is embodied in our mind-sets.”

“Those who lose out economically or who cannot stand the economic uncertainty of not knowing what it takes to succeed in the new era ahead retreat into religious fundamentalism.”

This war against inflation should have ended long ago. The original reasons for it have long since passed: the oil embargo, rapidly rising food costs, the hangover from the Vietnam War and inflationary expectations. Yet the war against inflation continues.

The Extinct Inflation Volcano

Belief in inflation has changed more slowly than the reality. Inflation fighting is still the dominant focus of central banks worldwide. They step on the fiscal policy brakes before inflation can drive wages up, and they believe that the best inflation extinguisher is higher unemployment, which drives down wages. Because central banks love to be inflation busters, they are likely to see inflationary ghosts where none exist. The banks have maintained that if they can hold down inflation long enough, they will gain credibility with the markets and rapid, non-inflationary growth will resume. Unfortunately, that has not been the actual result.

Inflation fighters used unemployment and low wages with the intention of offsetting costs, and that succeeded. Western Europe has double-digit unemployment. Japan admits that while its official unemployment rate is 3% to 4%, its actual rate of unemployment is about 10%.

If we add to the U.S. unemployment rate those who have given up seeking work, who don't meet the official definition of unemployment or who are unwilling part-timers and want full-time work (some 4.5 million), the U.S.'s actual unemployment rate is nearing 14%.

Because of these changes, anyone examining the economic surface of the earth based on its condition in, say 1970, would find the earth's surface unrecognizable today. The expectation is that this shift will grow even more dramatic in the years ahead.

Capitalism's Story

To succeed, a society must unite its members around a powerful story or a sustaining ideology. Without a story, leaders have no agenda and citizens have no belief. All religions have such a story; certainly communism did. One reason for the rise in religious fundamentalism is that a powerful story sustains its ideology.

So what story does capitalism tell its citizens? Capitalism has just one story: individual interest prevails over other interests. But can personal greed be the goal that holds a society together over time? In reality, a division is growing between democracy's belief in equality and the market's increasing generation of unequal economic power. What is needed is a vision, or a story, that will motivate society's members to transcend narrow self-interest and reconstruct an economy that produces greater equality. The big question, of course, is what will that story be?

Finding Fault

A geological fault line runs across the surface of the economic globe. On one side is the Japanese trade surplus, \$130 billion in 1994. On the other side is the American account deficit, \$145 billion in 1994. Other nations contend that U.S. consumers should trim their trade deficit, while overlooking that without this deficit, they would not enjoy a trade surplus.

No country, not even a country as large as the U.S., can run a trade deficit indefinitely. Even if the deficit does not grow from one year to the next, it has to be financed. Interest on it must be paid. Eventually, trade deficits result in an account that is so large it cannot be financed. And, eventually, world financial markets will cry “foul” just as they did when Mexico flirted with insolvency. This isn't a question of when the big economic shock will occur. The earthquake certainly is coming; the only question is what the

“Capitalism is going to be asked to do what it does least well — invest in the distant future and make deliberate adjustments in its institutional structure to encourage individuals, firms, and governments to make long-term decisions.”

“No country not experiencing a revolution or a military defeat with a subsequent occupation has probably ever had as rapid or as widespread an increase in inequality as has occurred in the United States in the past two decades.”

aftereffects will be. And it may not come as one big earthquake, but as a series of smaller shocks that also cause great damage.

The Future?

Capitalism lacks any social imperatives. It does not care whether people save or don't save; it simply hands out the result if they refuse to behave prudently. Falling real wages and increased inequality now affect a majority — no longer a minority — of America's workforce. Perhaps the new social contract will be lifetime employability, rather than lifetime employment. The difference is that this social contract would guarantee that companies will invest in their worker's job skills, so that people remain employable when technological shifts occur. In any case, the pressures are building up inside the volcano, and it is time for the social system to prepare for the disturbances to come.

To counter the rise in religious fundamentalism, governments must recognize that they are in trouble throughout the world simply because they have been unable to address their citizens' real needs and wants. Democracies react well to crises, because they focus consensus on the problem. The fact is that, currently, there is no financial crisis. Currently, the real income of nonsupervisory workers is declining at less than 1% per year. While that is a significant rate over 25 years, it hardly qualifies as a crisis. No heated political debate is underway, for example, about the redistribution of wealth and income.

On the other hand, while the current situation can hardly be described as a crisis, all is not well either. The situation calls for massive changes in the economic and social infrastructure, and that is not the type of work democracies do well. We are experiencing an Age of Contentment for those at the very top, and an Age of Diminishing Expectations for those at the middle and lower end. This unstable situation cannot continue forever. A society built on concepts of equality and equal opportunity, cannot keep generating ever-larger inequalities and net income reductions for the majority of its voting members. Something has to give.

The instability of modern capitalism will not make it implode, as communism did. Stagnation, not collapse, is the danger, given that capitalism faces no serious rival on the world's stage of ideas. From its birth, capitalism's obvious weakness was its tendency to give rise to growing disparities between the haves and have-nots. The question is what to do about this long-standing weaknesses. The first step is to be willing to navigate honestly the uncertainties ahead.

About The Author

Lester C. Thurow, a professor of economics at MIT, is recognized as an insightful commentator on the American economy. He has been a contributing editor to *Newsweek*, former dean of MIT's Sloan School of Management and a member of the editorial board of *The New York Times*. He is the author of several other books, including *The Zero-Sum Society*, *The Zero-Sum Solution*, *Dangerous Currents: The State of Economics* and *The Impact of Taxes on the American Economy*.

Buzz-Words

Age of Contentment / Lifetime employability / Stagnation