

## CHAPTER ONE

# The Capitalist Illusion

“The Economy, Stupid,” read the famous sign that James Carville posted in Bill Clinton’s Little Rock campaign headquarters in the 1992 presidential race. It was a reminder to the campaign team that they needed to focus on the weakness of the economic recovery under their opponent, President George H. W. Bush. Both before that election and certainly since, many presidential campaigns have been decided by voters’ perceptions of the strength or weakness of the economy. Donald Trump’s surprising victory in 2016 had much to do with a large segment of the electorate believing that the economy under Obama had failed to generate the kind of growth that they expected. Even some voters who were willing to credit President Obama with rescuing the economy from free fall at the time of his inauguration were worried that Hillary Clinton was unlikely to do well in generating good jobs and increasing real wages. A lot of voters believed that Donald Trump’s business success would make him a more effective economic manager than his opponent.

While views about the health of the economy really matter for politics, so also do beliefs about what kind of economy we have, how it works, and what policies might strengthen or weaken it. Today, virtually everybody—left, right, and center—believes both that our economy is capitalist and that the economy is autonomous, coherent, and regulated by its own internal logics. Many go to the next step and embrace the idea that if we pursue policies that conflict with the imperatives of capitalism, they will inevitably backfire and produce slower growth and fewer jobs.

Here is the problem. For years now, voters have cast their ballots for the candidate they think will manage the economy more effectively, but they are almost always disappointed by the results. Disappointment occurs because presidents and their advisers believe that because we have a capitalist economy, our policy options are extremely constrained. Whatever ambitions a newly elected president has when he first arrives at 1600 Pennsylvania Avenue, he pretty soon discovers that there is no set of legitimate policy tools that can deliver what the public wants because of the constraints of capitalism.

And so our politics have been caught in a loop that alternates between center-left Democrats and increasingly extreme Republicans, none of whom have been able to make good on their economic promises. Meanwhile, much of the electorate remains convinced that the nation is headed in the wrong direction. It now seems inevitable that a disappointed public will turn against whoever is in the White House; the only question is how soon that disillusionment will set in.

There is, however, a way out of this cycle of raised hopes followed by disappointment, and it involves challenging the received wisdom that capitalism operates according to its own inner laws. My title, *Capitalism: The Future of an Illusion*, is borrowed

from Sigmund Freud's 1927 *The Future of an Illusion*. The illusion that Freud was challenging was religion; he argued in that book that religions tell made-up stories that address some of the primal psychological conflicts of human existence. At the time, Freud's title offended many, but today, it is far more radical and disturbing to suggest that capitalism is an illusion. After all, profit-oriented firms own and control most of the world's productive capacity. Why would anybody suggest that a label that is so obviously appropriate is, instead, an illusion?

Here, Freud is a useful guide. In describing religion as an illusion, Freud did not imagine that it was inconsequential or unimportant. He knew that people's religious beliefs shaped their actions; he wrote his book shortly after World War I, when millions had died at the front imagining that they were fighting with God on their side. Moreover, Freud was keenly aware that religious teachings were linked to puritanical attitudes toward human sexuality that he viewed as psychologically destructive. In a word, Freud was insisting that religion was both extremely important and an illusion.

My argument is parallel to this. The widespread belief that we live in a capitalist society is enormously consequential. But many of the stories that people tell us about the nature of capitalism are myths comparable to the biblical story of the Garden of Eden. The project of this book is to debunk the view of capitalism that has become hegemonic. Dispelling this illusion will open up possibilities for political and economic reform that exist now only on the margins of contemporary political debate.<sup>1</sup>

Deep political crises in both the U.S. and Europe indicate the urgency of opening up space for major reforms. Trump's unprecedented election is a symptom of how badly the U.S. political

system is broken. It is the first time since 1940 that a political outsider was able to win the nomination of one of the major parties, but Trump is a far more troubling outsider than Wendell Willkie. Trump won his party's nomination because a majority of Republican voters were in open revolt against the party establishment. His populist rhetoric against immigrants and free trade deals and his promise to "make America great again" resonated with voters. During the same primary season, Bernie Sanders's populist challenge to Hillary Clinton was also far more successful than most observers had expected. Even though Clinton ultimately prevailed, the resonance of Sanders's attacks on the millionaire and billionaire class also indicated deep currents of discontent among voters.

John Judis has recently linked the populist insurgencies led by Trump and Sanders to similar patterns in European politics.<sup>2</sup> Because of the differences in the electoral systems, the European challengers tend to come from outsider parties, but Judis shows that populist parties of the right and of the left have been gaining support in many countries of Europe, while support for the traditional mainstream governing parties has been eroding. The right-wing populist parties include the United Kingdom Independence Party, the French National Front, the Danish People's Party, and the Alternative Party in Germany, while the left-wing populist parties include Syriza in Greece and Podemos in Spain.

