

**The Center on Capitalism and Society  
Columbia University  
Working Paper No. 93\***

**Dangers in a Repeat of Historic Corporatism**

**Edmund Phelps**

**January 2017**

**Abstract**

In the view of many commentators, we are seeing in America a political shift from left-leaning “elites” to right-leaning “populists” – from the metropolitan to the rural, the cosmopolitan to the nationalist. A wave of rebellion has swept over much of the West. In America, Economic ideology has shifted from the corporatism of “solidarity” born in the 19<sup>th</sup> century to the corporatism of central control tried in the 20<sup>th</sup>.

\*This paper was presented on the panel “Nobels on Where Is the World Economy Head?” at the 2017 Annual Meeting of the American Economic Association in Chicago on January 6-7, 2017. A previous draft appeared in *Project Syndicate* under the title, “Trump, Corporatism, and the Dearth of Innovation,” on January 17, 2017. The following revised version was published in *Journal of Policy Modeling* on May 19, 2017.

# Dangers in a Repeat of Historic Corporatism

by Edmund Phelps\*

## 1. The Two Causes

What brought the economic shift? It is mounting dissatisfactions. For decades, Americans held the faith that they were riding a magic carpet of growth – lifted by science at first and later on by Silicon Valley. In fact, the growth rate of total factor productivity fell in *half* by 1972 and slow growth has continued ever since – with only a fleeting respite during the internet boom of 1996-2004.<sup>1</sup> With business investment running into diminishing returns as a result, its rate of return declined, causing businesses to cut back their investing. With labor productivity (marginal as well as average) slowed, hourly labor compensation slowed absolutely and relatively to household wealth, causing households to cut back their labor force participation.<sup>2</sup> This is Alvin Hansen’s “secular stagnation”<sup>3</sup>

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\* The 2006 Recipient of the Nobel Prize in Economics and the Director of The Center on Capitalism and Society, Columbia University.

<sup>1</sup> These inferences are drawn from examination of estimates of annual tfp growth over a long historical span published by Banque de France in late 2015.

<sup>2</sup> Even if labor compensation had stopped, wealth would have continued to accumulate until it reached the target level.

<sup>3</sup> He sometimes added slow population growth. See Alvin Hansen, “Capital Goods and the Restoration of Purchasing Power,” *Proceedings of the Academy of Political Science*, Vol. 16, No. 1, Money and Credit in the Recovery Program, April 1934, pp. 11-19. He built on predecessors whom most English-speaking economists had not read – Knut Wicksell, Arthur Spiethoff, Joseph Schumpeter and Gustav Cassel – and their predecessor, Michel Tugan-Baranowsky. See Hansen, *Business Cycles and National Income*, (New York: W. W. Norton, 1951), Chapters 13 and 16.

As this unending stagnation has proceeded, sizeable parts of the public have felt mounting exasperation with government leaders who had other concerns on their minds – the Bushes, the Clintons and Obama – though the stagnation has meant little to established wealth, as the prices of their shares have risen since 1972 owing to the huge fall of the natural rate of interest – a characteristic of the stagnation phenomenon. Some in the public have gone so far as to conclude there is no longer a role for capitalism to play, now that the economy is coming to the end of its long march to a stationary state of capital saturation – a state that may or may not be accompanied by occasional fluctuation. I will conclude the opposite.

Who have been hit by all this and who have not? As I read the data, this stagnation is not a Marxian thing between Labor and Capital: Since 1970, aggregate labor compensation – wages received plus fringe payments – has grown only a little slower than aggregate profits have.<sup>4</sup>

Yet more is going on than a symmetrical, textbook stagnation. It is striking that average hourly compensation of *working class* employees (production and non-supervisory workers) in the private sector grew *far more* slowly than that of *all* workers.<sup>5</sup> (That is surely why *median* hourly compensation among all workers grew far more slowly.) Wages at the *bottom* – John Rawls’s “least advantaged” – have *not* slowed relative to the “middle class.”<sup>6</sup> (They were losing ground, then they got it back.<sup>7</sup>) Second, labor force participation of *men*, ages 15-64, has shrunk badly relative to their numbers: from 87.5% in 1965-69 to 78.5% in 2014-2015 – unlike the participation rate of women.<sup>8</sup> Relatedly, payroll employment in *manufacturing* as a percentage of total nonagricultural

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<sup>4</sup> Labor compensation in percent of national income declined from 63.9% in 1968 to 63.0% in 2005 and has recovered so far to 62.7% in second quarter of 2016. U.S. Commerce Department, Bureau of Economic Analysis.

<sup>5</sup> The average compensation of production and nonsupervisory workers – about 80 percent of private payroll employment – grew from 1973 to 2014 by only 9.2%. See EPI, *infra*. See also “The Productivity-Pay Gap,” EPI, Updated August 2016.

<sup>6</sup> Communication with Lawrence Katz ca. 2008 at a Columbia meeting on the middle class.

