Special Collection of Essays by Jerry Z. Muller

Over the course of the last three decades, Jerry Z. Muller, now emeritus professor of history at the Catholic University of America, has published numerous books dealing with the history of capitalism, and its interpretation by intellectuals. These include *Adam Smith in His Time and Ours* (1993, an excerpt of which was published in this journal as "Thinking Like Adam Smith," *Journal of Applied Corporate Finance* Vol. 21, No.1, (Winter, 2009), pp.90-95), *The Mind and the Market: Capitalism in Western Thought* (2002) and *Capitalism and the Jews* (2011), and a lecture series for the Teaching Company's "Great Courses," "Thinking about Capitalism." Jerry has been a fellow of the American Academy in Berlin; the Rockefeller Foundation Center in Bellagio, Italy; the Olin Foundation; the Bradley Foundation; and the American Council of Learned Societies.

In addition, he has published essays, articles, and book chapters that place capitalism in wider historical, philosophical, and cultural contexts. A selection of these occasional pieces, which first appeared in scattered venues over the past two decades, are presented here for the benefit of our readers who may be interested in thinking broadly about contemporary capitalism. These five essays have been lightly edited and revised by the editor of the *Journal of Applied Corporate Finance* and the author:

1. The Neglected Moral Benefits of the Market
2. Capitalism and Inequality
3. Capitalism and Nationalism
4. The Threat of Democracy to Capitalism
5. Capitalism and the Jews Revisited

DOI: 10.1111/jacf.12598

Journal of
APPLIED
CORPORATE FINANCE

REPRINT

The neglected moral effects of the market: Arguments from the last 300 years

Jerry Z. Muller

Department of History, The Catholic University of America, Washington DC 20064, USA

Correspondence
Jerry Z. Muller, The Catholic University of America, Washington DC, USA.
Email: mullerj@cua.edu

This is a lightly edited version of an article first published in *Society*, Jan/Feb. 2006, pp. 12–14, as part of a symposium on "Morals and Markets."

INTRODUCTION

In our society, defenses of the market come primarily from those concerned with economic and material well-being. Those who see themselves as the protectors of morality are much more likely to express antipathy to the market.

But what about the positive moral effects of the market that tend to get overlooked in narrowly economic discussions about production and distribution? To be sure, many of these benefits also have potential costs. But since these costs tend to receive considerable (to the point of exclusive) attention from moralists, I will just note them here without expanding on them, not because they are less significant but because they are likely to be more familiar.

One perennial pitfall in thinking about the moral effects of capitalism arises from the role of comparison. When philosophers ask about the morality of capitalism, they too rarely ask "compared to what"? Of course, capitalism is morally inferior to the vision held out by many a philosophical utopia. And our comparative evaluation of capitalism gets further skewed by the fact that when we compare capitalism to past regimes, the comparison tends to reflect (at least implicitly) the perspectives of those who profited most and suffered least in past systems—that is, the perspectives of lords rather than serfs, masters rather than slaves, aristocrats rather than commoners.

CAPITALISM AND AUTONOMY

With that caveat in mind, let me turn to the first of the arguments about the positive moral effects of the market—namely, the link between individual autonomy and self-support through legally free labor. Adam Smith famously wrote that

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. Nobody but a beggar chooses to depend chiefly upon the benevolence of his fellow-citizens.

This passage is almost invariably cited as a statement of the potential social efficacy of self-interest. But notice the strength of its suggestion that dependence upon the benevolence of others is morally degrading and, hence, something to be avoided if possible. Thomas Carlyle—and later Marx and Engels—would deplore this system of mutual appeals to self-interest as evidence of the tyranny of "the cash nexus." But the flip side of the cash nexus is, first of all, the freedom and self-determination that comes from *having* cash. Second, the fact that relations based on cash do not involve the total subordination of one individual to the will of another represents significant progress when set against the older, prevailing characteristic forms of human relations under slavery, serfdom, or indentured servitude. Nor does the use of cash involve the subordination of the individual to the will of the state and its officials, one of the defining characteristics of socialism. That is why Hegel, who certainly appreciated the role of the state, insisted that supporting oneself by earning a living is one of the most important ways in which men get a sense of themselves as autonomous individuals. What Hegel called "the ethic of bourgeois society," includes a commitment to "the activity of supporting oneself through reason and industriousness."

All this insistence on self-reliance, to be sure, has dark sides, potential and real. It may lead us to a mindless commitment to work at the expense of other goods. It could also lead to the belief that personal value comes only from paid labor, leading in turn to a fear of dependence on others, or an undervaluing of and under-investment of our time in volunteering and other important but (for the most part) unpaid activity.

CAPITALISM AND PERPETUATION OF THE FAMILY

The second argument asserts that the *moral* quality of self-support derives in good part from the fact that it so often extends beyond the individual, to his or her family and descendants. This argument reminds us not to confuse self-interest with selfishness, for the "interests" we pursue in the marketplace often involve more than just ourselves. As Edmund Burke put it,

> The power of perpetuating our property in our families is one of the most valuable and interesting circumstances belonging to it, and that which tends the most to the perpetuation of society itself. It makes our weakness subservient to our virtue; it grafts benevolence even upon avarice.

Or, as Hegel explained, it is in the family that the self-interested actors of the market become members of a collectivity to which they are emotionally and ethically attached. It is this collective interest that gives property and self-interest a very different meaning. For it is the desire to form a family that often makes it necessary to acquire a continuous stream of income in the first place. And property is an integral part of family life. "The external and public reality of the family is its wealth," Hegel writes, "its family fortune, which forms the basis for the survival of its members."

In sum, one way in which the love and deep obligation that characterize the family are expressed is by earning a living in the marketplace. In the search for familial wealth, Hegel says, self-interest and selfishness are transformed into an ethical concern for something shared.

The potential dark side here is that a commitment to the support of one's family can overshadow our concern with the well-being of those *beyond* our family. It can thus serve as a motive for civic neglect, or even fraud.

CAPITALISM AS CREATING SELF-INTERESTED SOLICITUDE

The third argument is that the market leads to a self-interested concern for others, to what one might call non-altruistic reciprocity, or what Kant called "unsocial sociability." This takes several forms. As Adam Smith pointed out, regular market relations are conducive to the development of honesty. And this insight has been rediscovered by contemporary game-theorists. The reiterated multi-lateral exchanges known to economists as "repeat dealings" create incentives to develop the trust of other players by scrupulous action. That explains why merchants out to make a single sale to customers are more likely to engage in fraud, while those who seek return business have reason to be honest. It helps explains why successful companies have generous return policies and offer money-back guarantees. It is also why companies seeking to attract and retain investors strive for financial transparency—in contrast to fly-by-night operations and their executives intent on a single "killing."

Another way in which the market conduces to the development of a concern for others was explored by Hegel. Because we are dependent on others to meet our needs, and because we can earn money only by supplying their wants, we are forced to orient ourselves to other people, and take an interest in what they think and want. The link of self-interest to mutual concern is expressed in the sales clerk's cheery quip, "Can I help you?"—a phrase that is often scorned, except by those forced to live in societies where sales clerks, for lack of institutional incentives, habitually ignore potential customers.

Viewed from the heights of moral rigor, such commercially motivated solicitude invites contempt for its lack of genuine charity and altruism. But seen historically and comparatively, the market's ability to create a self-interested regard for others is probably preferable to the indifference that tends to characterize the relations of imperfect men and women toward others with whom they have no natural affinity or empathy.

George Simmel carried this argument an interesting step further in his discussion of competition and its effects on entrepreneurs. Competition, he pointed out, is not only a relationship between those who compete; it is a struggle for the affection, attention, or money of a third party. To compete successfully, Simmel noted, the competitors must discover the wishes of that third party. Often, competition "achieves what usually only love can do: the divination of the innermost wishes of the other, even before he himself becomes aware of them."

And Simmel was right: how many of us divined 20 years ago that we would need a computer on our desks? How many of us divined 10 years ago that we could hardly live without a high-speed internet? This competition for customers and consumers had a highly democratic aspect as well. "Modern competition," Simmel observed, "is often described as the fight of all against all, but at the same time it is the fight of all *for* all." Competition, he wrote, forms

> a web of a thousand social threads: through concentrating the consciousness on the will and feeling and thinking of fellowmen, through the adaptation of producers to consumers, through the discovery of ever more refined possibilities of gaining their favor and patronage.

Each of these moral benefits has its potential dark side: self-interested solicitude can lead to complete inauthenticity, a sense of always selling oneself. That is why it has been so consistent a theme of social criticism from Rousseau's critiques through "Death of a Salesman" and beyond. And the inculcation of ever-new needs by the market—when not bounded by a sense of priorities and of how new commodities fit into our life-plan—may put us on a treadmill of joyless consumption.

CAPITALISM, CONNECTIVITY, AND COOPERATION

The fourth argument in the moral case for capitalism is its tendency to create ever wider forms of human association. From Smith through Friedrich Hayek it has been pointed out that commerce connects us to foreigners whom we come to regard not as barbarians but as potential suppliers and potential customers. In so doing, capitalism creates an awareness of their needs and wants, and to the extent that we view them as customers for our products and as producers of the goods we hope to consume, we become linked to them.

One effect of such exchange, as no less than Marx and Engels have put it, is that "National one-sidedness and narrow-mindedness become increasingly impossible, and from the numerous national and local literatures, there arises a world literature." And to that benefit one might add a world music, a more cosmopolitan cuisine, and an exchange of cultural goods such that there are more and more Buddhists in the United States and more and more classical musicians coming from places such as South Korea.

A related argument holds that capitalism leads to a diminution of religious and communal antagonism. Indeed, one of the great arguments in favor of capitalism is that it diffuses cultural and religious sources of conflict. It does so by creating incentives to cooperate with people of differing ultimate commitments, leading to a greater zone of indifference to the ultimate goals of others. We find this argument memorably expressed by Voltaire in the description of the London stock exchange that appears in his *Philosophical Letters*:

> Come into the London Exchange, a place more respectable than many a court. You will see assembled representatives of every nation for the benefit of mankind. Here the Jew, the Mohametan and the Christian deal with one another as if they were of the same religion, and reserve the name "infidel" for those who go bankrupt.

It is their shared focus on a common means—money—that diffuses the religious antagonisms between the Jew, the Muslim, and the Christian. George Simmel carried this insight a step farther when he observed that money is "the ultimate means." And minds ever more oriented to the weighing of means, Simmel tells us, become more tolerant, more conciliatory, because, focused on their *own* means, they become less concerned about the ultimate *ends* of others. Spending less time thinking about salvation or perfection and more on obtaining means, they become more indifferent to the divergent ways in which others seek perfection or salvation. The market thus conduces to wider co-operation by lowering the ultimate stakes of social relations.

Of course, this creation of wider forms of association is itself a source of moral complaint by those who champion cultural and religious particularism, and who rightly view trans-cultural contact as a threat to their inherited identity, at least in its traditional form. And the lower stakes of market relations may itself become a source of discontent by those who scorn such relations as mundane and trivial.

CAPITALISM AND NEW POSSIBILITIES FOR SELF-REALIZATION

The last argument worth considering is that capitalism creates new and more complex forms of individuality. Simmel proposed the suggestive idea of viewing the limited-liability corporation as the model for many characteristic forms of association in an advanced capitalist society. Individuals cooperate with a clearly *limited* portion of their lives for common but limited purposes.

In previous societies, one's status as a peasant, artisan or merchant often defined all aspects of one's existence. Being a member of a guild, for example, encompassed a complete set of social roles—economic, legal, political, and even religious. Modern market society, by contrast, is based upon looser, more temporary associations that are founded and designed to pursue specific economic, cultural, or political interests. Such associations demand only a small part of the individual, sometimes as little as monetary contributions in the form of dues.

As a result, the modern individual can belong to a greater range of groups, but groups that are looser and less all-encompassing. In contrast to earlier forms of association, modern associations allow for participation without absorption. They make it possible for the individual to develop a variety of interests and to become involved in a wider range of activities than would otherwise be possible, yet to do so without surrendering the totality of his or her time, income, or identity to any particular association, from the family to the state.