Judis and other observers argue that the recent successes of these populist insurgencies are due to the economic difficulties that the U.S. and Europe have experienced since the global financial crisis of 2008. Mainstream parties have insisted for years that a global economy based on free trade and free capital mobility would lift all boats and assure ever-rising standards of living. Yet the public sees instead rising levels of unemployment

and underemployment, stagnant incomes, and greater economic uncertainty. Their votes for these various populist insurgencies are a signal to the leaders of the establishment that something is very wrong and that something must be done.

But the messages of these protest voters are not getting through. In Greece in 2015, an angry electorate put Syriza, a newly formed leftist populist party, in charge of the government. But in negotiating a new financial aid package for Greece, the leaders of the European Community told the new government that it had to ignore the voters. The European leadership insisted that Greece continue the same cruel austerity measures that had led the electorate to revolt in the first place.

To be sure, Greece is an extreme case. But for years now, highly respected economists have been saying that in both Europe and the U.S., governments should take advantage of historically low long-term interest rates to make major investments in new infrastructure spending as a way to revive these weak economies. Big government investments in infrastructure would put some people to work, might stimulate greater private investment, and could assist the fight to ameliorate the ravages of climate change. And yet this increased infrastructure spending has not happened. Centrist, center-right, and hard-right political leaders have worked together to block increased infrastructure spending.

How do we explain this? When voters everywhere are turning to populist protest candidates, the job of mainstream politicians is to do something to reduce voter discontent. That is certainly what happened in the United States in the 1930s. When faced with a threat from socialist and communist movements on the left and populists such as Huey Long and Father Coughlin on the right, Franklin Roosevelt and congressional Democrats carried out the ambitious legislative reforms of the New Deal.<sup>3</sup>

And in the period right after World War II, centrist politicians in Europe threatened by strong left-wing movements carried out sweeping reforms that included a significant expansion of the state's role both in managing the economy and in providing various forms of social insurance.<sup>4</sup> However, this most recent period of populist agitation has produced no comparable experimentation with bold reforms.

One would think that there would at least be extensive debate and discussion of major reform measures that might restore economic prosperity. But that has not happened. Aside from some discussion about more spending on infrastructure, there have been very few bold ideas to revitalize the European Community or accelerate growth in the U.S. economy. And despite his election rhetoric, once in office, Trump has simply followed the familiar Republican agenda of steep tax cuts for corporations and the rich. At the very least, one might expect that the parties that are out of power would be debating these kinds of reform ideas in the hope that voters would turn to them in the next election, rather than to the protest parties, but such new thinking is largely absent on both sides of the Atlantic.

One standard explanation for this policy inertia is that mainstream politicians in all of these countries have become so tightly intertwined with entrenched business interests that they are unwilling to entertain any ideas that might threaten those powerful economic elites. But business interests are not highly unified; many business leaders are also unhappy with the poor performance of the global economy in recent years. Many large firms, for example, would benefit enormously from greatly increased public-sector infrastructure investments. In fact, even in the U.S., there are signs of business interests lobbying for such expenditures.<sup>5</sup> In earlier reform epochs when political leaders

were pressured by populist revolts, they found ways to shape a reform agenda that business leaders could live with.

But it is not so easy to dismiss the role of far-right business interests in the U.S., such as the extremely wealthy Koch brothers.<sup>6</sup> They have organized right-wing billionaires and millionaires who espouse an extreme anti-state ideology. Through campaign funding and think tanks, this group has gained extraordinary influence over the Republican congressional delegations, and they have been able to block even relatively modest reform ideas that violate their “small state” beliefs. However, this does not explain the caution of the Democratic Party establishment, and Europe by and large does not have groups analogous to the Koch brothers’ network.

A more persuasive argument focuses on the specific influence of one sector of the business community—the financial sector, which has grown enormously over the last thirty years.<sup>7</sup> Bankers have long been the upholders of economic orthodoxy; they almost always oppose deficit spending by governments and any significant changes to the status quo. Moreover, we have seen recent examples of center-left governments that were strongly supportive of financial interests. Bill Clinton’s administration (1993–2000) and Tony Blair’s New Labour government in England were notorious for their solicitous approach to financial firms on Wall Street and in the City of London.

In tracing out the linkages between financial interests and establishment politicians, the most useful idea is that of “cognitive capture.”<sup>8</sup> It is not just personal connections and campaign contributions that make political leaders beholden to financial interests. The core problem is that most politicians, including “populists” such as Trump, have adopted the same beliefs about how the economy works as the financial community. It is as

though they all went to school together and read the same books, so they share the same belief system. This means that bold reforms of the existing system are automatically ruled out as irrational and counterproductive.