<sup>7</sup> The wage differential between the 10<sup>th</sup> and 50<sup>th</sup> percentiles widened from 1973-75 to 1985-87 but *recovered* by 2015.

<sup>8</sup> Following the women’s liberation movement, the participation rate of women soared from 42.6% in 1960-64 to 68.4% in 1990-94 and since declined slightly. Participation, employment and unemployment rate data are extracted from the online library of the OECD.

payroll employment has fallen from 13.9% in 1998 to 8.6% at the end of 2015.<sup>9</sup> It is clear that the *white working class men* have been hit harder over these recent decades.

Why, though, the anger? One answer (often given) is that the job losses in manufacturing has created a giant Rust Belt in America – mostly in Appalachia.<sup>10</sup> In this region, most men have a *standard* of living little better or even worse than their parents once had. Now you might say, so what? Well, prevailing standards matter a great deal. First, this community of workers may have come to feel as the years wore on that society has showed them a lack of *respect*. (Adam Smith wrote of the shame a person may feel when appearing in public if he or she cannot meet the prevailing standard of appearance.<sup>11</sup>) Second, the Rust Belt community of workers may have lost their feeling of *importance* to their family, their community or country. (John Rawls spoke of the shame a father may feel who cannot afford to perform his duties as a father<sup>12</sup> – to take his son to a ballgame, say.) Lastly, these workers may also feel an *injustice* if high-income earners are not redistributing any gains to the working class or they see benefits paid to people who do not work.

There are other reasons for anger *not found* in *standard* economics. Most people desire meaningful work. People generally want work providing them a sense of *agency*:<sup>13</sup> They need that space if they are to have a chance of *prospering* – of having the satisfaction of succeeding at something. Given the opportunity, people would also appreciate the experience of *flourishing* – “becoming” or constantly “forming” in the course of a career – and would appreciate chances for self-expression through imagining and creating useful things. The “good jobs” in parts of manufacturing offered many men

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<sup>9</sup> Payroll employment in *manufacturing* has gone from about 17.6 million employees in 1998 to 12.3 million at the end of 2015. Table B-14: Employees on nonagricultural payrolls, by major industry, 1972-2015. Economic Report of the President, February 2016.

<sup>10</sup> Two general books of much interest on Appalachia are J.D. Vance, *Hillbilly Elegy: A Memoir of a Family and Culture in Crisis* (New York, Harper, 2016) and Andrew Chlerin, *Labor's Love Lost* (New York, Russell Sage, 2014).

<sup>11</sup> See Adam Smith's *The Wealth of Nations*, 5<sup>th</sup> Edition, (London: Methuen & Co. Ltd.), 1904, Book V, Chapter II, “Of the Sources of the General or Public Revenue of the Society,” Article IV: “Consumable commodities are either necessities or luxuries.”

<sup>12</sup> See John Rawls's *A Theory of Justice*, Cambridge, MA: Harvard University Press, 1971.

<sup>13</sup> The term is used in this modern sense as early as Richard Sennett, *The Culture of the New Capitalism* (New Haven, Yale University Press, 2006).

in Appalachia some prospect of learning, some challenges and some attendant promotions; the bottom-rung jobs in retailing services these men are forced to take do not. In losing their “good jobs,” then, these men were losing the *meaning* of their very *lives* – or a central part of their lives. The rise of suicide and drug-related deaths among Americans that Anne Case and Angus Deaton turned up last spring might be evidence of just that sense of loss.<sup>14</sup>

## 2. Imagined Cures

What is to be done? – bearing in mind both the stagnation and the job losses in manufacturing. It is natural (though not always essential) to consider the cause or causes before going very far with economic policies.

I note that some economists pin the blame for the loss of manufacturing jobs on *trade* – the explosion of Chinese exports. Which is it, innovation or trade? It is revealing that the “innovation nations” – America, Britain, France – show *much larger* declines in male participation than do the “trading nations” – Holland and (less markedly) Germany. In fact, participation rates there have gone *up*! That suggests that innovation is the main cause of the declines in participation. (Italy, which is between these poles, shows a modest fall and Spain a terrible fall. Maybe Italy is somewhat innovative. I cannot explain the fall in Spain.)<sup>15</sup>

At the place my book *Mass Flourishing* finally gets to the stagnation in the West, it sees the cause in America as a *decline, or narrowing, of innovation* in the late 1960s – as Alvin Hansen would have expected.<sup>16</sup> Maybe entrepreneurs’ zeal was unbridled, but the innovative spirit – a love of imagining, exploring, experimenting and creating – had weakened by then. Moreover, a *corporatist* ideology came to permeate the government at all or most layers, replacing the modern ethos that fueled capitalism. Private ownership

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<sup>14</sup> See Anne Case and Angus Deaton, “Rising morbidity and mortality in midlife among white non-Hispanic Americans in the 21<sup>st</sup> century,” *PNAS*, Vo. 112, No.29, December 8, 2015.