Under such circumstances, individual identity arises from the *set* of one's interests and associations, a set different, in theory at least, for each individual and valued precisely because it is voluntarily chosen. I may be a husband and father, a Buddhist, a jazz aficionado, a molecular biologist, a marksman, and a reader of modernist fiction. What is remarkable—and historically unprecedented, if not altogether *new*—is the possibility of one's being all of these things at the same time. Being any one of them does not entail the others, and so my identity, my sense of myself as an individual is constituted in large part by the choices I have made and the intersection of interests that come together in me.

And this historically new range of possibilities—life options, if you will—is made possible in no small part by the market. It is the division of labor facilitated by the market that allows for this profusion of possibilities. It makes it possible for me to specialize in molecular biology, and to be sufficiently productive to make enough money that I can buy the commodities that allow me to develop my interests —musical instruments, recorded music, novels, and trips to the ashram.

The dark side of this argument, however, is the danger of the development of a protean self, without a set of binding commitments to anyone or anything—a world where the bottom line of every social contract is the escape clause.

CLOSING THOUGHTS

There are, no doubt, plenty of good economic arguments about how (under the right conditions and in the long run) capitalism has made nations better off materially. And there are plenty of good arguments about the moral hazards of a market society, some of which have been touched on above. But as I've tried to suggest in this short essay, there are also plausible arguments about capitalism's *moral* advantages that are perhaps more easy to overlook. Indeed, many of the moral advantages and conceptions of selfhood that people in capitalist societies tend to take for granted are due in no small part to capitalism itself.

KEYWORDS
Adam Smith, Cash Nexus, connectivity, cooperation, Edmund Burke, Friedrich Engels, Friedrich Hayek, Georg Hegel, Karl Marx, moral effects, morality of capitalism, self-realization, voltaire

How to cite this article: Muller, Jerry Z. 2024. "The neglected moral effects of the market: Arguments from the last 300 years." *Journal of Applied Corporate Finance* 1–4. https://doi.org/10.1111/jacf.12598

DOI: 10.1111/jacf.12600

Journal of
APPLIED
CORPORATE FINANCE

REPRINT

Capitalism and inequality: What the right and the left get wrong

Jerry Z. Muller

Department of History, Catholic University, Washington DC, USA

Correspondence
Jerry Z. Muller, Catholic University, Washington DC, USA.
Email: mullerj@cua.edu

This article was first published in *Foreign Affairs*, March-April, 2008, pp. 18–35.

INTRODUCTION

Recent political debate in the United States and other advanced capitalist democracies has been dominated by two issues: the rise of economic inequality and the scale of government intervention to address it. As recent US presidential elections and Congressional battles over the "fiscal cliff" have demonstrated, the central focus of the Left today is on increasing government taxing and spending, primarily to reverse the growing stratification of society. The central focus of the Right is on decreasing taxing and spending, primarily to ensure economic dynamism. Each side minimizes the concerns of the other, and each seems to believe that its desired policies are sufficient to ensure prosperity and social stability. Both are wrong.

Inequality is indeed increasing almost everywhere in the postindustrial capitalist world. But despite what many on the Left think, this is not the result of politics, nor is politics likely to reverse it—for the problem is more deeply rooted and intractable than generally recognized. Inequality is an inevitable product of capitalist activity, and expanding equality of opportunity only increases it—because some individuals and communities are simply better able than others to exploit the opportunities for development and advancement that capitalism affords. Despite what many on the Right think, however, this is a problem for everybody, not just those who are doing poorly or those who are ideologically committed to egalitarianism. Why? Because if left unaddressed, rising inequality and economic insecurity can erode social order and generate a populist backlash against the capitalist system at large.

Over the last few centuries, the spread of capitalism has generated a phenomenal leap in human progress, leading to both previously unimaginable increases in material living standards and the unprecedented cultivation of all kinds of human potential. Capitalism's intrinsic dynamism, however, produces insecurity along with benefits, and so its advance has always met resistance. Much of the political and institutional history of capitalist societies, in fact, has been the record of attempts to ease or cushion that insecurity—and it was only the creation of the modern welfare state in the middle of the 20th century that finally enabled capitalism and democracy to coexist in relative harmony.

In recent decades, developments in technology, finance, and international trade have generated new waves and forms of insecurity for leading capitalist economies, making life increasingly unequal and chancier for not only the lower and working classes, but much of the middle class as well. The Right has largely ignored the problem, while the Left has sought to eliminate it through government action, regardless of the costs. Neither approach is viable in the long run. Contemporary capitalist polities need to accept that inequality and insecurity will continue to be the inevitable result of market operations and find ways to shield citizens from their consequences—while somehow still preserving the dynamism that produces capitalism's vast economic and cultural benefits in the first place.

COMMODIFICATION AND CULTIVATION

Capitalism is a system of economic and social relations marked by private property, the exchange of goods and services by free individuals, and the use of market mechanisms to control the production and distribution of those goods and services. Some of its elements have existed in human societies for ages, but it was only in the 17th and 18th centuries, in parts of Europe and its offshoots in North America, that they all came together in force. Throughout history, most households had consumed most of the things that they produced and produced most of what they consumed. Only at this point did a majority of the population in some countries begin to buy most of the things they consumed and do so with the proceeds gained from selling most of what they produced.

The growth of market-oriented households and what came to be called "commercial society" had profound implications for practically every aspect of human activity. Prior to capitalism, life was governed by traditional institutions that subordinated the choices and destinies of individuals to various communal, political, and religious structures.

These institutions kept change to a minimum, blocking people from making much progress but also protecting them from many of life's vicissitudes. The advent of capitalism gave individuals more control over and responsibility for their own lives than ever before—which proved both liberating and terrifying, allowing for both progress and regression.

The capitalist process of *commodification*—by which I mean the transformation of activities performed for private use into activities performed for sale on the open market— allowed people to use their time more efficiently, specializing in producing what they were relatively good at and buying other things from other people. New forms of commerce and manufacturing used the division of labor to produce common household items cheaply and also made a range of new goods available. The result, as the historian Jan de Vries has noted, was what contemporaries called "an awakening of the appetites of the mind," an expansion of subjective wants and a new subjective perception of needs. This ongoing expansion of wants has been chastised by critics of capitalism from Rousseau to Marcuse as imprisoning humans in a cage of unnatural desires. But it has also been praised by defenders of the market from Voltaire onward for broadening the range of human possibility. Developing and fulfilling higher wants and needs, in this view, is the essence of civilization.

Because we tend to think of commodities as tangible physical objects, we often overlook the extent to which the creation and increasingly cheap distribution of new cultural commodities have expanded what one might call the means of and possibilities for *self-cultivation*. For the history of capitalism is also the history of the extension of communication, information, and entertainment—things to think with, and about.

Among the earliest modern commodities were printed books—in the first instance, typically the Bible—and their shrinking price and increased availability were far more historically momentous than, say, the spread of the internal combustion engine. So, too, with the spread of newsprint, which made possible the newspaper and the magazine. Those innovations gave rise, in turn, to new markets for information and to the business of gathering and distributing news. In the 18th century, it took months for news from India to reach London; today it takes moments. Books and news have made possible an expansion of not only our awareness but also our imagination, our ability to empathize with others and imagine living in new ways ourselves. Capitalism and commodification have thus facilitated both humanitarianism and new forms of self-invention.

Over the last century, the means of cultivation were expanded by the invention of recorded sound, film, and television; and thanks to the rise of the Internet and home computing, the costs of acquiring knowledge and culture have fallen dramatically. For those so inclined, the expansion of the means of cultivation makes possible an almost unimaginable enlargement of one's range of knowledge.

FAMILY MATTERS

If capitalism has opened up ever more opportunities for the development of human potential, however, not everyone has been able to take full advantage of those opportunities or progress far once they have done so. Formal or informal barriers to equality of opportunity, for example, have historically blocked various sectors of the population—notably women, minorities, and the poor—from benefiting fully from all capitalism offers. But over time, in the advanced capitalist world, those barriers have gradually been lowered or removed, so that now opportunity is more equally available than ever before. The inequality that exists today thus derives less from the unequal availability of opportunity than it does from the unequal ability to exploit opportunity. And that unequal ability in turn stems from differences in the inherent human potential that individuals begin with and in the ways that families and communities enable and encourage that human potential to flourish.

The role of the family in shaping individuals' ability and inclination to make use of the means of cultivation that capitalism offers is hard to overstate. The household is not only a site of consumption and of biological reproduction. It is also the main setting in which children are socialized, civilized, and educated, and in which habits are developed that influence their subsequent effectiveness as human beings and success as market actors. To use the language of contemporary economics, the family is a workshop in which human capital is produced.

Over time, the family has shaped capitalism by creating new demands for new commodities. It has also been repeatedly reshaped by capitalism because new commodities and new means of production have led family members to spend their time in new ways. As new consumer goods became available at ever-cheaper prices during the 18th century, families devoted more of their time to market-oriented activities, with positive effects on their ability to consume. Male wages may have actually declined at first, but the combined wages of husbands, wives, and children made higher standards of consumption possible.

Economic growth and expanding cultural horizons did not improve all aspects of life for everybody, however. The fact that working-class children could earn money from an early age created incentives to neglect their education, and the unhealthiness of some of the newly available commodities—white bread, sugar, tobacco, distilled spirits—meant that rising standards of consumption did not always mean an improvement in health and longevity. And as female labor time was reallocated from the household to the market, standards of cleanliness appear to have declined, increasing the chance of disease.

The late 18th and early 19th centuries saw the gradual spread of new means of production across the economy. This was the age of the machine, characterized by the increasing substitution of inorganic sources of power (above all the steam engine) for organic sources of power (human and animal), a process that increased productivity tremendously. Rather than a society based largely on agriculture and "cottage" industries, manufacturing now increasingly took place in the factory, built around new engines that were too large, too loud, and too dirty to have a place in the home. Work was therefore more and more divorced from the household, which ultimately changed the structure of the family.

At first, the owners of the new, industrialized factories sought out women and children as employees, since they were more tractable and more easily disciplined than men. But by the second half of the 19th century, the average British workingman was enjoying substantial and sustained growth in real wages, and a new division of labor came about within the family itself, along lines of gender. Men, whose relative strength gave them an advantage in manufacturing, increasingly worked in factories for market wages, which were high enough to support a family. The 19-century market, however, could not provide commodities that produced "goods" such as cleanliness, hygiene, nutritious meals, and the mindful supervision of children. Among the upper classes, these services could be provided by servants. But for most families, such services were increasingly provided by wives. This caused the rise of the breadwinner-homemaker family, with a division of labor along gender lines. Many of the improvements in health, longevity, and education from the mid-19th to the mid-20th century, according to de Vries, can be explained by this reallocation of female labor from the market to the household and, eventually, the reallocation of childhood from the market to education, as children left the work force for school.

DYNAMISM AND INSECURITY

For most of history, the prime source of human insecurity was nature. In such societies, as Marx noted, the economic system was oriented toward stability—and stagnancy. Capitalist societies, by contrast, have been oriented toward innovation and dynamism, to the creation of new knowledge, new products, and new modes of production and distribution. All of this has shifted the locus of insecurity from nature to the economy.

Hegel observed in the 1820s that for men in a commercial society based on the breadwinner-homemaker model, one's sense of self-worth and recognition by others was tied to having a job. But this posed a problem since, in a dynamic capitalist market, unemployment was a distinct possibility. The division of labor created by the market meant that many workers had skills that were highly specialized and suited for only a narrow range of jobs. The market created shifting wants, and increased demand for new products meant decreased demand for older ones. Men whose lives had been devoted to their role in the production of the old products were left without jobs, and without the training that would allow them to find new work. And the mechanization of production also led to a loss of jobs. From its very beginnings, in other words, the creativity and innovation of industrial capitalism were shadowed by insecurity for members of the work force.