But what are the actual ideas that have cognitively captured the minds of these political leaders? This is precisely what I am calling the capitalist illusion. Both elites and the wider public have come to believe that given the nature of capitalism, all that can be done to stimulate growth is to balance government budgets, cut regulations, and rely on central banks to expand the money supply. Any more radical reforms are rejected in advance because they are allegedly incompatible with the nature of capitalism.

This cognitive capture occurs because of the formidable power of finance, direct linkages between politicians and wealthy donors in the financial sector, and a decades-long campaign to convince everyone that capitalism is an internally coherent and unchangeable system. In short, political elites have been extraordinarily passive in the face of growing populist discontent precisely because they are in thrall to these capitalist illusions, which rule out consideration of reforms that could potentially revitalize weakening economies.

Reversing this cognitive capture could not be more urgent. As long as political and business elites imagine that they are powerless because capitalism cannot be changed, we face a replay of the 1930s, with dangerous authoritarians seizing power and unleashing the threat of another world war.<sup>9</sup> But this danger can be averted if large segments of the public and some of these elites are able to recognize our collective ability to carry out bold reforms that could, once again, produce an economy that meets the needs of the citizenry. This is the argument of the present book.



Since cognitive capture looms so large, the focus of this book is on the definition of capitalism that prevails on the center and the right of the political spectrum. But the story is complicated because the term “capitalism” was basically invented and popularized by the socialist left. However, key aspects of that leftist definition have been appropriated by mainstream thinkers. So, for example, the idea that capitalism cannot be effectively reformed was central to the writings of Karl Marx, Friedrich Engels, and many later Marxists. They insisted that the only way to overcome the evils of the existing order was to replace it with something radically different—socialism. Now, however, it is writers on the center and the right who argue that we have to accept the negative aspects of the current system precisely because the only real alternative is socialism, which, they insist, would mean accepting a much diminished standard of living.

As I seek to debunk the capitalist illusion, it would be too confusing to weave in the story of the complex ways in which thinkers on the left and on the right have influenced each other’s formulations. Instead, my plan is to concentrate on criticizing the understanding of capitalism that prevails among thinkers in the center and on the right. In the afterword, I address some of the illusions about the nature of capitalism that are held by some on the political left.

#### THE NATURE OF THE CAPITALIST ILLUSION

When I describe the capitalist illusion and its principal components, they will not all be immediately recognizable. These are not the kinds of claims that one puts on bumper stickers or that candidates shout out on the campaign stump. They are, rather, like the hidden part of the iceberg that lies submerged and

invisible under the water's surface. They are the unstated assumptions and beliefs that are necessary to support the familiar rhetoric about economic policy that dominates our political debates. It is precisely because they are not readily visible that it takes a whole book to identify and challenge these illusions.

The core illusion is the idea that capitalism is a system that has its own logic and rules that must be obeyed or we risk losing the material well-being that has been achieved to date. It is also believed that this system has been largely stable for at least two hundred years. Most definitions of capitalism are explicit in defining it as a system in which owners of private property compete on markets to make profits, with the consequence that firms have strong incentives to become ever more efficient. But this now hegemonic understanding of capitalism includes four implicit corollaries that are responsible for the illusion of unity, coherence, and permanence.

It is important to emphasize here that many recent books and articles define the nature of capitalism in ways that are very different from the capitalist illusion that I am describing here.<sup>10</sup> Sometimes these definitions of capitalism are quite lengthy, as these thinkers seek to differentiate their view from the simplicity of the illusionary view that capitalism is unified and coherent. But these efforts run up against the problem that the meaning of familiar words will sometimes change through usage. This is something that parents of teenagers sometimes recognize with horror. For example, the word "dating" that they associate with two people chastely enjoying dinner and a movie now often refers to a sexual relationship. Whether the word is "capitalism" or "dating," it is a futile endeavor to try to restore the older definition.

The first corollary in this now dominant definition of capitalism is that the economy is and should be autonomous, so that it

can follow its own logic. It is recognized that government must do certain things, including enforcing laws of property and contract and providing for national defense, but government must avoid acting in ways that interfere with the autonomy of the economy. The second corollary is that there is a fundamental tension between democracy and capitalism because the voters might foolishly elect leaders who interfere with the autonomy of the market by raising taxes too much or imposing burdensome regulations. The third corollary is that capitalism requires individuals to be responsive to the signals of the marketplace, so society must emphasize the value of individuals pursuing their economic self-interest, including, particularly, the accumulation of wealth. The final corollary is a theory of causality that argues that capitalism works because it has the proper micro-foundations. This means that individuals are motivated to pursue their self-interest within a set of property relations that assures the appropriate rewards to those who make productive investments.

