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Sociology from Economics

As sociologists, we view capitalism and its optimal needs differently from conventional economists. Ironically, however, our own perspective draws on the work of well-known early economists – sociologically astute, but often misunderstood or neglected in economics today. Those earlier economists provide us with most of the important building blocks for our argument. They also remind us that the foundations of economics are fundamentally different from the widespread contemporary belief that markets work best when political and social forces do not interfere with them. The historical perspective suggests that this contemporary view is wrong and that putting it into practice has caused serious economic damage. *We will show that capitalism performs best when states possess the intellectual and institutional capacities to manage their economies effectively and when societies are blessed with basic social cohesion, so that the interests of the many in widespread prosperity are not outweighed by those of the privileged few*. Our concern, however, is that state capacity and social cohesion are in short supply these days because their conditions of existence have been badly damaged; hence our plea to reverse this situation is quixotic. We do not suffer from the illusion that a better way will necessarily be found that will realize our desires. But we do believe that, without a better understanding of what makes capitalism work well, the situation will not improve.

Sociologists see capitalism as a much more complex system of social relations than do most economists. Economic activity is based not only on people pursuing their economic interests but also on trust, historical tradition, and personal identity. Sociologists also recognize that capitalism is embedded in a wide variety of institutions – political and cultural, as well as economic. And sociologists understand that the way in which capitalism operates varies significantly across countries and over time. But what is perhaps most noticeable about sociology is its fundamental criticism of capitalism. The greatest sociologists on the subject spoke of the alienation, anomie, and disenchantment associated with capitalism. There is nothing inherently wrong with this view, given the exploitation of workers in many capitalist societies both past and present, and we really speak warmly in this book only about the Golden Age of capitalism – that is, the first few decades following the Second World War – when, by contemporary standards, the interests of the many carried greater weight relative to those of the few. To be sure, those economists whose thought we admire had their own reservations about capitalism. But they differ from the sociologists in two ways: First, they were aware of and appreciated the dynamism and prosperity that capitalism can produce; second, they provided useful sociological insights about the mechanisms of capitalism and the institutions needed to make it work – and whose absence brings chaos. It is for this reason that we rely on the work of six historically eminent economists: Adam Smith, Albert Hirschman, Friedrich List, John Maynard Keynes, Joseph Schumpeter, and Karl Polanyi. Many of their insights have been forgotten; we resurrect and expand them here.

It might seem strange to focus on this group of economists. After all, they lived during very different eras of capitalism and, as a result, had very different views of capitalism. Smith was a leading member of the eighteenth-century Scottish Enlightenment, writing during the early years of capitalism when the factory system was just emerging, with the logistics of transportation and communication still essentially primitive. List lived in the early nineteenth century, when tariff barriers inside Germany were being torn down so as to increase specialization and trade. Keynes lived through the Great Depression and two world wars. He died just after the Second World War and lived in Britain as its power in the world was diminishing. Schumpeter, an Austrian, lived during the same period, but he spent the last two decades of his life in the United States at a time when its hegemonic power was blossoming. This latter pair witnessed the rise of multinational corporations, steam ships, automobiles, air travel, and telephones. Polanyi was another mid-twentieth-century economist, but he was one who lived in Austria, Britain, the United States, and Canada, and who lived long enough to see the emergence of the Cold War, the European Economic Community (forerunner to the European Union), and the full weight of the United States as an international superpower. Finally, Hirschman, the youngest member of our group, was born during the First World War in Berlin, where he witnessed Hitler's rise to power, before fleeing to France. Hirschman fought on behalf of the Spanish Republic in the Spanish Civil War, helped Jews and others to escape Nazi-occupied France, and eventually emigrated to the United States, where he died in 2012 having seen the moon landing, the globalization of capitalism, the collapse of the Soviet Union, the birth of the Internet, and the emergence of China as a leading economic player on the world stage. Yet, despite their different experiences, these economists shared two things in common: Each developed views of economics that were unorthodox for their time, and each appreciated in varying degree how important social cohesion and state capacities are if capitalist societies are to prosper.