Marx and Engels provided a compelling picture of capitalism's dynamism, insecurity, refinement of needs, and expansion of cultural possibilities in *The Communist Manifesto*:

> *The bourgeoisie has, through its exploitation of the world market, given a cosmopolitan character to production and consumption in every country. To the great chagrin of reactionaries, it has drawn from under the feet of industry the national ground on which it stood. All old-established national industries have been destroyed or are daily being destroyed. They are dislodged by new industries, whose introduction becomes a life and death question for all civilized nations, by industries that no longer work up indigenous raw material, but raw material drawn from the remotest zones; industries whose products are consumed, not only at home, but in every quarter of the globe. In place of the old wants, satisfied by the production of the country, we find new wants, requiring for their satisfaction the products of distant lands and climes. In place of the old local and national seclusion and self-sufficiency, we have intercourse in every direction, universal interdependence of nations.*

In the 20th century, the economist Joseph Schumpeter would expand on these points in his characterization of capitalism as a continuous process of "creative destruction" in which new products and forms of distribution and organization displaced older forms. Unlike Marx, however, who saw the source of this dynamism in the disembodied quest of "capital" to increase (at the expense, he thought, of the working class), Schumpeter focused on the role of the entrepreneur, an innovator who introduced new commodities and discovered new markets and methods.

The dynamism and insecurity created by 19th-century industrial capitalism led to the creation of new institutions for the reduction of insecurity, including the limited liability corporation, which worked to spread and so limit investor risks; labor unions, to further worker interests; mutual-aid societies, to provide loans and burial insurance; and commercial life insurance. But then came the Great Depression. And in the middle decades of the 20th century, in response to the mass unemployment and deprivation—and the political appeal of both communism and fascism as a viable alternatives to capitalist democracy itself—Western democracies began to adopt elements of the welfare state. Different nations created different combinations of specific programs, but the new welfare states had a good deal in common, including old-age and unemployment insurance and various measures to support families.

The expansion of the welfare state in the decades after World War II took place at a time when the capitalist economies of the West were growing rapidly. The success of the industrial economy made it possible to siphon off corporate profits and wages through taxation for social purposes and "redistribution" by government. The demographics of the postwar era, in which the breadwinner-homemaker model of the family predominated, also contributed to such redistribution, as moderately high birthrates created a favorable ratio of active workers to dependents. Educational opportunities expanded, as elite universities increasingly admitted students on the basis of their academic achievements and potential, and more and more people attended institutions of higher education. And barriers to full participation in society for women and minorities began to fall as well. The result of all of this was a temporary equilibrium during which the advanced capitalist countries experienced strong economic growth, high employment, and relative socioeconomic equality.

LIFE IN THE POSTINDUSTRIAL ECONOMY

For humanity in general, the late 20th and early 21st centuries have been a period of remarkable progress, due in no small part to the spread of capitalism around the globe. Economic liberalization in China, India, Brazil, Indonesia, and other countries in the developing world has allowed hundreds of millions of people to escape grinding poverty and move into the middle class. Consumers in more advanced capitalist countries such as the United States, meanwhile, have experienced a radical reduction in the price of many commodities, from clothes to televisions, and the availability of a river of new goods that have transformed their lives.

Most remarkable, perhaps, have been changes to the means of self-cultivation. As the economist Tyler Cowen notes, much of the fruit of recent developments "is in our minds and in our laptops and not so much in the revenue-generating sector of the economy." As a result, "much of the value of the internet is experienced at the personal level and so will never show up in the productivity numbers." Many of the great musical performances of the 20th century, in every genre, are now available on YouTube for free. Many of the great films of the 20th century, once confined to occasional showings at art houses in a few metropolitan areas, can be viewed by anybody at any time for a small monthly charge. Soon, the great university libraries will be available online to the entire world, and other unprecedented opportunities for personal development will follow.

All this progress, however, has been shadowed by capitalism's perennial features of inequality and insecurity. In 1973, the sociologist Daniel Bell noted that in the advanced capitalist world, knowledge, science, and technology were driving a transformation to what he termed "postindustrial society." Just as manufacturing had previously displaced agriculture as the major source of employment, he argued, so the service sector was now displacing manufacturing. In a postindustrial, knowledge-based economy, the production of manufactured goods depended more on technological inputs than on the skills of the workers who actually built and assembled the products.

That meant a relative decline in the need for and economic value of skilled and semiskilled factory workers—just as there had previously been a decline in the need for and value of agricultural laborers. In such an economy, the skills in demand included scientific and technical knowledge and the ability to work with information. The revolution in information technology that has swept through the economy in recent decades, meanwhile, has only exacerbated these trends.

One crucial impact of the rise of the postindustrial economy has been on the status and roles of men and women. Men's relative advantage in the preindustrial and industrial economies rested in large part on their greater physical strength—something now ever less in demand. Women, in contrast, whether by biological disposition or socialization, have had a relative advantage in human skills and emotional intelligence, which have become increasingly more important in an economy more oriented to human services than to the production of material objects. The portion of the economy in which women could participate has expanded, and their labor has become more valuable—meaning that time spent at home now comes at the expense of more lucrative possibilities in the paid work force.

This has led to the growing replacement of male breadwinner–female homemaker households by dual-income households. Both advocates and critics of the move of women into the paid economy have tended to overemphasize the role played in this shift by the ideological struggles of feminism, while underrating the role played by changes in the nature of capitalist production. The redeployment of female labor from the household has been made possible in part by the existence of new commodities that cut down on necessary household labor time—such as washing machines, dryers, dishwashers, water heaters, vacuum cleaners, microwave ovens. The greater time devoted to market activity, in turn, has given rise to new demand for household-oriented consumer goods that require less labor—such as packaged and prepared food—and the expansion of restaurant and fast-food eating. And it has led to the commodification of care, as the young, the elderly, and the infirm are increasingly looked after not by relatives but by paid minders.

The trend for women to receive more education and greater professional attainments has been accompanied by changing social norms in the choice of marriage partners. In the age of the breadwinner-homemaker marriage, women tended to place a premium on earning capacity in their choice of partners. Men, in turn, valued the homemaking capacities of potential spouses more than their vocational attainments. It was not unusual for men and women to marry partners of roughly the same intelligence, but women tended to marry men of higher levels of education and economic achievement. As the economy has passed from an industrial economy to a postindustrial service and-information economy, women have joined men in attaining recognition through paid work, and the industrious couple today (thanks to a process dubbed "assortative mating") is more likely to be made of peers, with more equal levels of education and more comparable levels of economic achievement.

INEQUALITY ON THE RISE

These postindustrial social trends have had a significant impact on inequality. If, thanks to assortative mating, family income doubles at each step of the economic ladder, then the total incomes of those families higher up the ladder are bound to increase faster than the total incomes of those further down. But for a substantial portion of households at the lower end of the ladder, there has been no doubling at all. For as the relative pay of women has grown and the relative pay of less-educated, working-class men has declined, the latter have been viewed as less and less marriageable. Often, the limitations of human capital that make such men less employable also make them less desirable as companions, and the character traits of the chronically unemployed often deteriorate as well. With less to bring to the table, such men are regarded as less necessary—in part because women can now count on provisions from the welfare state as an additional independent source of income, however meager.

In the United States, among the most striking developments of recent decades has been the stratification of marriage patterns among the various classes and ethnic groups of society. When divorce laws were loosened in the 1960s, there was a rise in divorce rates among all classes. But by the 1980s, a new pattern had emerged: divorce declined among the more educated portions of the populace, while rates among the less-educated portions continued to rise. In addition, the more educated and more well-to-do were more likely to wed, while the less educated were less likely to do so.

Given the family's role as an incubator of human capital, such trends have had important spillover effects on inequality. Abundant research shows that children raised by two parents in an ongoing union are more likely to develop the self-discipline and self-confidence that make for success in life, whereas children—particularly boys—reared in single-parent households (or, worse, households with a mother who has a series of temporary relationships) have a greater risk of adverse outcomes.

All of this has been taking place during a period of growing equality of access to education and increasing stratification of marketplace rewards, both of which have increased the importance of human capital. One element of human capital is cognitive ability: quickness of mind, the ability to infer and apply patterns drawn from experience, and the ability to deal with mental complexity. Another is character and social skills: self-discipline, persistence, responsibility. And a third is actual knowledge. All of these are becoming increasingly crucial for success in the postindustrial marketplace. As the social analyst Brink Lindsey notes in his recent book *Human Capitalism*, between 1973 and 2001, average annual growth in real income was only 0.3% for people in the bottom fifth of the US income distribution, as compared to 0.8% for people in the middle fifth and 1.8% for those in the top fifth. Somewhat similar patterns also prevail in many other advanced economies.

Globalization has not caused this pattern of increasingly unequal returns to human capital but has reinforced it. The economist Michael Spence has distinguished between "tradable" goods and services, which can be easily imported and exported, and "untradable" ones, which cannot. Increasingly, tradable goods and services are imported to advanced capitalist societies from less advanced capitalist societies, where labor costs are lower. As manufactured goods and routine services are outsourced, the wages of the relatively unskilled and uneducated in advanced capitalist societies decline further, unless these people are somehow able to find remunerative employment in the untradable sector.

THE IMPACT OF MODERN FINANCE

Rising inequality, meanwhile, has been compounded by rising insecurity and anxiety for people higher up on the economic ladder. One trend contributing to this problem has been the financialization of the economy, above all in the United States, creating what was characterized as "money manager capitalism" by the economist Hyman Minsky and has been called "agency capitalism" by the financial expert Alfred Rappaport.

As late as the 1980s, finance was an essential but limited element of the US economy. The trade in equities (the stock market) was made up of individual investors, large or small, putting their own money in stocks of companies they believed to have good long-term prospects. Investment capital was also available from the major Wall Street investment banks and their foreign counterparts, which were private partnerships in which the partners' own money was on the line. All of this began to change as larger pools of capital became available for investment and came to be deployed by professional money managers rather the owners of the capital themselves.

One source of such new capital was pension funds. In the postwar decades, when major American industries emerged from World War II as oligopolies with limited competition and large, expanding markets at home and abroad, their profits and future prospects allowed them to offer employees defined-benefit pension plans, with the risks involved assumed by the companies themselves. From the 1970s on, however, as the US economy became more competitive, corporate profits became more uncertain, and companies (as well as various public-sector organizations) attempted to shift the risk by putting their pension funds into the hands of professional money managers, who were expected to generate significant profits. Retirement income for employees now depended not on the profits of their employers but on the performance of their pension funds.

Another source of new capital was university and other nonprofit organizations' endowments, which grew initially thanks to donations but were increasingly expected to grow further based on their investment performance. And still another source of new capital came from individuals and governments in the developing world, where rapid economic growth, combined with a high propensity to save and a desire for relatively secure investment prospects, led to large flows of money into the US financial system.

Spurred in part by these new opportunities, the traditional Wall Street investment banks transformed themselves into publicly traded corporations—that is to say, they, too, began to invest not just using their own funds but also other people's money—and tied the bonuses of their partners and employees to annual profits. All of this created a highly competitive financial system dominated by investment managers working with large pools of capital, paid based on their supposed ability to outperform their peers. The structure of incentives in this environment pressured many fund managers to try to maximize short-term returns, and this pressure trickled down to corporate executives. The shrunken time horizon created a temptation to boost immediate profits at the expense of longer-term investments, whether in research and development or in improving the skills of the company's work force. For both the managers and the employees of such companies, the result has been a constant churning that increases the likelihood of job losses and economic insecurity.

To be sure, an advanced capitalist economy requires a vibrant financial sector with well-functioning capital markets and public companies. Part of this is a simple extension of the division of labor: outsourcing decisions about investing to professionals allows the rest of the population the mental space to pursue things they do better or care more about. The increasing complexity of capitalist economies means that entrepreneurs and corporate executives need help in deciding when and how to raise funds. And private equity firms that have an ownership interest in growing the real value of the firms in which they invest play a key role in fostering economic growth.