Together, the definition and these four corollaries constitute a kind of social theory about capitalist societies. But it is different from most other social theories because it is unapologetically a form of economic determinism.<sup>11</sup> The social theory of capitalism that I am describing has a logic similar to that of Carville's 1992 sign: it is the economy that drives and shapes society, and we must do whatever it takes to make sure that the basic mechanisms of capitalism are not impeded.

This embrace of economic determinism is somewhat surprising because for many decades the political valence of such doctrines was very different. Thinkers of the left, especially Marxists, were denounced for having a view of the world that rested on economic determinism. Conservatives claimed that attributing all that causal power to the economy neglected the importance in

social life of politics, religion, and ideas. More than a century ago, when Charles Beard advanced his economic theory of the U.S. Constitution, it was considered a scandal because he replaced all of the passion and vision of the Founders with a story that centered on groups defending their economic interests.<sup>12</sup> Even half a century ago, when I was in college, liberal professors expressed discomfort with the New Left–inspired economic determinism that ran through the essays and papers I wrote for my classes.

But all of this has changed; many on the center and the right and some on the left now proudly adhere to the capitalist social theory that I have described. And the fact that it builds in economic determinism has not interfered with its popularity. On the contrary, the last three decades, during which time this social theory became dominant, have also seen the diminishing influence of competing social theories that reject economic determinism. Sociology, particularly, has lost much of its influence on public debates. In the 1950s, work by social thinkers such as David Riesman and C. Wright Mills reached a broad audience. In the 1970, the sociologist Daniel Bell was among the society's most influential intellectuals.<sup>13</sup> Today, however, very few social thinkers are known outside of their discipline, and their books never make it anywhere near the best-seller list.<sup>14</sup> The capitalist social theory has taken over public debate.

This theory, as well as each of its main components, however, is incorrect. The fundamental reality is that capitalism, whether conceptualized in global or national terms, is not a coherent and unified system. On the contrary, successful market economies depend on a complex combination of conflicting institutions and motivations; they are contradictory and unstable, and they periodically require major structural reorganizations. During these reform epochs, nobody has a roadmap or a guidebook;

experimentation—sometimes bold experimentation—has been required for societies to identify the reforms needed to pave the way for economic revitalization.<sup>15</sup>

Again, I am not alone in challenging this capitalist social theory. A large body of work by social scientists has by now shown many of the ways in which this framework is wrong. For example, many political scientists and sociologists have contributed to a literature on “varieties of capitalism” that shows large and durable differences in the institutional arrangements of nations with capitalist property relations.<sup>16</sup> If, for example, the U.S. and Germany have very different systems of labor relations, very different welfare systems, and very different financial systems, it logically follows that capitalism is not one coherent unified thing.

But while these analysts have correctly emphasized how much variation and variability there is within different profit-oriented economies, their message has been drowned out by the hegemonic view that capitalism is a unified and largely unchanging system. When they stress the variations within capitalist societies, their audience tends to focus on the commonalities. This is because when most people see or hear the word “capitalism,” it brings to mind the whole capitalist social theory that I am describing, and this occurs whether people have positive or negative views of capitalism. In fact, during the campaign of Bernie Sanders for the Democratic nomination, public opinion polls showed astonishing numbers of young people in the U.S. who said they preferred socialism to capitalism.<sup>17</sup> But whether they hate it or like it, they conceptualize capitalism as a unified, coherent, and unchanging system whose inner logic must be obeyed.

Scholars or pundits who try to give the term “capitalism” a different meaning than that inhering in the capitalist illusion are in the awkward situation that Lewis Carroll described in

*Through the Looking Glass*.<sup>18</sup> Alice has an illuminating conversation with Humpty Dumpty that is very much about the nature of words and concepts. It begins with Humpty pointing out the superiority of celebrating unbirthdays over birthdays, since there are 364 of the former and only one of the latter:

“And only *one* for birthday presents, you know. There’s glory for you!”

“I don’t know what you mean by ‘glory,’” Alice said.

Humpty Dumpty smiled contemptuously. “Of course you don’t—till I tell you. I meant ‘there’s a nice knock-down argument for you!’”

“But ‘glory’ doesn’t mean ‘a nice knock-down argument,’” Alice objected.

“When *I* use a word,” Humpty Dumpty said, in rather a scornful tone, “it means just what I choose it to mean—neither more nor less.”

“The question is,” said Alice, “whether you can make words mean so many different things.”

“The question is,” said Humpty Dumpty, “which is to be master—that’s all.”