<sup>15</sup> See data gathered by the OECD.

<sup>16</sup> “Secular stagnation is caused by the lack of new inventions or new industries,” said Hansen. See “Capital Goods and the Restoration of Purchasing Power,” *Proceedings of the Academy of Political Science*, Vol. 16, No. 1, Money and Credit in the Recovery Program, 1934, pp. 11-19.

remains extensive, but government exerts control over much of the private sector. And this control, in hindering or blocking competition from outsiders in existing industries, exacts a heavy toll on innovation.<sup>17</sup> Silicon Valley saved the situation through the creation of new industries offering new products. But now it has run into diminishing returns.

From this perspective, a new focus on the business sector is desirable in principle. I would urge the Trump administration to give major attention to opening up competition – as well as cutting back regulation – in the hope of restoring innovation. But that has not been the focus so far.

Thus far, the focus of the Trump team is just the opposite and, I feel, quite dangerous. First, there is the assumption that the job and income losses among the working class are caused by *trade*, not by losses of *innovation* – a hypothesis put forward by some highly able economists. Which is it, innovation or trade? I ran a little test: I found that the countries that were (at one time, at any rate) the “innovation nations” – I chose America, Britain and France – show *much larger* declines in male participation than do the countries I think of as “trading nations,” relatively speaking – Holland and Germany. In fact, in those trading nations, participation rates went *up!*<sup>18</sup> That suggests that the main cause of the slowdown of wages and the declines in participation were the losses in aggregate innovation and a surge of innovation bringing greater automation to manufacturing.

Second, there is the assumption of the Trump team that supply-side measures to boost after-tax corporate profits will bring generally heightened incomes and employment. Such a policy, of course, runs the risk it will lead to an explosion of public debt and thus ultimately cause a serious loss of confidence, a fall of investment and slow-down of growth and a deep recession. That is another dangerous territory.

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<sup>17</sup> A private actor with a new idea would need government approval to start up in many industries. Firms that could enter an existing industry could expect to face incumbents having government support.

<sup>18</sup> From 1986 to 2006 (thus before the financial crisis) UK’s LFPR for men shrank from 87.6% to 83.4%, France’s from 78.9% to 74.9%. Holland’s *rose* from 80.0% to 84.6% and Germany’s *rose* from 80.9% in 1986 to 81.4% in 2006. OECD.

Finally, and the most hazardous, there is the assumption that by bullying corporations, such as Ford and Carrier, and stepping in to aid other corporations, such as Google, the Trump administration can achieve various objectives that will widely boost output and employment. But this is an expansion of corporatist policy of a kind not previously seen since the German and Italian economies of the 1930s. If history is any guide, by expanding protection and inference in the business sector, the Trump administration may block the innovation of outsiders and newcomers more than it stimulates the innovation among insiders. I can't refrain from mentioning that, despite their active use of totalitarian powers over companies in the economy, Mussolini and Hitler did not achieve over the second half of the '30s – when their countries' recovery from depression was complete – anything approaching the powerful innovation achieved in the relatively free American economy.

Economists in America must wake up to the dangers presented by a return to the corporatism of Europe's Interwar Years. Such a broad manipulation of the American economy threatens to drive a silver spike into the heart of the innovation process.

### **3. Comments**

1. This has been a fascinating discussion and I'm sure your heads are spinning as much as mine over the complexity of the problems we face and the wealth of ideas. I guess I have always had a preference for simple formulations, as I think they are often compelling. I can grasp the idea of inequality between one subset of people and another, such as workers at the bottom and those in the middle, but not the concept of inequality as a whole. The Gini coefficient, for example, does not resonate with me.

For me, the Gini co-efficient is largely irrelevant. I think that what we want is two things. It is hard to keep two balls up in the air at the same time, but I think we have to do that. One, we want an economy that can be deemed to be just, a "just economy." I happen to be a Rawlsian – I was lucky to be influenced by Rawls in 1969-70. So I'm a big fan of low wage employment subsidies. But as the decades wore on, I finally moved on to something else.

I've taken on board a second thought and that is that we also want what I call a "good economy." We want a just economy – sure – but we also want a good economy. That's an economy that makes it possible for people to have at least a chance of a good life in Aristotle's sense. Never mind the details of what he said. People want to have an economy in which they have a chance in succeeding at something, as I said in my talk, and have the thrill of coming up with a new thought or having a new idea. The experience of work is so very, very important. I use the experience of people in Appalachia as a way of dramatizing that more general point.

2. The Gini co-efficient is often misleading. Some inequalities are repellent, thus innocuous. When the Gini coefficient goes up, maybe that is just because of an increase in inequality at the top, between the top tenth and the second tenth, and it may have no bearing on anybody's life experience. It's totally irrelevant. So, I wouldn't find it useful to base a social policy on the Gini-coefficient. I think, with all due respect, it would be almost ridiculous.