Because these matters have such important consequences, and handling them effectively requires intelligence, diligence, and drive, it is neither surprising nor undesirable that specialists in this area are highly paid. But whatever its benefits and continued social value, the financialization of society has nevertheless had the effect of increasing income inequality by raising the top of the economic ladder (thanks to the extraordinary rewards for senior executives) and, in many cases, creating insecurity among lower-level managers and employees of public companies subjected to global competition and excessive pressure to meet near-term earnings targets.

THE FAMILY AND HUMAN CAPITAL

In today's globalized, financialized, postindustrial environment, human capital is more important than ever in determining life chances. This makes families more important, too, because as each generation of social science researchers discovers anew (and much to their chagrin), the resources transmitted by the family tend to be highly determinative of success in school and in the workplace. As the economist Friedrich Hayek pointed out half a century ago in *The Constitution of Liberty*, the main impediment to true equality of opportunity is that there is no substitute for intelligent parents or for an emotionally and culturally nurturing family. In the words of a recent study by the economists Pedro Carneiro and James Heckman, "Differences in levels of cognitive and noncognitive skills by family income and family background emerge early and persist. If anything, schooling widens these early differences."

Hereditary endowments come in a variety of forms: genetics, prenatal and postnatal nurture, and the cultural orientations conveyed within the family. Money matters, too, of course, but is often less significant than these largely nonmonetary factors. (The prevalence of books in a household is a better predictor of higher test scores than family income.) Over time, to the extent that societies are organized along meritocratic lines, family endowments and market rewards will tend to converge.

Educated parents tend to invest more time and energy in childcare, even when both parents are engaged in the work force. And families strong in human capital are more likely to make fruitful use of the improved means of cultivation that contemporary capitalism offers (such as the potential for online enrichment) while resisting their potential snares (such as unrestricted viewing of television, playing of computer games, and engagement with social media).

This affects the ability of children to make use of formal education, which is increasingly, at least potentially, available to all regardless of economic or ethnic status. At the turn of the twentieth century, only 6.4% of American teenagers graduated from high school, and only one in 400 went on to college. There was thus a huge portion of the population with the capacity, but not the opportunity, for greater educational achievement. Today, the US high school graduation rate is about 75% (down from a peak of about 80% in 1960), and roughly 40% of young adults are enrolled in college.

The Economist recently repeated the shibboleth that "In a society with broad equality of opportunity, the parents' position on the income ladder should have little impact on that of their children." The fact is, however, that the greater equality of institutional opportunity there is, the more families' human capital endowments matter. As the political scientist Edward Banfield noted a generation ago in *The* Unheavenly *City Revisited*, "All education favors the middle- and upper-class child, because to be middle- or upper-class is to have qualities that make one particularly educable." Improvements in the quality of schools may improve overall educational outcomes, but they tend to increase, rather than diminish, the gap in achievement between children from families with different levels of human capital. Recent investigations that purport to demonstrate less intergenerational mobility in the United States today than in the past (or than in some European nations) fail to note that this may in fact be an unintended and unwanted effect of generations of increasing equality of opportunity. And in this respect, it is possible that the United States may simply be on the leading edge of trends found in other advanced capitalist societies as well.

DIFFERENTIAL GROUP ACHIEVEMENT

The family is not the only social institution to have a major impact on the development of human capital and eventual success in the marketplace. So do communal groupings, such as those of religion, race, and ethnicity. In his 1905 book, *The Protestant Ethic and the Spirit of Capitalism*, the sociologist Max Weber observed that in religiously diverse areas, Protestants tended to do better economically than Catholics, and Calvinists better than Lutherans. Weber presented a cultural explanation for this difference, grounded in the different psychological propensities created by the different faiths. A few years later, in *The Jews and Modern Capitalism*, Weber's contemporary Werner Sombart offered an alternative explanation for differential group success, based partly on cultural propensities and partly on racial ones. And in 1927, their younger colleague Schumpeter titled a major essay "Social Classes in an Ethnically Homogeneous Environment" because he took it for granted that in an ethnically mixed setting, levels of achievement would vary by ethnicity, not just class.

The explanations offered for such patterns are less important than the fact that differential group performance has been a perennial feature in the history of capitalism, and such differences continue to exist today. In the contemporary United States, for example, Asians (especially when disaggregated from Pacific Islanders) tend to outperform non-Hispanic whites, who in turn tend to outperform Hispanics, who in turn tend to outperform African Americans. This is true whether one looks at educational achievement, earnings, or family patterns, such as the incidence of nonmarital births.

Those western European nations (and especially northern European nations) with much higher levels of equality than the United States tend to have more ethnically homogeneous populations. As recent waves of immigration have made many advanced postindustrial societies less ethnically homogeneous, they also seem to be increasingly stratifying along communal lines, with some immigrant groups exhibiting more favorable patterns than the preexisting population and other groups doing worse. In the United Kingdom, for example, the children of Chinese and Indian immigrants tend to do better than the indigenous population, whereas those of Caribbean blacks and Pakistanis tend to do worse. In France, the descendants of Vietnamese tend to do better, and those of North African origin tend to do worse. In Israel, the children of Russian immigrants tend to do better, while those of immigrants from Ethiopia tend to do worse. In Canada, the children of Chinese and Indians tend to do better, while those of Caribbean and

Latin American origin tend to do worse. Much of this divergence in achievement can be explained by the differing class and educational backgrounds of the immigrant groups in their countries of origin. But because the communities themselves act as carriers and incubators of human capital, the patterns can and do persist over time and place.

In the case of the United States, immigration plays an even larger role in exacerbating inequality, for the country's economic dynamism, cultural openness, and geographic position tend to attract both some of world's best and brightest and some of its least educated. This raises the top and lowers the bottom of the economic ladder.

WHY EDUCATION IS NOT A PANACEA

A growing recognition of the increasing economic inequality and social stratification in postindustrial societies has naturally led to discussions of what can be done about it, and in the American context, the answer from almost all quarters is simple: education.

One strand of this logic focuses on college. There is a growing gap in life chances between those who complete college and those who do not, the argument runs, and so as many people as possible should go to college. Unfortunately, even though a higher percentage of Americans are attending college, they are not necessarily learning more. An increasing number are unqualified for college-level work, many leave without completing their degrees, and others receive degrees reflecting standards much lower than what a college degree has usually been understood to mean.

The most significant divergence in educational achievement occurs before the level of college, meanwhile, in rates of completion of high school, and major differences in performance (by class and ethnicity) appear still earlier, in elementary school. So, a second strand of the education argument focuses on primary and secondary schooling. The remedies suggested here include providing schools with more money, offering parents more choice, testing students more often, and improving teacher performance. Even if some or all of these measures might be desirable for other reasons, none has been shown to significantly diminish the gaps between students and between social groups—because formal schooling itself plays a relatively minor role in creating or perpetuating achievement gaps.

The gaps turn out to have their origins in the different levels of human capital children possess when they enter school—which has led to a third strand of the education argument, focusing on earlier and more intensive childhood intervention. Suggestions here often amount to taking children out of their family environments and putting them into institutional settings for as much time as possible (Head Start, Early Head Start) or even trying to resocialize whole neighborhoods (as in the Harlem Children's Zone project).

Though there are examples of isolated successes with such programs, it is far from clear that these are reproducible on a larger scale. Many programs show short-term gains in cognitive ability, but most of these gains tend to fade out over time, and those that remain tend to be marginal. It is more plausible that such programs improve the noncognitive skills and character traits conducive to economic success—but at a significant cost and investment, employing resources extracted from the more successful parts of the population (thus lowering the resources available to them) or diverted from other potential uses.

For all these reasons, inequality in advanced capitalist societies seems to be both growing and ineluctable, at least for the time being. Indeed, one of the most robust findings of contemporary social scientific inquiry is that as the gap between high-income and low-income families has increased, the educational and employment achievement gaps between the children of these families has increased even more.

WHAT IS TO BE DONE?

Capitalism today continues to produce remarkable benefits and continually greater opportunities for self-cultivation and personal development. But now as ever, those upsides are coming with downsides, particularly increasing inequality and insecurity. As Marx and Engels accurately noted, what distinguishes capitalism from other social and economic systems is its "constant revolutionizing of production, uninterrupted disturbance of all social conditions, [and] everlasting uncertainty and agitation."

At the end of the 18th century, the greatest American student and practitioner of political economy, Alexander Hamilton, had some profound observations about the inevitable ambiguity of public policy in a world of creative destruction:

> *Tis the portion of man assigned to him by the eternal allotment of Providence that every good he enjoys, shall be alloyed with ills, that every source of his bliss shall be a source of his affliction—except Virtue alone, the only unmixed good which is permitted to his temporal Condition… The true politician… will favor all those institutions and plans which tend to make men happy according to their natural bent which multiply the sources of individual enjoyment and increase those of national resource and strength—taking care to infuse in each case all the ingredients which can be devised as preventives or correctives of the evil which is the eternal concomitant of temporal blessing.*

Now as then, the question at hand is just how to maintain the temporal blessings of capitalism while devising preventives and correctives for the evils that are their eternal concomitant.

One potential cure for the problems of rising inequality and insecurity is simply to redistribute income from the top of the economy to the bottom. This has two drawbacks, however. The first is that over time, the very forces that lead to greater inequality reassert themselves, requiring still more, or more aggressive, redistribution. The second is that at some point, redistribution produces substantial resentment and impedes the drivers of economic growth. Some degree of post-market redistribution through taxation is both possible and necessary, but just how much is ideal will inevitably be contested, and however much it is, it will never eliminate the underlying dynamics.

A second cure—the use of government policy to close the gaps between groups by offering preferential treatment to underperformers—is likely to be worse than the disease. Whatever their purported benefits, mandated rewards to certain categories of citizens inevitably create a sense of injustice among the rest of the population. More grave is their cost in terms of economic efficiency since, by definition, they promote less-qualified individuals to positions they would not attain on the basis of merit alone. Similarly, policies banning the use of meritocratic criteria in education, hiring, and credit simply because they have a "differential impact" on the fortunes of various communal groups or because they contribute to unequal social outcomes will inevitably reduce the quality of the educational system, the work force, and the economy.

A third possible cure—encouraging continued economic innovation that will benefit everybody—seems the most promising. The combination of the Internet and computational revolutions may prove comparable to the coming of electricity, which facilitated an almost unimaginable range of other activities that transformed society at large in unpredictable ways. Among other gains, the Internet has radically increased the velocity of knowledge, a key factor in capitalist economic growth since at least the 18th century. Add to that the prospects of other fields still in their infancy, such as biotechnology, bioinformatics, and nanotechnology, and the prospects for future economic growth and the ongoing improvement of human life look reasonably bright.

Nevertheless, even continued innovation and revived economic growth will not eliminate or even significantly reduce socioeconomic inequality and insecurity, because individual, family, and group differences will still affect the development of human capital and professional accomplishment. And thus for capitalism to continue to be made legitimate and palatable to populations at large—including those on the lower and middle rungs of the socioeconomic ladder, losers as well as winners—government safety nets that help diminish insecurity, alleviate the sting of failure in the marketplace, and help maintain equality of opportunity will have to be maintained and revitalized. Such programs already exist in most of the advanced capitalist world, including the United States, and the political Right needs to accept that they serve an indispensable purpose and so must be preserved rather than gutted. In sum, major government social welfare spending is a proper response to some inherently problematic features of capitalism, not a "beast" that should be "starved."

In the United States, for example, measures such as Social Security, unemployment insurance, food stamps, the Earned Income Tax Credit, Medicare, Medicaid, and the additional coverage provided by the Affordable Care Act offer aid and comfort above all to those less successful in and more buffeted by today's economy. It is unrealistic to imagine that the popular demand for such programs will diminish. It is uncaring to cut back the scope of such programs when inequality and insecurity have risen.