Lewis Carroll’s point is that since language is socially created, we cannot exercise the kind of dominion over words that Humpty imagines. Words not only have definitions, but also associations and connotations. And some words in particular, such as “capitalism” or “socialism” or “liberalism,” which have been central to political debates for extended periods of time, carry with them an enormous weight of associations. When social scientists attempt to give one of these words a precise definition, they are being like Humpty Dumpty—imagining that they can exercise dominion over words that have acquired a life and a set of meanings of their own. The reality is that whatever the definition, when the reader sees the word “capitalism,” he or

she is likely to plug in the meaning that has been acquired through previous experiences and learning. And sometimes, the meanings that the reader inserts are exactly the opposite of what was intended.

### THE ORIGINS OF THE ILLUSION

So where did this illusion come from and how did it become so dominant in shaping the views of both elites and publics? It was actually only in the 1980s that the word “capitalism” came into wide usage in the U.S. During the Cold War, the term was generally avoided in polite discourse because it was closely associated with Soviet and Communist Chinese anti-U.S. propaganda. When I was a college student, the term was still strongly associated with old left groups such as the Communist Party.

However, in 1965, Paul Potter, then president of Students for a Democratic Society (SDS), gave a speech at the first big student-led anti-Vietnam War march in Washington, D.C. The thrust of the speech was that the Vietnam War was not an accident, but the logical outcome of an entire system. The crux of the speech went as follows:

What kind of system is it that allows good men to make those kinds of decisions? What kind of system is it that justifies the United States or any country seizing the destinies of the Vietnamese people and using them callously for its own purpose? What kind of system is it that disenfranchises people in the South, leaves millions upon millions of people throughout the country impoverished and excluded from the mainstream and promise of American society, that creates faceless and terrible bureaucracies and makes those the place where people spend their lives and do their work, that consistently puts material values before human values and still persists in calling itself free and still persists in finding itself fit to police the

world? What place is there for ordinary men in that system and how are they to control it, make it bend itself to their wills rather than bending them to its?

We must name that system. We must name it, describe it, analyze it, understand it and change it. For it is only when that system is changed and brought under control that there can be any hope for stopping the forces that create a war in Vietnam today or a murder in the South tomorrow or all the incalculable, innumerable more subtle atrocities that are worked on people all over—all the time.<sup>19</sup>

I was a college freshman then, and I was in the crowd listening to this speech. I can remember the excitement we felt when he uttered the imperative to name the system. We all knew that he was talking about capitalism, but the term was still so forbidden that Potter did not actually use the word. We shared his conviction that racial inequality and the Vietnam War were proof that the basic economic structures of U.S. society needed to be challenged and changed.

The irony is that since that speech, the term “capitalism” moved from the margins to the center of political discourse in the United States. Some of the credit for this change can be taken by the New Left of the 1960s and the accomplishments of scholars who were part of a revival of the Marxist tradition in universities in the 1960s and 1970s.<sup>20</sup> In the 1970s, Immanuel Wallerstein, for example, published the first volume of a history of the modern capitalist world system, and several radical economists published a popular text called *The Capitalist System*.<sup>21</sup> These efforts helped give the term “capitalism” greater intellectual legitimacy; it was no longer just a tool of Soviet propaganda. Yet the influence of these leftist intellectuals on the political mainstream was short-lived because the country lurched rightward in the 1980s with the election of Ronald Reagan.



The heavy lifting in making the term “capitalism” respectable was actually done by a small group of right-wing intellectuals. As early as 1962, Milton Friedman published his conservative manifesto *Capitalism and Freedom*, and four years later the libertarian thinker Ayn Rand published a book of essays called *Capitalism: The Unknown Ideal*.<sup>22</sup> Both Friedman and Rand were hoping to flip the term—to strip it of its negative associations in much the same way as the Black Power movement proudly embraced the word “black,” which had earlier conveyed stigma. But the term “capitalism” was still so unpopular that using it just confirmed that Friedman and Rand were marginal intellectual figures. However, other conservatives eventually joined them, and the effort to flip the term’s political valence ultimately succeeded. Malcolm Forbes, publisher of *Forbes Magazine*, adopted the slogan “Forbes—Capitalist Tool” in 1966.<sup>23</sup> Denouncing a politician as a “capitalist tool” had long been one of the most stinging insults in the repertoire of leftist parties. Just as African American demonstrators might chant “I’m black and I’m proud,” so Forbes wanted businesspeople to say that they were capitalist and proud.