Contemporary economists tend to forget the lessons learned by their predecessors. This is unfortunate because taking that intellectual heritage seriously can inform a more complete understanding of how capitalism works – one that incorporates the important roles that states and social relations play in capitalism both domestically and internationally. In this regard, it is worth remembering that some of the economists we discuss did not describe their work as the study of economics at all but rather as the study of political economy – a much more encompassing approach to the analysis of capitalism than is typical of most economists today.[1] There are some exceptions to this generalization – notably, institutional economists and those concerned recently with economic inequality.[2] But modern economics evolved from a discipline based on institutional, historical, and comparative analysis to one based on formal mathematical modeling and parsimonious explanation – and then, as one economist told us, to narrow-minded empiricism focusing on small questions, thanks to the rise of computers and large data sets.[3]

Mainstream economists, as well as the policymakers and media pundits who heed their advice, take a very different view from ours. They believe that markets work best if politicians do not "interfere" with market processes. Perhaps most famously, former University of Chicago economist Milton Friedman argued, in his bestselling *Capitalism and Freedom*, that maximizing shareholder wealth through markets is the best way of delivering prosperity, and that most attempts by government to improve markets are doomed to failure and may even make things worse. He believed that the government should refrain from imposing tariffs, setting minimum wage rates, regulating industries, and requiring people to contribute to social security programs. Nor should the government license particular enterprises, occupations or professions, operate national parks or toll roads, redistribute income or provide social services to alleviate poverty.[4] Friedman won the Nobel Prize in Economics for his work. Other influential schools of economic thought held similar views. Rational expectations theory suggested that people anticipate the government's economic policies and then behave proactively in ways that nullify the intended effects of those policies; the efficient market hypothesis maintained that unfettered markets are the best way of establishing value and setting prices. Friedman's view and that of his likeminded compatriots is mistaken. Yet it is their perspective that helped to pave the way for the neoliberal (sometimes called free-market or laissez-faire) economic reforms that led to the 2008 financial crisis, perpetuated much of the economic misery that followed, and which may yet exacerbate the disastrous economic fallout of the coronavirus pandemic.

Some economists disagree with this orthodox view of what makes capitalism work well. Some even point occasionally to the importance of our two key variables, state capacities and social cohesion. Joseph Stiglitz complains that, in the mainstream view, "there is little need for community and no need for trust. Government is a hindrance; it is the problem, not the solution."[5] Paul Krugman scolds his fellow economists for neglecting that "economics inevitably takes place in a political context."[6] Stiglitz and Krugman, also both Nobel Prize winners, have concluded that the economics profession went astray when it followed orthodoxy, ignoring mountains of evidence indicating that it was the wrong path to follow, and that, as a result, it succumbed to a flawed ideology rather than subscribed to reasoned argument.[7] We agree, but we will have much more to say about how state capacities and social cohesion affect capitalism.

Before going any further, we must point to complexities in the character of capitalism. Every economist would agree that a minimal definition begins with the presence of private property, production for the market, and the principle of profit maximization by rational means. But, as noted, there is more to it than that, as becomes obvious once we ask ourselves about the nature of the society in which we live. Countries are marked not only by capitalism but also by national sentiment and by the character of their political regime. You cannot understand capitalism without understanding what unites or divides a society. Nor can you understand capitalism without understanding how the economy and state engage each other. Then, there is the fact that what happens inside a country often depends on events in the external world. The larger world is, of course, capitalist too, and nation-states must navigate within it. As a result, domestic political and social arrangements are subject to economic pressure from that larger world. But the larger world involves geopolitics that also affect capitalism inside countries.

Two implications follow from this last point. First, capitalism changes because of geopolitics, just as geopolitics change because of developments within capitalism. When the Chinese invented gunpowder, they banned its use for military production, limiting it instead to fireworks, because they had no geopolitical rivals. In Europe, where states were often at each other's throats, that move was not possible: it would have led to the destruction of any state that tried, because its rivals would not have done the same thing. Equally, the geopolitical agreement among members of the Organization of the Petroleum Exporting Countries (OPEC) to increase oil prices in the 1970s sent shock waves through the world's capitalist economies. In turn, this escalated geopolitical tensions between these capitalist countries and the OPEC cartel. Second, changes within international capitalism have been managed differently by states over time. World capitalism is far from politically neutral. Notably, its postwar institutions were largely created by the United States, thanks to both its military and economic strength in 1945, and the role of this hegemonic power remains exceptionally important today, even though its character has changed. These considerations make for complexities that we cannot ignore. Nonetheless, our focus is on capitalism, whose geographic range and intensity of interaction have increased significantly since the Second World War – and all the more so in the decades that followed the collapse of the Soviet bloc.