And the enlightened self-interest of those who profit most from living in a society of capitalist dynamism should lead them to recognize the shortsightedness and folly of refusing to part with some of their market gains in order to achieve continued social and economic stability. Government entitlement programs may need structural reform, but the Right should accept that a reasonably generous welfare state is here to stay, and for eminently sensible reasons.

The Left in turn needs to come to grips with the fact that aggressive attempts to eliminate inequality may be both too expensive and futile. The very success of past attempts to increase equality of opportunity—such as by expanding access to education and outlawing various forms of discrimination—means that in advanced capitalist societies today, large, discrete pools of untapped human potential are increasingly rare. Additional measures to promote equality are therefore likely to produce fewer gains than their predecessors, and at greater cost. And insofar as such measures involve diverting resources from those with more human capital to those with less, or bypassing criteria of achievement and merit, they are likely to reduce the economic dynamism and growth on which the existing welfare state depends.

The challenge for government policy in the advanced capitalist world is thus how to maintain a rate of economic dynamism that will provide increasing benefits for all while still managing to pay for the social welfare programs required to make citizens' lives bearable under conditions of increasing inequality and insecurity. Different countries will approach this challenge in different ways that reflect differences in their own priorities, traditions, size, and demographic and economic characteristics. (It is among the illusions of the age that when it comes to government policy, nations can borrow at will from one another).

But a useful starting point might be to reject both the politics of privilege and the politics of resentment and adopt a cleareyed view of what capitalism actually involves, as opposed to the idealization of its worshipers and the demonization of its critics.

KEYWORDS
capitalism, education, family, inequality

How to cite this article: Muller, Jerry Z. 2024. "Capitalism and Inequality: What the Right and the Left Get Wrong." *Journal of Applied Corporate Finance* :1–8. https://doi.org/10.1111/jacf.12600

DOI: 10.1111/jacf.12610

Journal of
APPLIED
CORPORATE FINANCE

REPRINT

Nationalism and capitalism

Jerry Z. Muller

Catholic University of America, Washington, District of Columbia, USA

Correspondence
Jerry Z. Muller, Catholic University of America, Washington, D.C., 20064, USA.
Email: mullerj@cua.edu

The original version of this article appeared in Cathie Carmichael, Mathew D'Auria, Aviel Roshwald (ed.) *The Cambridge History of Nationhood and Nationalism*, Vol. 2 (2024), pp.523-537.

INTRODUCTION

The relationship between capitalism and nationalism escapes easy generalization—hardly surprising given the many conceptions of nationalism and the many stages and varieties of capitalism. Let us begin, then, with some ideal-typical definitions—that is, with a model to which particular historical situations will approximate to varying degrees.

Nationalism is a form of politicized ethnicity in which a self-identified cultural group seeks or succeeds in creating a nation-state of its own. It also refers to ideological goals and tangible policies designed to preserve or strengthen the nation-state.

There are as many ways of defining capitalism as there are of nationalism. For our purposes, the following definition is most useful: Capitalism is a political-economic system in which property rights are legally protected by the state, in which prices are set primarily by supply and demand in a market composed of profit-seeking entrepreneurs or companies, usually (but not always) employing free wage labor. Or, to put it another way, a capitalist society is characterized by "commodification," in the sense that most people buy most of the things they consume, and do so with the proceeds gained from selling most of what they produce. Like our definition of nationalism, this definition is also a model intended to help us grasp how the various elements of a phenomenon are related to one another. In historical reality, of course, you will find exceptions to almost all elements of the characterization.

This essay starts by looking at some broad patterns in the historical relationship between nationalism and capitalism, including the development of modern nationalism *in the absence of* capitalism. It then explores some prominent social scientific explanations for the linkage of nationalism and capitalism, especially the theory of its most sophisticated expositor, Ernest Gellner. Next, it outlines arguments that capitalism is antipathetic to nationalism and ends up undermining it and the policies that have flowed from that understanding. It concludes by examining debates from the 18th century to the present about whether free trade or protectionism is more conducive to national power, and the policies that have followed from those debates.

SOME BROAD PATTERNS

Nationalism and capitalism have often gone together but in different ways. Historically, both have been means of mobilizing populations and resources to increase state power. In early modern Europe, for example, statecraft often aimed at commercial expansion to create economic growth. Some of that increased economic surplus would, in turn, be taxed by the state and thus provide the resources for an enhanced military and other government services. In this understanding, economic plenty—whether fostered by mercantilist or free trade policies—was seen as the primary means of enhancing state power, and state power was required to protect the commercial sources of plenty.[1] The drive to enhance state power often included campaigns to mobilize the larger populace, and few appeals were more plausible or effective than the appeal of nationalism.[2]

Such was the case in early modern Britain, for example,[3] and in the Japan of the Meiji era.[4] The combined cultivation of commerce and nationalism was more effective in states that already possessed a substantial degree of ethnic homogeneity, such as England, France, and Japan—and also among nationalist movements seeking to create nation-states by uniting populations that shared language and culture, as in the case of Germany.

[1] See the chapters on "The Nation-State and Private Enterprise" and "Power versus Plenty as Objectives of Foreign Policy in the Seventeenth and Eighteenth Centuries," in Viner, Jacob. 1991. *Essays on the Intellectual History of Economics*. Princeton: Princeton University Press; Hont, Istvan. 2005. *Jealousy of Trade: International Competition and the Nation-State in Historical Perspective*. Cambridge: Cambridge University Press, introduction and chapters 2 and 7.

[2] Gat, Azar. 2013. *Nations: The Long History and Deep Roots of Political Ethnicity and Nationalism*. Cambridge: Cambridge University Press, passim.

[3] Colley, Linda. 2005. *Britons: Forging the Nation, 1707–1837*, 2nd edition. New Haven: Yale University Press.

[4] Landes, David S. 1998. *The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor*. New York: W. W. Norton, chapter 23 is excellent on this; see also Greenfeld, Liah. 2001. *The Spirit of Capitalism: Nationalism and Economic Growth*. Cambridge, MA: Harvard University Press, chapter 5.

A different pattern emerged when the quest for power and plenty was pursued by multi-ethnic empires, which promoted capitalist economic development as part of their attempt at modernization. In such cases, the spread of capitalism had the effect of increasing ethno-national consciousness and conflict. As regions on the margin of the world capitalist economy are incorporated into it, multi-ethnic states invariably experience recurrent patterns of increased ethnic contention. That is because the first fruits typically fall to merchant ethnic minorities, whose relative success tends to be resented by the less commercially oriented majority.[5]

NATIONALISM WITHOUT CAPITALISM

Capitalism is by no means a prerequisite for the development of nationalism. For, as numerous historians have demonstrated—foremost among them, Azar Gat, in his *Nations: The Long History and Deep Roots of Political Ethnicity and Nationalism*—nationalism, understood as the overlap of peoplehood and political boundaries, generally comes well before the rise of capitalism, although with notable exceptions.[6] As an example of the latter, ethnic consciousness was deliberately cultivated in the decidedly non-capitalist Soviet Union, in a manner that unintentionally promoted the development of ethno-nationalist nation-states. In keeping with the Leninist dictum that policy was to be *socialist in content but national in form*,[7] the Soviet government during the 1920s and 1930s developed a policy of "indigenization" that called for "identifying, classifying, bounding, and in some cases inventing ethnic collectivities that would be assigned their own 'native' administrative units." Larger ethnic communities were allocated *republics*, in which their language was favored and in which they were to be promoted to positions of responsibility—a policy and set of practices that survived beyond the 1930s.[8]

As a result, Lenin and his successors succeeded in creating a sense of national consciousness—but one that can in turn be seen as fueling the independence movements in ethnically defined republics that came after the breakup of the Soviet Union. In this case, nationalism developed without capitalism, and as a direct consequence, partly intended and partly not, of communist policy.

GELLNER AND THE MODERNIST ARGUMENT

The "modernist" conception of nationalism asserts that it is a distinctly modern phenomenon, one made possible by the rise of capitalism, print, urbanization, mass education, and political mobilization. Its foremost expositor was Ernst Gellner (1925–1995), an English social scientist and polymath born and raised in Prague. In his classic *Nations and Nationalism*, first published in 1983, Gellner posited a linkage between capitalism and the development of nationalism.

His was a historical explanation that highlights the role of economic factors without resorting to economic reductionism or a focus on class conflict as the major driving force in history. Gellner's major contention was that nationalism was an inevitable byproduct of modern commercial industrial society and that the nation-state therefore became the characteristic political form of modern industrial society.[9] He eschewed the use of the term "capitalism," preferring the term "industrialization" or "industrial society." But he used those terms "in a broader sense" that was meant to take account of

> *the earlier commercialisation of society, which only becomes 'industrial' in a narrower sense (power machinery, large-scale production) later, thereby however allowing the social changes already initiated by commercialism to be preserved, extended and to become entrenched.*[10]

In the mid-19th century, as Gellner noted, most of Europe and the contiguous regions of Russia and Asia were organized not as nation-states but as *empires*. His focus was on the development of nation-states out of those great multi-ethnic empires.

In each of these empires, Gellner argued, the social and political structure had been stratified by ethnicity. The governing monarchy and landed nobility were often different in terms of language and ethnic origin from those who conducted trade and commerce in the towns. Those who conducted trade and commerce were usually different in language, ethnicity, and often religion from the peasants who made up most of the population. In the Habsburg and Romanov empires, those who conducted trade and commerce were often Germans or Jews. In the Ottoman Empire, the merchants were often Greek, Armenian, or Jewish. In each of these empires, the peasant population was often ethnically diverse, with, say, Polish and Ukrainian speakers living in separate villages in the same region.

In the 19th century, these societies were still largely agrarian. Most people lived as peasants in the countryside, and few of them were literate. In this sort of agrarian society, each stratum of society lived a very distinct style of life, and most people did not expect to move out of their social positions. The children of peasants were taught to be peasant farmers. They did not know, nor did they aspire to know, much about commerce or government administration. The children of urban merchants had no desire to become peasants, nor could they reasonably aspire to nobility. Nobles, in most cases, looked with disdain upon commerce; that was déclassé, the sort of thing that only Jews, Greeks, or Armenians did.

In such a society, Gellner emphasized, social and economic stratification was largely a matter of ethnic stratification. People

[5] See, for example, Muller, Jerry Z. 2010. *Capitalism and the Jews*. Princeton: Princeton University Press; Chua, Amy. 2002. *World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability*. New York: Doubleday; and literature on merchant minorities.

[6] Gat, *Nations*, passim.

[7] Slezkine, Yuri. 1994. "The USSR as a Communal Apartment, or How a Socialist State Promoted Ethnic Particularism." *Slavic Review* 53/2(Summer): 414–452, esp. 418.

[8] Blitstein, Peter A. 2006. "Cultural Diversity and the Interwar Conjuncture: Soviet Nationality Policy in its Comparative Context." *Slavic Review* 65/2(Summer): 273–293, at 282; Slezkine, "USSR as a Communal Apartment," 445; Martin, Terry. 2002. *The Affirmative Action Empire: Nations and Nationalism in the Soviet Union, 1923–1939*. Ithaca: Cornell University Press.

[9] Gellner, Ernest. 1983. *Nations and Nationalism*. Ithaca: Cornell University Press.

[10] Gellner, Ernest. 1996. "Reply to Critics." In *The Social Philosophy of Ernest Gellner*, edited by John A. Hall and Ian Jarvie, 636. Amsterdam: Brill.

were educated largely by their families, and they were educated to perform the tasks typical of their ethnic group. The state had no interest in promoting homogeneity among these communities.[11] In a society with little possibility of vertical social mobility, social position was caste-like—and inherited social position seemed eternal and natural.[12] Until the rise of modern nationalism, all of this seemed quite unproblematic to most people.