But the most important work along these lines was done by the neoconservative intellectual and publicist Irving Kristol. His *Two Cheers for Capitalism*, published in 1978, acknowledged that the term “capitalism” had historically belonged to opponents of the system, but Kristol argued that conservative defenders of the status quo would gain power by embracing the term.<sup>24</sup> Kristol was thoroughly familiar with Marxism; he had been one of those famously argumentative Trotskyists in Alcove 1 in the City College cafeteria in the 1930s. He recognized that one key advantage of “capitalism” as a term was its focus on the systemic consequences of certain fundamental arrangements. Marx had argued that a capitalist does not seek to pursue profits because

he or she is greedy or suffers some character defect. The individual capitalist does not have any choice; the failure to pursue profits will quickly end his or her business career. The relentless pursuit of profit is a structural imperative of the entire system.

The conservative writer George Gilder quickly followed up on Kristol's lead in his 1981 book *Wealth and Poverty*, which became one of the bibles of the Reagan era.<sup>25</sup> While Kristol had been unwilling to give capitalism a third cheer, Gilder had no such hesitation. He embraced capitalism as superior to all other economic systems on the grounds of both efficiency and morality. He portrayed capitalists as heroic moral figures who selflessly served the interests of society as a whole by their willingness to make risky investments. On this basis, Gilder argued for massive tax cuts that would reward the wealthy as well as the dismantling of many of the regulations that constrained business firms. Gilder's book was hugely influential and sold more than a million copies.

Gilder and these other conservative intellectuals understood that appropriating the idea of capitalism as a unified and coherent system had the potential to give the right greatly increased leverage in its struggles against political liberalism. Historically, conservative thinkers had emphasized the voluntary and individualistic dimension of free market arrangements. They had defined a market economy as the aggregation of contracts entered into by separate individuals, and they had gone on to argue that it is desirable for both liberty and economic efficiency to allow these voluntary arrangements to operate with a minimum of "outside interference"—especially from government. But this formulation had been weakened by decades of arguments by political and legal reformers that changes in the legal rules and regulations governing private transactions were consistent with the principle of voluntary contracting.

In fact, many of the reforms carried out by Franklin Roosevelt's New Deal were justified in the legal arena as being consistent with voluntary contracting.<sup>26</sup> So, for example, a series of reforms of the rules governing the labor market gave employees a variety of protections against overly long hours, inadequate wages, and management's refusal to engage in collective bargaining. But these arguments were justified by insisting that the new rules merely modified the context in which employee and employer negotiated their voluntary contracts. After all, the goal of collective bargaining was for the two sides to negotiate a mutually agreeable contract.

In the 1960s and 1970s, as consumer and environmental consciousness was growing in the U.S., this kind of incremental reform process gained new momentum. Even after Republicans gained the White House in 1969, Richard Nixon signed into law legislation creating new government agencies to protect the environment and improve occupational health and safety. Once again, proponents argued that the new rules just modified the context in which contracts were negotiated. However, businesses felt that they were facing an ever-stricter regulatory environment where their freedom to make profits was being severely constrained.

This is why Kristol's project of stealing the concept of capitalism was so important for business interests. The voluntary contracting framework no longer provided protection from the incremental expansion of new rules and regulations. The logic was unassailable. If we have rules that block business from selling certain dangerous products, why not extend those laws to cover unsafe automobiles or toys that could hurt children? There were no broad theoretical grounds for stopping this incremental expansion of regulation. But if one argues that all of the individual

choices that are made in the market aggregate into a coherent and cohesive system, then one is in a much stronger position to resist incremental reforms. Systems demand obedience to their organizing imperatives, and measures that are inconsistent with those imperatives can be expected to produce predictably damaging consequences. Newton's third law of motion—for every action, there is an equal and opposite reaction—describes the characteristics of a system. It follows that going against the logic of the system will inevitably produce equal and opposite undesirable consequences.

In a word, Irving Kristol and other conservative intellectuals and strategists did to Marx what Marx said he had done to Hegel—stood him on his head. Marx had emphasized the systemic character of capitalism as a way to demonstrate the futility of reform proposals. He and Engels wanted radical transformation—a “root and branch” change in the form of economic organization—and their analyses and political initiatives were designed to persuade others that only a revolutionary challenge to capitalism could succeed in transforming it.<sup>27</sup>

But by the time of Kristol's intervention, revolution was no longer a serious danger to existing market arrangements in the U.S. Kristol and his conservative allies were far more worried that the United States would follow the path of European social democracies, which had an elaborate regulatory structure and extensive public provision of social services. So they eagerly appropriated Marx's analysis to show the profound dangers of any effort to reform the “capitalist system.” In 1965, Paul Potter had urged his listeners to name the system. But once the society's intellectuals and elites had named, described, and analyzed the system as capitalism, reformist efforts were placed at a tremendous disadvantage. In fact, under conservative hegemony,

many of the incremental reforms that had been won between the 1930s and the 1970s were successfully dismantled with the justification that giving businesses greater leeway would make capitalism work better.

