

Inaugural Conference of the Center on Capitalism & Society
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INTRODUCTORY REMARKS

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First, a word about the Center's genesis. The Center was conceived by Roman Frydman and myself in the late 1990s. It would not have been possible to proceed, however, without early expressions of support by Richard Nelson, Andrzej Rapaczynski, Glenn Hubbard and Bruce Greenwald. We started generating mission statements in the year 2000, if I recall correctly. With the arrival at Columbia of Joseph Stiglitz and Amar Bhide in 2001 we reached a critical mass: We got the authorization of the University to start up and began to have occasional meetings. Later we proudly added Janusz Ordover and Robert Shiller to our roster. We also added Jeffrey Sachs, an addition that was twice-blessed. When he arrived to direct the Earth Institute in the summer of 2002 he offered to take the Center under the Institute's wing.

I want to say something here about the Center's subject matter, most of it also the subject of this Inaugural Conference, and about the Center's perspective on it. First, the meaning of the word *capitalism*.

Capitalism is *not* the system of markets that is sometimes called the "market economy." From Ricardo, Mill, Barone and Lange to Arrow-Debreu, there is a tradition of studying markets without ownership, without capitalism – as if the economy described were one of *market socialism*. (Schumpeter, Mises and Hayek put ownership in and had important insights to offer.) Much of existing macroeconomic theory can also be interpreted as about a market-socialist economy with private wealthowing, in which households hold public and private debt, possibly state-enterprise shares.

Capitalism is *not* accurately viewed as *the* economic system based on private ownership. Other private-ownership systems exist. As the 19th century witnessed the birth of socialist theory and several socialist experiments (lapping into the early decades of the next century), the 20th century saw far-reaching experiments with the system generally called *corporatism*. The corporatist economies that developed in the Interwar period were a "third way" in which private

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ownership exists but community, employee and other factions have to be consulted and may veto the interests of the private owners.

Capitalism is *not* a “free market” system in the sense of laissez-faire – hence a minimal public sector. Where a potentially wild system like capitalism operates, a fairly extensive public sector is justified to monitor abuses – investor fraud, consumer and employee deception, and so forth – and, in some areas, to certify and regulate in order to build trust. Relatedly, there can be capitalism in a country with or without economic justice through wage subsidies. And there can be capitalism with a welfare state or without one.

Capitalism *is* an economic system in which private capital is relatively free to innovate and invest without permissions from the state and green lights from communities and regions, from workers, and other so-called social partners. (“State capitalism” is a system in which capital is lent or invested by state banks, possibly in partnership with private investors.) Family capitalism, entrepreneur-based capitalism and managerial capitalism are the main species.

That said, why a research center on capitalism? First, there is a need to develop an adequate “theory” of capitalist systems – of their *functioning*. The premise of the Center, I would say, is that a predominantly capitalist economy has economic institutions that make its operating system distinctive – markedly different from the operating system of a relatively corporatist economy, with its economic institutions, and also radically different from the operating system of a relatively market-socialist economy, with its economic institutions. The hypothesis is that these institutional distinctions make a difference: the institutions peculiar to capitalism have consequences for *dynamism* – for the generation and selection of innovations; and so do the institutions of corporatism and those of socialism. A challenge to the Center is that, to date, we do not understand well the workings of the capitalist systems out there (to the extent they are capitalist – no actual economy is 100% pure); so we don’t yet know which institutions are the keys to dynamism.

Worse yet, most economists believe Schumpeter ‘did’ capitalism theory in his great 1912 book and there are no serious problems with it requiring the profession’s attention.¹ In the theory, a business person may stumble on an idea for a profitable innovation, much as one might stumble on a five dollar bill. Such cognitive discoveries or intellectual advances cannot be modeled. Yet, if we step around the miracle of innovation – the mysteriousness of its origins – the rest is

¹ J. A. Schumpeter, *Theorie der wirtschaftlichen Entwicklung* (1912), Leipzig, Duncker & Humbolt. Eng. trans., *Theory of Economic Development*, Cambridge, Harvard, 1932.

straightforward: the selection of the new ideas to finance and the try-out in the market. Schumpeter himself agreed.² So it is believed.

But is it satisfactory to depict innovative ideas of business people as exogenous random disturbances?³ To depict financiers as omniscient and of like mind?⁴ Stock markets as having “rational” expectations? Established corporations as barren of new ideas?⁵ These abstractions throw out the baby with the bath water.

Second, there is the need as a practical matter to identify the role of economic institutions in the *economic performance* of nations: *Without* some understanding of the nature and significance of jobs in the business sector under current economic institutions we may miss key sources of the satisfaction and personal growth among the working-age population – or of the profound dissatisfaction and non-development, which I think we see manifestations of on the European Continent in the form of low participation and frequent strikes. *Without* some understanding of what entrepreneurial forces and mechanisms lie behind the investment activities that lie behind employment levels we may miss the true nature of what is driving a big swing in the economy, such as we have seen recently in the U. S. economy. *Without* some understanding of the calculus (the pros and cons) of innovation versus imitation we may miss the main sources of the lag of productivity in Europe behind that in the U. S. So there is a gaping hole in our economic knowledge of the world. We cannot be remotely confident we have understood the estimated differences in economic performance among nations – particularly the advanced “market economies” – until we have penetrated to the influence of their economic institutions, their operating systems.

This need is now urgent. It is suspected that economic performance in western continental Europe is worse – worse on all the basic measures (excepting one or two countries) – than in the U.S. because of a dearth of dynamism that, in turn, stems from impediments and deficiencies in the economic institutions. So the role of economic institutions is becoming Topic A on the Continent. A parallel debate has arisen in the U.S. over what to do about corporate governance to shore up or improve economic performance here. We hope that, with time and increasing understanding, these are issues to which the Center will be able to contribute in the next few years.

² “All banks have [the knowledge] and act upon it,” p. 90, in Schumpeter, *Business Cycles* (1939), Abridged edn., Rendigs Fels, ed., New York, McGraw-Hill, 1964, p. 90.

³ Friedrich Hayek implied they derived from local observation and specialized knowledge. Schumpeter himself spoke of entrepreneurs’ imitative behavior and “herdlike movements.”

⁴ Michael Polanyi’s concept of “personal knowledge” expressed the financier’s difficulty.

⁵ Schumpeter thought not in *Capitalism, Socialism and Democracy* (1941), Harvard.