According to Gellner, this set of arrangements began to be called into question by the rise of modern ethno-nationalism. Its key precepts were that each people or nation needed its own state, and each state should be made up of a single people. Gellner contended that there was a functional reason for the rise of such ethno-nationalism—namely, that "the nation is a consequence of the functional necessities of industrial society,"[13] by which, as we have seen, Gellner meant the requirements of a capitalist society. Modern industrial societies, he argued, depend on the exchange of information to a much greater degree than earlier, agrarian societies. They depend therefore on near-universal literacy, a standard that was simply unimaginable in agrarian societies.

In agrarian societies, most people learn the trade they will occupy from their fathers and mothers. But modern industrial societies are more dynamic. They depend on the possibility of training individuals for a variety of jobs. Literacy is no longer the preserve of a specialized group; it becomes the precondition for all economic specialization. That means most people need to become literate and require education outside the family to be fit for work.[14] This requires standardized, universal education, and it gives new authority to those empowered to provide educational credentials. A state that seeks to make its population fit for industrialization must therefore *impose* education on its citizens, and since all parts of the population must be able to communicate with one another, the polity must impose some shared, common, literate culture.[15] And that is what most states—nation-states as well as imperial states—have tried to do, with varying degrees of effort and success, from the 18th century on.

There are economic stakes involved in membership in a shared, literate culture, since those who have not mastered the dominant language and idiom are disadvantaged.[16] But there are also social psychological stakes; insofar as the coming of capitalist society brings with it the erosion of many subgroups between the individual and the state, attachment to the political community of the nation increases, almost by default.[17]

There is a certain dynamism and egalitarianism built into the very structure of industrial society, as Gellner stressed. For "[i]ndustrial society is the only society ever to live by and rely on sustained and perpetual growth, on an expected and continuous improvement." Such a society is based on a vision of cognitive and economic growth, and on a division of labor that is both complex and changing. Since permanent barriers of rank would hamper this changing division of labor, modern industrial-capitalist society "has to be mobile whether it wishes to be so or not, because this is required by the satisfaction of its terrible and overwhelming thirst for economic growth." There is thus a degree of egalitarianism built into its ideological structure.[18]

At the same time, however, there is bound to be tension between the egalitarian promise of industrial society and its reality, especially when such a society is emerging from an ethnically stratified imperial agrarian past. For some groups do better than others. And that inevitable disparity of outcomes, Gellner contends, provides the motivation for ethnic political mobilization by those who do less well. Under circumstances of growing literacy and growing urbanization, the possibility of finding a job depends on the language one speaks and reads. Of course, some people can and do learn second and third languages. But for most people—especially newly educated peasants and workers—the language they know is the only one they are likely to learn. In a society based on the exchange of information, language becomes an important economic fact, for it influences the ease with which one can communicate, and with whom one can communicate. Those who speak a particular language come increasingly to identify with one another, as having something important in common.

That is why in the late 19th century, as Gellner explains, we find struggles over the language in which commerce, industry, education, and government were carried out. Each ethno-linguistic group united and lobbied to have these matters conducted in its own language.

Thus, in Gellner's account, there is an economic basis for the rise of ethno-nationalism. The result was that people began to identify themselves as members of one or another ethnic group and to improve the chances for their ethnic group, they insisted that *their* ethnic group should be regarded as a nation. In keeping with the tenets of nationalism, they demanded that their nation have a state of its own. In their own nation, they would be the masters.

Not all of these potential nationalisms led to the formation of nation-states. But when new nation-states were created in areas of mixed ethnicity, the state sought to create a homogeneous population and culture. It could do so in one of three ways: by killing, expelling, or assimilating non-nationals.[19] The third, and most humane, possibility—assimilation—has not proved to be the most frequent.

Gellner distinguishes between several ideal types of nationalism, all of which involve ethnicity. In Western Europe were the dynastic states along the European Atlantic seaboard (England, France, Spain, and Portugal), where a politically united, ethnically homogeneous state preceded the rise of industrial society.[20] Second are cases of "unificatory nationalism," such as Italy and Germany, "in which a fully effective high culture only needs a political roof," to unite existing smaller political entities.

Third is "eastern or Balkan nationalism," where a previously subordinate, often peasant culture was transformed into a literate, high culture, which was to provide the basis of an ethno-national

[11] Gellner, *Nations and Nationalism*, 10.
[12] Ibid., 11–13.
[13] Lessnoff, Michael. 2002. *Ernest Gellner and Modernity*. Cardiff: University of Wales Press, 33.
[14] Gellner, *Nations and Nationalism*, 27.
[15] Ibid., 18.
[16] Gellner, "Reply," 626.
[17] Gellner, *Nations and Nationalism*, 62. This argument was made earlier by Elie Kedourie. in *Nationalism*, 4th edition (Oxford: Blackwell, 1993), first published in 1960.

[18] Gellner, *Nations and Nationalism*, 22–23.
[19] Ibid., 2. For a relatively recent empirical exemplification of the processes described by Gellner (though the author fails to recognize this), see King, Jeremy. 2002. *Budweisers into Czechs and Germans: A Local History of Bohemian Politics, 1848–1948*. Princeton: Princeton University Press.
[20] Lessnoff, Ernest Gellner, 35. 21

state. Such aspiring nationalisms struggled "in ferocious rivalry with similar competitors, over a chaotic ethnographic map of many dialects, with ambiguous historical or linguo-genetic allegiances." The attempt to create ethno-national states under these circumstances required a great deal of cultural engineering, exchange or expulsion of population, forcible assimilation, and sometimes even liquidation "in order to attain that close relationship between state and culture which is the essence of nationalism."[21]

In addition to these three types of nationalism, there is a fourth, which Gellner terms "diaspora nationalism." Gellner mentions under this rubric Greeks, Armenians, Parsees, overseas Chinese, Indians, and Ibos in Nigeria. But the paradigmatic, if extreme, case is represented by the Jews. Diaspora nationalism is a reaction to the rise of the other types of nationalism. It occurs among groups who in the earlier, ethnically segmented agrarian order had been accorded a status which combined political powerlessness with stigmatized but necessary occupations such as finance. Such groups had been tolerated at the price of political and military impotence. In addition to this tradition of alienation from the means of violence, their military weakness is intensified by their geographical dispersion and the lack of a compact territorial base.

Under conditions of legally free competition and economic development, Gellner argues, "their previous training and orientation often make them perform much more successfully than their ethnic rivals"[22]—more successfully than not only the children of peasants, but the old landed and military nobility as well. As Gellner observes about "the ruling strata" of traditional agrarian societies,

> *[they]are often imbued with an ethos which values warfare, impulsive violence, authority, land-owning, conspicuous leisure and expenditure, and which spurns orderliness, time or other budgeting, trade, application, thrift, systematic effort, forethought and book learning.*

But these disdained traits are precisely those traditionally cultivated by the stigmatized commercial minority. As a result, when the legal barriers to competition come down, members of that minority do disproportionately well.[23]

But now their economic and cultural success is a source of envy and danger. The occupations in which such groups excel, from commerce and finance to the free professions, are now, in theory, open to and coveted by all. The traditional nobility and the ethnically dominant majority find themselves in the economic shadow of the once despised and now envied ethnic minority. The state, which once had an interest in protecting such minorities in the age of ethnically segmented agrarian empires (where they were easy to milk as a source of revenue), now finds that it has more of an interest in buying off the discontent of the wider population by dispossessing and persecuting the envied minority. Though "sometimes a precarious and uneasy balance is maintained," "the consequences range from genocide to expulsion."[24]

[21] Gellner, *Nations and Nationalism*, 99.
[22] Ibid., 104–105.
[23] Ibid., 91.
[24] Ibid., 105–106.

Azar Gat has argued that the modernist conception is based on an unwarranted extrapolation from a limited set of cases for which this explanation works well. That is especially the case for east-central Europe, the region from which many of the foremost "modernist" theorists of nationalism hailed—notably, Gellner, Hans Kohn, and Eric Hobsbawm—and the experience of which they used as the basis of their conception of nationalism. But as Gat shows, in many parts of the world, including China, Japan, and much of Southeast Asia, national identity long preceded the modern era.[25]

OTHER MATERIALIST EXPLANATIONS

Another social scientist who attempted to chart the causal links between nationalism and capitalism was Benedict Anderson. In his *Imagined Communities*, first published in 1983, Anderson made the startling claim that nationalism first began in colonial Latin America, made possible by what he termed "print capitalism," by which he meant the commercial circulation of books and journals. Such communication, he contended, made it possible for creole elites to "imagine" themselves as part of a distinct community, composed of individuals who did not know one another but who shared a common sense of identity made possible by a shared culture in a vernacular language—a culture that could be shared because of the dissemination made possible by print capitalism.[26]

A similar process, he argued, occurred in Europe beginning in the later 18th century. From there, it could be adopted elsewhere in the world as an ideological "module," a packaged ideology.[27] But this claim has invited skepticism, not least because, as Azar Gat, Aviel Roshwald, and others have shown, "rumors of nationalism's recent birth as a general phenomenon have been greatly exaggerated."[28]

In the Marxist interpretation, articulated for example by Eric Hobsbawm, the emphasis is on the manipulation of nationalist sentiment as an ideological remedy to the class conflict created by capitalist development. Here national consciousness is ultimately understood as a form of false consciousness—since the correct view would be for the workers to regard themselves primarily as members of a common, international class with shared class interests. In this interpretation, nationalism is created and manipulated by ruling elites to prevent the workers from attaining "true" consciousness. Hence the emphasis of Hobsbawm and others influenced by him on the deliberate invention of nationalist traditions.[29]

[25] Gat, *Nations*, chapter 1.
[26] Anderson, Benedict. 2006. *Imagined Communities*, revised edition, London: Verso, 36–46.
[27] Ibid., 157.
[28] Roshwald, Aviel. 2006. *The Endurance of Nationalism*. Cambridge: Cambridge University Press, 10.
[29] Hobsbawm, Eric J. 1987. *The Age of Empire, 1875–1914*. New York: Pantheon, ch. 6; Hobsbawm, Eric J. 1992. *Nations and Nationalism since 1780: Programme, Myth, and Reality*, 2nd edition. Cambridge: Cambridge University Press; Hobsbawm, Eric J. and Terence Ranger, eds. 1983. *The Invention of Tradition*. Cambridge: Cambridge University Press.

DOES CAPITALISM COUNTERACT NATIONALISM?

In contrast to explanations that stress the positive relationship between nationalism and capitalism, intellectuals of various stripes have argued since at least the 18th century that the spread of commerce weakens ethnic and national particularity, and creates bonds of common interest across ethno-national groups. Those of a broadly liberal orientation, such as Voltaire or Adam Smith, have tended to welcome this development. Defenders of national particularity (such as Hans Freyer), by contrast, have agreed with the analysis but diverged in evaluation, viewing international commerce (later rechristened "globalization") as a threat to national particularity and national self-determination. The international economy, they argued, gave rise to more cosmopolitan tastes, as well as identifications and allegiances beyond the nation.[30] In addition, international economic ties and commitments were thought to weaken the ability of the state to protect the nation's economy.

The response, in the 1930s, was a variety of attempts aimed at promoting national economic self-sufficiency at the expense of international trade.[31] In the late 20th and early 21st centuries, analysts have pointed to the resurgence of nationalism (as well as other movements of cultural particularity) as a response to intensified capitalist globalization.[32]

NATIONAL POWER: FREE TRADE VERSUS PROTECTIONISM

An ongoing set of policy debates concerns the role of free trade versus protectionism in the pursuit of national power. Both sides of this debate are broadly pro-capitalist, but they diverge over issues of economic policy.

In *The Wealth of Nations*, Adam Smith made a powerful argument in favor of the benefits of international free trade between nations and one that would have great influence in the 19th century and beyond. Smith was not an antinationalist, but one of the main goals of his book was to present a more pacific conception of the economic relations between nations, as opposed to the dominant view of his time, which regarded international economic competition as a species of warfare.