### THE ROLE OF ECONOMICS AND ECONOMIC POPULARIZATIONS

While Irving Kristol deserves a lot of credit for popularizing the capitalist illusion, his ultimate success depended on parallel developments in the discipline of economics that were later broadly diffused to the public. As noted, Milton Friedman used the word “capitalism” in a book title as early as 1962. Friedman was one of the first to recognize that redefining markets as a unified and coherent capitalist system would empower advocates of the free market and weaken their liberal opponents.

From the 1950s onward, Friedman and his Chicago colleagues were engaged in a war against the dominant Keynesian faction within the U.S. economics discipline. The Keynesians, followers of John Maynard Keynes, developed their views in response to the Great Depression of the 1930s. They believed that government should take an active role in moving the economy toward full employment and correcting other market failures. Friedman and his colleagues insisted that if markets were allowed to be self-regulating, they would achieve optimal results, and they insisted that government actions almost always produced perverse and undesirable consequences.<sup>28</sup>

Friedman and his allies were provided an opportunity by the economic difficulties that the U.S. economy experienced in the 1970s. A period of stagflation that combined slow economic growth with persistent inflationary pressures was an embarrassment for

the reigning Keynesian faction. The economy was supposed to have elevated unemployment or elevated inflation, but not both at the same time. Friedman's faction triumphed within the discipline; thus began an extended period during which mainstream economists became more enthusiastic about markets and considerably less enthusiastic about governmental policies.

One of the main weapons that the Friedmanites used in their battle to discredit and replace the dominant Keynesian faction was the insistence that their opponents' work was not built on solid micro-foundations. By this they meant that the Keynesian theory of how the economy worked was not sufficiently connected to accounts of how individual economic actors responded to market signals. For the Friedmanites, any convincing argument had to start with rational economic actors making particular choices. This proved to be an effective weapon against the Keynesians, but as we shall see later, this insistence on a theory of causality centering on individual choices results in a social theory that is blind to the exercise of power in the modern world.

The Friedmanite triumph over the Keynesians legitimated the rise of financial economics, and the successes of that field made possible the spectacular growth of financial markets. The Keynesians had a healthy skepticism about finance because they remembered the speculative stock market boom of the late 1920s that resulted in the 1929 crash and the subsequent depression. But the growing legitimacy of the Chicago School made it possible for a new generation of financial economists to argue that the new tools that they were developing could greatly increase the efficiency with which capital is allocated to different purposes, and this would mean greater prosperity for all.

With Ronald Reagan's election as president in 1980, these ideas were put into action. New regulations allowed for the

trading of previously unknown financial products, and changes in the tax law made such trading a more lucrative activity. At the same time, legislative changes opened up much greater opportunities for individuals to save for their own retirement through tax-deferred accounts. The consequence was a fantastic increase in the size of the financial sector of the economy that contributed to the severity of the crisis in 2008.<sup>29</sup> Almost overnight, a new strata of super-rich individuals appeared, including Wall Street traders, dealmakers at investment banks, and private equity and hedge fund managers, some of whom were able to make tens or hundreds of millions of dollars in a given year.

One of the most important aspects of this financialization of the economy has been the diffusion of the concept of capitalism elaborated by Friedman, Kristol, and Gilder. Some of the popularizers were the writers of fabulously successful business books that explained how people could get rich in this exciting new economy. Others were the financial advisors and financial writers who explained to the middle and upper class how they needed to invest their savings, taking advantage of new opportunities in the financial markets. Still others were the thinkers and policy analysts, whose numbers expanded dramatically as a whole group of right-wing think tanks and policy organizations expanded from the mid-1970s onward. Finally, many politicians incorporated the new understanding of capitalism into their standard speeches.<sup>30</sup>

To be sure, these popularizers did not explain the nature of capitalism systematically or even explicitly. But their impact over time was to convey to the public the idea that capitalism is a unified, coherent, and unchanging system whose inner laws must be obeyed. With versions of this story line repeated day after day by armies of popularizers over more than thirty years,

this view of capitalism has been burned into the consciousness of both elites and publics.

### THE PLAN

My argument is that the capitalist illusion is an entire economic social theory that has become part of society's common sense. But this erroneous theory distorts our perceptions and ties us up in political knots, making it far more difficult to see what kinds of changes in institutions at the local, national, and global level could help us to address the multiple crises that we face. However, one cannot effectively challenge such a theory without offering a compelling alternative theory. We need theories to make sense of the world, and even when we see that a particular theory has big weaknesses, we are reluctant to discard it until we have found an alternative.