We live life forward and understand it backward. We now possess enough hindsight to see that there was an exceptional postwar period in which the advanced core of the capitalist world benefited from peace and prosperity thanks largely to the United States setting the rules by which capitalism operated. That relatively benign era of stability has come to an end; history is on the move again, with destabilizing effects – in part, because the United States now chooses to use some of its power to renegotiate those rules, such as those it helped to establish for the General Agreement on Tariffs and Trade (GATT), now the World Trade Organization (WTO), and also because the international architecture of capitalism is changing, driven primarily by the rise of China.

We now turn to our general argument by describing our two variables, social cohesion and state capacity. We do this with help from the great economists mentioned earlier. Chapter 2 begins by examining the disasters of the mid-twentieth century in which capitalism was thoroughly disrupted by geopolitical forces. It then turns to the amazing postwar recovery – the Golden Age – that was made possible by geopolitical settlement. Chapter 3 chronicles the slow decline of the Golden Age; then, in the next two chapters, we consider capitalism's contemporary difficulties. Chapter 4 looks at the deterioration of social cohesion. Growing economic inequality and stifled economic mobility, on the one hand, and rising nationalist discontent, on the other, are undermining social cohesion and therefore destabilizing politics and state capacity throughout the advanced capitalist world. Chapter 5 analyzes in detail this deterioration of state capacity. No description is neutral, so we will conclude in Chapter 6 by discussing prospects for the future, particularly in light of the unprecedented challenges to capitalism posed by the coronavirus pandemic, the digital information age, and climate crisis.

Building Blocks

It makes sense to begin with Adam Smith, often seen as the founding father of economics. He favored competitive markets – an idea best captured in his notion of the "invisible hand," a process that stems from individuals pursuing their economic interests by rationally calculating costs and benefits, then striking the best deals they can in the marketplace. In the aggregate, the accumulation of these many individual deals constitutes the forces of supply and demand, which express the general economic interests of society and increase national prosperity and wealth.[8] This idea has become the foundation of today's mainstream economics. However, mainstream economists forget that Smith had much more to say about all this. He also recognized the importance of social cohesion and state capacity for the development and success of capitalism.

Consider social cohesion first. As is well known, Smith argued in *The Wealth of Nations* that prosperity in capitalism stemmed from the division of labor – or, more precisely, the specialization, dexterity, and innovative powers of workers. His famous example was a pin factory: when the task of manufacturing pins was broken down into its component steps and each step was assigned to a different worker, pin manufacturing became much more efficient and productive. Smith shows here his continual sympathy for labor, his insistence being that high levels of human capital resulting from basic social cohesion underlie prosperity, which in turn increased social solidarity.

But there was another source of social cohesion of greater importance. While Smith praised the rational pursuit of self-interest in *The Wealth of Nations*, his earlier book *The Theory of Moral Sentiments* maintained that something else is the principal motivation of human behavior.[9] The single most important human motivation was not the pursuit of material well-being but the longing to be loved, to which he added at the end of his life the desire to find oneself lovable. As he put it, "the chief part of human happiness arises from the consciousness of being beloved."[10] In other words, people are fundamentally social creatures driven by what other people think of them. Those around us serve as a looking-glass through which we can gauge and adjust our own behavior.[11]

From this, Smith derived a crucial point: we tend to admire success and often flaunt it. As a result, we are jealous of and want to catch up with those above us in the economic pecking order. For Smith, this is the most essential source of social cohesion – less a belief in capitalism in and of itself than an appreciation of the role that money-making has within the comparisons to others that marks social life.[12] What this suggests metaphorically is an ascending escalator – one without end – on which people are aware of each other, constantly trying to catch up with those above them, running and running until their death. As long as you believe that you might catch up, cohesion is assured, even if the odds are against you, because everyone above and ahead of you is running too. If people cease to hold the belief that they can catch up, illusory though it may be, then trust in the system will decline, social cohesion will break down, and capitalism will run into trouble. For Smith, the illusion of the societal escalator keeps the wheels of capitalism turning even though it is neither morally admirable nor indeed sensible.