Smith's argument rested in good part on the productive advantages of the division of labor, advantages that grew with the scope of the market. Thus, for Smith, the arguments in favor of freer domestic trade should be extended to international trade, which increased the scope of the market even more, leading to greater productivity and making possible the "universal opulence" that was the goal of his system.[33] Smith's argument in favor of international trade was extended and expanded a generation later by David Ricardo's theory of comparative advantage, which maintained that each nation profited from specializing in the production and export of those commodities in which it had a comparative (not absolute) advantage.

ALEXANDER HAMILTON AND THE CASE FOR PROTECTING "INFANT INDUSTRIES"

But Smith's arguments in favor of international free trade did not go unchallenged. Arguments in favor of one or another form of protectionism often had as their explicit premise that the goal of economic policy was to strengthen the economy, society, or military prowess of the nation as such, in ways that transcended the needs of individual consumers.

Among the most effective arguments in favor of national protectionism was that developed by Alexander Hamilton, who became the first Secretary of the Treasury of the United States in 1789. In 1791, he submitted to Congress his "Report on the Subject of Manufactures."[34] For Hamilton, the issue was how to bring about the capitalist development of a relatively underdeveloped nation, underdeveloped relative to the leading world capitalist powers, especially Great Britain. Under Britain's Navigation Acts, the American colonies had been prohibited from exporting products that competed with British products, including textiles. The new United States was therefore primarily an agricultural country, with plantations in the south and smaller farmers elsewhere, though with some manufacturing in the north.

Hamilton thought that Smith got most things right in explaining how a capitalist market economy worked and how it could be made to work better. On the whole, he agreed with Smith's arguments in favor of free trade between nations, unhampered by government prohibitions or protection. But he thought that Smith's strictures did not apply at all times and under all circumstances. In the relatively backward economy of the new United States, the government needed to play a more active role in the promotion of commerce, especially in the promotion of industry, or what the 18th century called "manufacture." Hamilton thought it was necessary for the United States to develop economically and, to him, that meant it had to develop its industries.

That was a controversial view among some of his contemporaries, notably Thomas Jefferson, who believed that it was better for a republic to be made up of small farmers. That would in turn promote greater self-reliance and equality. The rise of industry, on the other hand, was bound to create a divide between owners and workers, the rich, and everybody else.[35]

Hamilton, by contrast, wanted a more industrial republic, for several reasons. Smith had shown that a more extensive division of labor was possible in manufacturing than in farming, so an economy made up of manufacture meant a more productive economy. In addition, Hamilton argued, there was more room for human ingenuity in creating labor-saving machinery in manufacturing than in farming. Second, he argued, a manufacturing

[30] Muller, Jerry Z. 1987. *The Other God that Failed: Hans Freyer and the Deradicalization of German Conservatism*. Princeton: Princeton University Press, ch. 3.

[31] James, Harold. 2001. *The End of Globalization: Lessons from the Great Depression*. Cambridge, MA: Harvard University Press, ch. 5, "The Age of Nationalism versus the Age of Capital."

[32] See, for example, Friedman, Thomas L. 1999. *The Lexus and the Olive Tree: Understanding Globalization*. New York: Random House; Barber, Benjamin. 1995. *Jihad vs. McWorld: How Globalism and Tribalism are Reshaping the World*. New York: Crown.

[33] See Muller, Jerry Z. 1993. *Adam Smith in His Time and Ours: Designing the Decent Society*. New York: Free Press.

[34] Hamilton, Alexander. 1791. *Report on Subject of Manufactures*, https://founders.archives.gov/documents/Hamilton/01-10-02-0001-0007

[35] McCoy, Drew. 1980. *The Elusive Republic: Political Economy in Jeffersonian America*. Chapel Hill: University of North Carolina Press.

economy left more room for enterprise or entrepreneurship—and that too would lead to a more productive society. Third, an economy with many sorts of manufacture would be able to find more valuable uses for a wider range of human talents and abilities. Fourth, America was underpopulated: it needed to attract immigrants from Europe, and could attract a wider range of people if there were jobs for them beyond simply farming. Fifth, he argued that the increased availability of manufactured goods would give farmers more to buy, and so act as a stimulus for them to be more productive.

His sixth argument concerned defense. There would be times when the United States would find itself at war and cut off from European suppliers. It would therefore be prudent to produce the full range of commodities required for its national defense.

On all these grounds, Hamilton recommended government policies that would foster the growth of manufacturing through protective tariffs and government subsidies to manufacturing (that were called "bounties"). He did not want such protection to become permanent, only long enough for manufacturing to become profitable on its own; this was the argument for the protection of "infant industries."

Without such protection, Hamilton argued, it would not be profitable for American entrepreneurs to compete with imports from Europe. Thus, the government had to use financial incentives to encourage people to start businesses and make investments that they would otherwise not do on their own. Hamilton also wanted the government to spend money on infrastructure, to provide the roads and canals that made commerce possible. He also recommended the creation of a US national bank, on the model of the Bank of Amsterdam and the Bank of England, which would have the power to issue paper money.

Some of the national measures promoted by Hamilton were adopted in the years after he stepped down as Treasury Secretary in 1796. By 1840, industrial tariffs had reached the strikingly high level of 40%, where they remained for most of the 19th century. The United States became an international industrial powerhouse behind a wall of protective tariffs.

FRIEDRICH LIST, THE RISE OF "THE AMERICAN SYSTEM," AND OTHER EXPERIMENTS IN NATIONAL INDUSTRIAL POLICY

Hamilton's example resonated far beyond the United States. His arguments were popularized in Europe by Friedrich List (1789–1846). At various times a government official, a political prisoner, a university professor, a businessman, a farmer, an editor, and a diplomat, List became an advocate of creating national institutions for Germany at a time when German speakers were divided among 30 different states, each with its own tariffs. His ideas were considered so subversive of existing governments that he was imprisoned and then forced to emigrate. In 1825 he moved to Pennsylvania, where he owned a business, edited a newspaper, and took part in political debate.

List was much impressed by Hamilton's ideas, which were continued by what became known as the "national economists." List first put forth his ideas in his *Outlines of American Political Economy* of 1827. In 1834, he returned to Germany and became active in political journalism, again as an advocate of industrial development, and especially of the new, revolutionary form of infrastructure, the railroad. He moved to France for a few years, where he also became an advocate of railroads and industrialization. It was there that he composed his major book, *The National System of Political Economy*, which he wrote in German and published in 1841.[36]

List tried to put forth a way of thinking about economic matters that would be relevant for any nation striving to advance economically. The distinctive characteristic of List's system was its emphasis on the nation, as the intermediate organ between the individual and humanity. Every nation, he said, has its own language, history, and customs, and it is through the nation that people obtain "mental culture, power of production, security, and prosperity."

On that basis, List advocated a unified German nation-state. He contended that because it was economically underdeveloped, Germany needed a policy of state intervention to become competitive in a world of more economically developed nations. Like Hamilton, List believed that free trade was the best system, but only between nations at the same level of economic development. Thus, Germany first needed to raise itself to the same level of economic development as England, and that meant industrial development.

In the mid-19th century, this tradition of nationalist economics was popularized in the United States by Henry C. Carey (1793–1879) under the slogan of the "American System." Hamilton and List were forerunners of theories of uneven development, concerned with what to do when nations were on different levels of development, especially those with less commerce and industry. The typical thrust of such theories was that relative backwardness requires a more active role by the government in encouraging and shaping the direction of economic development.[37]

What is more, deliberate government cultivation of capitalist development in the interests of the nation has continued down to the present, with differing degrees of effectiveness and success. Beginning in the 1950s, for example, the Japanese Ministry of Trade and Industry (MITI) tried to promote technologies seen as cutting edge—notably, the automobile industry—by supporting their adoption in large Japanese firms (*keiretsu*). The Japanese policies included government-subsidized credit for favored firms and industries, tax incentives, and preferential access to foreign exchange.[38] In the name of national assertion, heavily protectionist policies were adopted (with much less success) in postcolonial India (under Nehru) and Ghana (under Nkrumah).[39]

Beginning in the 1960s, the government of South Korea under Park Chung-Hee promoted the development of what were called "national champions" in steel, ship-building, and other industries. Single corporations, or oligopolies, were insulated from both

[36] List, Friedrich. 1909. *The National System of Political Economy*. London: Longmans, Green and Co.

[37] Gerschenkron, Alexander. 1962. *Economic Backwardness in Historical Perspective*. Cambridge, MA: Harvard University Press.

[38] Bernstein, Jeffrey R. 1997. "Japanese Capitalism." In *Creating Modern Capitalism*, edited by Thomas K. McGraw, 439–489. Cambridge, MA: Harvard University Press.

[39] Austin, Gareth. 2014. "Capitalism and the Colonies." In *The Cambridge History of Capitalism*, vol. II, edited by Larry Neal and Jeffrey G. Williamson, 301–347. Cambridge: Cambridge University Press, at 338.

domestic and international competition to allow them to become profitable, invest in research and development, and profit from economies of scale, thus becoming internationally competitive and a source of national prosperity.[40]

Such national industrial policies continue to have their advocates, including in the United States.[41] China in the era since 1978 provides the most dramatic case of government-guided capitalist development in the interests of national self-assertion. Their capitalist development has been employed as a deliberate strategy by the ruling Chinese Communist Party, with policies that have included massive involvement by the government and the People's Liberation Army in banking and industry.[42]

* * * * * * * * *

To sum up, then, capitalism did not create nationalism. Nationalism predated capitalism and often developed in its absence. Capitalism, particularly in its international form of "globalization," has frequently found itself in tension with the preservation of distinct national identities and national self-sufficiency. Yet in many cases, the promotion of nationalism and capitalism went hand in hand, sometimes as a matter of policy, sometimes as an unintended consequence. And the proper role of government measures intended to stimulate and shape capitalism in the interests of national power and well-being has remained a central topic of political debate and action.

KEYWORDS
capitalism, ethno-nationalism, industrial policy, nationalism, nation-state

How to cite this article: Muller, Jerry Z. 2024. "Nationalism and Capitalism." *Journal of Applied Corporate Finance* :1–7.
https://doi.org/10.1111/jacf.12610

[40] Tudor, Daniel. 2012. *Korea: The Impossible Country*. North Clarendon, VT: Tuttle Publishing, ch. 5, "Capitalism with a Korean Face."

[41] See, for example, Atkinson, Ronald D. and Michael Lind. 2018. *Big is Beautiful: Debunking the Myth of Small Business*. Cambridge, MA: MIT Press.

[42] Milanovic, Branko. 2019. *Capitalism, Alone: The Future of the System that Rules the World*. Cambridge, MA: Harvard University Press.

DOI: 10.1111/jacf.12599

Journal of
APPLIED
CORPORATE FINANCE

REPRINT

The threat of democracy to capitalism

Jerry Z. Muller

Department of History, The Catholic University of America, Washington, D.C. 20064, USA

Correspondence
Jerry Z. Muller, The Catholic University, Washington, D.C., USA.
Email: mullerj@cua.edu

This article first appeared as "The Democratic Threat to Capitalism" in *Daedalus*, Summer, 2007, pp.77-86.

While there have been many historical instances of capitalism without liberal, representative democracy, there are no known cases of liberal, representative democracy *without* capitalism. But with few exceptions, academic analysts have tended to focus either on the threat capitalism poses to democratic institutions, or on the support democratic politics offer to capitalist legitimacy.

Academic discussion of the *tensions* between democracy and capitalism tends to treat capitalism as a hindrance, or even danger, to democracy. Capitalism is based upon inequality of reward, while democracy is based upon some notion of equality. The inequality of wealth, and the ability of the wealthy to influence the holders of political power, is said to undermine the equality of representation inherent in the democratic ideal.

There are also powerful arguments for the *compatibility* of democracy and capitalism. Democracy smooths away the rougher edges of capitalism in a manner that ultimately contributes to capitalism's legitimacy. Transfer payments from the wealthy to the less wealthy, insurance against illness, unemployment, and old age, and other policies associated with the democratic welfare state all work to soften the harsh effects of the market, helping to reconcile the vast majority of the populace to market institutions.