The alternative theory I propose relies heavily on four somewhat distinct strands of scholarship. The first includes the works of a number of heterodox economic thinkers that includes Karl Polanyi, Albert Hirschman, and J.K. Gibson-Graham, all of whom have advanced powerful critiques of the economy as a self-regulating mechanism.<sup>31</sup> The second is the work of legal scholars—both those of the 1930s and 1940s, including legal realists such as Robert Hale, and more recent critical scholars such as Duncan Kennedy, Karl Klare, and Roberto Unger.<sup>32</sup> All of these thinkers have helped to deconstruct economic categories and have challenged what Unger calls the “false necessity” of standard economic rhetorics. The third is the work of contemporary economic sociologists, a number of whom work in an explicitly Polanyian tradition. These include Peter Evans, Greta Krippner, Margaret Somers, and Viviana Zelizer.<sup>33</sup> Finally, there are the



postindustrial theorists: Daniel Bell (who taught me when I was an undergraduate), Larry Hirschhorn (we wrote together decades ago), and the late historian Martin J. Sklar.<sup>34</sup> To be sure, many of these people might well disagree with how I have used their ideas to fit my framework. But they have constructed the foundation on which I have tried to build.

In proposing this alternative social theory, I confront a fairly common dilemma of exposition. The first option is to lay out the alternative framework from the start and then show how it explains things better than the dominant view. The other is to develop the alternative in the process of showing the limitations of the prevailing framework. Both of these choices have significant downsides, however. Laying out an alternative framework by starting with first principles is usually a tedious process that can strike readers as abstract and unpersuasive. Yet developing the alternative as one criticizes the dominant framework is often confusing. When a reader doesn't know where the author is headed, it can be difficult to follow the argument through the process of demolition.

My plan is to pursue a hybrid strategy that combines elements of the two approaches. In the next chapter, I will put my cards on the table, as it were, and explain in fairly concise terms the basic premises of my conceptual approach. While this is not a full elaboration of my framework, it should be enough for the reader to make sense of the alternative that I am offering. The next four chapters will focus on critique, showing what is wrong with the dominant and familiar way of thinking. In the conclusion, I will show how when we embrace the alternative I have proposed, we open up political possibilities rendered invisible by dominant modes of thought. Finally, in the afterword, I clarify how my perspective differs from views that continue to be voiced on the political left.

The way I develop my critique of existing ways of thinking follows standard practices in the social sciences. Books or articles often begin by saying that the literature in the field has explained a particular phenomenon in terms of theory A or theory B or theory C. The author then provides data to show that all of these theories are inadequate and only theory D provides an elegant and powerful way to make sense of the fact patterns.

This is the model that I am following. Given the complexity, there is no choice but to piece together strands of data from many different sources to construct an argument. This is what historians and other social scientists who study large-scale social change have done for many years. It is, for example, what Max Weber did in his multiple studies designed to explain why “rational capitalism” achieved its breakthrough in Western Europe rather than in other parts of the world. Hence, I will be drawing on aggregate data that reports trends over time in employment, economic output, and patterns of residential settlement, as well as a wide variety of more focused studies, journalistic reports, analyses of trends in academic literature, and my own observations over the last fifty years.

In the next chapter, I contrast the capitalist social theory with my alternative social theory. The capitalist social theory views the economy as similar to a natural entity—a living creature or a planetary system—that obeys a distinct set of laws. My alternative approach uses the metaphor of construction: a market economy, even a profit-oriented economy, is built out of many different kinds of materials and does not have its own distinct set of laws. Moreover, it is constantly in the process of changing and being reconstructed. In explaining why it is wrong to naturalize the economy or see it as similar to an organism, I directly

challenge the first corollary of the capitalist social theory: that the economy is and should be autonomous.

In chapter 3, I take on the second corollary—the idea that there is a fundamental tension between a profit-oriented economy and democracy. I argue that democracy and democratic practices are part of what has made a profit-oriented economy work effectively, and that trying to shield the economy from the decisions of voters has economically disastrous consequences. In chapter 4, I look at the third corollary—the claim that the economy works best when people pursue their economic self-interest single-mindedly. I show that, in fact, the celebration of unlimited wealth is bad for both the economy and the society.

Chapter 5 takes on the mistaken belief that the core institutional structures of capitalism have remained unchanged for centuries; it argues that there have been continuous and dramatic shifts in the way that economic activity is organized. Chapter 6 challenges the fourth corollary—the theory of causality that imagines that the basic structures of a capitalist society are built up from the micro-foundations of individual choices. Here I return to the construction metaphor and argue that the way the economy is built has an enormous influence on the choices that individuals make. The structures of the economy can be rebuilt, I argue, in ways that provide individuals with much broader choices and the capability of building a better and more resilient society. In chapter 7, I pull the argument together by suggesting some of the possibilities that are open to us once we overcome the capitalist illusion.