My purpose in this essay is to explore the other, less examined side of the coin: a series of arguments that democracy may be a threat to the functioning of the capitalist market.

Most of these arguments begin with the assumption that as an information and incentive system, the market tends to be more efficient than representative democracy. It was Adam Smith, in *The Wealth of Nations*, who explained why productivity tends to increase with the expansion of the market. The existence of a market in which supply and demand, rather than political fiat, determine prices creates monetary incentives for entrepreneurs, landlords, and workers to move their resources to their most profitable uses. Prices and wages supply information indicating where effective demand is greater than supply. For entrepreneurs, landlords, and workers, prices act as signals—and larger profits, rents, and wages offer monetary incentives to follow those signals.

In the 20th century, theorists such as Friedrich Hayek have expanded our understanding of the role of the market in providing information valuable for decision-making. In a social world of remarkable complexity, in which prices are affected by everything from the weather to political developments to ongoing changes in the tastes of billions of consumers, prices are "sound proxies for relevant information, proxies that every day allow billions of people to make adjustments to new supply and demand circumstances of which they may be entirely ignorant."[1]

All of the critical analyses that follow assume that because the competitive market is more productive, efficient, and innovative, it tends to produce a rising standard of living. And rising standards of living are, in turn, assumed to be conducive to democracy. Indeed, modern democracies derive no small part of their legitimacy from their ability to provide rising standards of living.

Modern society, as portrayed in Ernest Gellner's trenchant characterization,

> is the only society ever to live by and rely on sustained and perpetual growth, on an expected and continuous improvement…. Its favored mode of social control is universal Danegeld, buying off social aggression with material enhancement; its greatest weakness is its inability to survive any temporary reduction of the social bribery fund, and to weather the loss of legitimacy which befalls it if the cornucopia becomes temporarily jammed and the flow falters….[2]

A growing economy also blunts political conflict by allowing for some degree of redistribution of wealth, in which increasing the income of some need not come at the expense of others.

Economic growth, to be sure, is not the only good in life or politics, and polities with other strong sources of legitimacy can

[1] Friedman, Jeffrey. 2005. "Popper, Weber and Hayek: The Epistemology and Politics of Ignorance." *Critical Review* 17(1–2): xxvii. Friedman's entire piece is highly relevant to the theme of this essay. Hayek's classic papers on these issues are "The Use of Knowledge in Society" (1945) and "The Meaning of 'Competition'" (1946), both in Hayek, Friedrich A. 1948. *Individualism and Economic Order*. Chicago: University of Chicago Press.
[2] Gellner, Ernest. 1983. *Nations and Nationalism*. Ithaca, N.Y.: Cornell University Press, 22.

weather substantial economic downturns and even depressions. But modern history provides case after case, especially in inter-war Europe, of economic stagnation and decline spelling the end of representative democracy.

* * * * * * * * * *

But can democratic political processes themselves contribute to economic stagnation or even decline? The question is bound to occur, especially to anyone observing recent attempts in Western Europe to reform pension systems, taxes, and labor laws with the aim of reinvigorating stagnant economies.[3]

Discussion of the potential for political interests to distort or diminish the beneficent effects of the market preceded the democratic age. We find powerful statements of such arguments in the works of Adam Smith and Edmund Burke. Indeed, it was a major theme of *The Wealth of Nations*. Whereas most of the first half of the book explains how the capitalist market, under the right conditions, can lead to "universal opulence"—conceived of an ongoing rise in the standard of living for the vast majority of the populace—much of the second half is devoted to careful analysis of the forces working to *resist and undermine* the optimal functioning of the market.

For the market to operate most effectively, everyone must be able to sell labor, invest capital, or rent land in ways that best promote their self-interest. However, as Smith showed, much of European society and government was structured to limit the free movement of labor, capital, land, and goods. Smith believed that the public interest would be best served if every man channeled his self-interest through the market. But he also recognized that, for the individual producers or groups of producers, there were clear benefits—and thus a powerful temptation—to find ways to circumvent the competitive market and use all available means to *avoid or prevent* competition, in order to obtain the highest possible price for their wares.

Smith thought that wherever and whenever individuals or groups could promote their interests by protecting themselves from market competition, they would willingly do so at the expense of the public. As Smith observed in one of his most cited quips,

> People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

The citizens of the towns, Smith documented, contrived to keep the price of urban-made goods high, at the expense of the inhabitants of the countryside. Manufacturers were the most successful in pressing their private interests through their disproportionate influence over members of parliament.

Merchants, too, were well positioned to persuade those in power that what they wanted was identical to the general interest. Though few in number, they were located in large cities and had economic means at their disposal, making their "sophistry and clamour" more effective than that of rival groups.

What's more, merchants long accustomed to limiting competition in the towns had in more recent decades learned to limit competition in international trade. One of the five books of *The Wealth of Nations* is devoted to an attack on the policies of international trade then dominant in Europe—policies Smith dubbed as "mercantilist" and part of "the mercantile system" out of his belief that it reflected the interests and mentality of merchants and manufacturers at the expense of the public good. With the expansion of the franchise in the century and a half that followed the publication of *The Wealth of Nations*, the problems and tactics of groups organized to exert political influence to circumvent market competition were not so much eliminated as universalized. Indeed, they are with us still.

In one of his last works, *Thoughts and Details on Scarcity*, published in 1796, Edmund Burke explored the theme of economic ignorance among politicians and voters—a subject that later became the focus of the likes of John Stuart Mill, Joseph Schumpeter, and other trenchant skeptics about democratic politics. Burke began by observing that, in 1794 and 1795, poor harvests had led to a rise in British food prices and to rural unrest. The result was a series of proposals for the government to lower the price of food or raise the wages of laborers. Burke maintained that most people poorly understood the functioning of the market for basic foodstuffs and that those who traded in such goods were unjustly vilified and the objects of great prejudice.

For Burke, one important social role of the intellectual in politics was to advise legislators to stand up to short-term political and moral pressures when they threaten long-term national economic interests. To have wages set by government officials rather than through negotiations between employers and employees, he maintained, placed crucial decisions about the agricultural economy into the hands of those who lacked either knowledge of or interest in agriculture. It was also foolish for politicians to heed the cries of urban dwellers who demanded government intervention to lower food prices, for such city folk "are in a state of utter ignorance of the means by which they are to be fed."

Agriculture, Burke argued, ought to operate according to the common principles of commerce—namely, that all involved should be on the lookout for the highest profit. The government's task was not to criticize and condemn but to protect middlemen such as the "factor, jobber, salesman, or speculator, in the markets of grain" from the ignorance and envy of farmers and consumers. Against those who objected to large-scale middlemen in the grain trade, Burke argued that their larger capital made it possible for them to operate with lower profit margins—an outcome that ultimately benefited the producer and consumer. The envy and resentment of the middlemen and merchants by the poor, as Burke explained the situation, reflected their failure to understand the social function of the rich in accumulating and putting to work their capital—with the resulting tendency of the poor to act against their interests that Burke describes as follows:

> But the throats of the rich ought not to be cut, nor their magazines plundered; because, in their persons they are trustees for those who labour, and their

[3] Smith, Timothy B. 2004. *France in Crisis: Welfare, Inequality and Globalization since 1980*. Cambridge: Cambridge University Press; Miegel, Meinhard. 2002. *Die deformierte Gesellschaft: Wie die Deutschen ihre Wirklichkeit verdrängen*. Munich: Propyläen.

> hoards are the banking-houses of these latter …. When the poor rise to destroy the rich, they act as wisely for their own purposes as when they burn mills, and throw corn into the river, to make bread cheap.[4]

Smith and Burke were reflecting upon the effects of political institutions that, although representative, had too limited a suffrage to count as "democratic." But the political tendencies that aroused their concern—the use of political influence to distort the market, and ignorance about the functioning of the capitalist market by politicians and voters—have proved remarkably durable. With the expansions of the franchise in Western societies in the course of the 19th and 20th centuries, analysis of these two problems has been extended and refined by a series of important thinkers down to our own time.

In his book *Considerations on Representative Government*, published in 1861, John Stuart Mill voiced the recurrent fear of 19th-century liberals that the political power of the non-property-owning majority in a democracy might have disastrous economic consequences. Even those unpropertied majorities that recognize "it is not for their advantage to weaken the security of property … by any act of arbitrary spoliation" might still be inclined to enact policies that would damage or destroy the capitalist market.

Among the dubious policies that concerned Mill was excessive taxation of possessors of property and, especially, on savings. He also feared repudiations of the national debt, and excessive taxation of inheritances and government spending "without scruple, expending the proceeds in modes supposed to conduce to the profit and advantage of the laboring classes." Still, other possibilities were government mandates designed to raise wages, limit competition in the labor market, or discourage labor-saving innovations—as well as the time-honored adoption of tariffs to protect local producers from foreign competition. Although *all* these policies were likely to be at odds with the long-term interests of the working classes, Mill thought, such measures might be consistent with their short-term interests—and certainly with their *perceived* short-term interests.

THE RISE OF "PUBLIC CHOICE" THEORY (OR HOW THE POLITICAL PROCESS AFFECTS THE ECONOMY)

The turn of the century Italian sociologist and economist Vilfredo Pareto popularized the term "spoliation" to refer to the use of political power by the less productive to extract gains from the more productive. "Illegal appropriation by violence is easily explained by the law of the strongest," Pareto noted. "Likewise, it is understandable that the majority which makes the laws is in a position to exact for itself whatever tribute it pleases." The more intriguing question, for him, was "how a small number of individuals is able, by underhand methods, to get the majority to pay tribute to a minority."[5]

Pareto's answer has been reformulated by many later analysts, of whom the best known is perhaps Mancur Olson, in his books *The Logic of Collective Action: Public Goods and the Theory of Groups* (1971) and *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (1981). The logic of collective action—whose methodological cousin is known as "public choice theory"—begins with the premise that individuals in the political arena can best be understood as self-interested actors, just as they are assumed to be in the marketplace for purposes of economic analysis.[6] "An individual in any large group with a common interest," Olson explained, "will reap only a minute share of the gains from whatever sacrifices the individual makes" to achieve the common goals of his group. But in small groups, where each individual stands to gain a great deal from the attainment of the group's goal, the members have a far stronger incentive to influence politicians on behalf of the group's interest.

Take the classic case of sugar production in the US Domestic producers are relatively few in number, and each stands to gain a lot from tariffs on imported sugar, which prevent a free market in sugar and hence raise its price by impeding downward pressure on sugar prices from foreign competition. US consumers of sugar, by contrast, are a large and diffuse group, and each stand to lose only a little by being forced to pay more for sugar through tariffs. The handful of producers will therefore be more likely to organize to influence elected representatives, devoting substantial resources to getting and retaining the tariffs from which the sugar producers' profit. Meanwhile it is unlikely that sugar consumers will form a lobby at all (though, of course, candy manufacturers may well lobby against sugar tariffs in an attempt to lower their raw material costs and enhance their profits).

Thus, each group seeks protection from market competition for the commodity or service it produces. As groups gain protection, the efficiency and productivity of the market decline and, in extreme cases, stop altogether.

* * * * * * * * *

A related theorem of the logic of collective action is known as "rational ignorance." Acquiring the knowledge of government policy needed to ascertain the interests of one's group requires time, money, and attention. For those with a small stake in the outcome (say, sugar consumers), it is not worth their while to obtain the necessary knowledge, just as it is not worth the effort required to pursue their self-interest. In this sense, their ignorance is "rational."

One telling criticism of the rational ignorance thesis is that it radically overestimates the rationality of individuals *as voters*. Academic theorists of democracy often overlook the many empirical studies that demonstrate how little voters know about the candidates for whom they cast their ballots and about the policies they represent. Analysts from Burke through Joseph Schumpeter down to Jeffrey Friedman in our day have argued that voters fail to pursue their economic self-interest in the political arena because

[4] McDowell, Robert Brendan, ed. 1991. *The Writings and Speeches of Edmund Burke*, vol. 9. Oxford: Clarendon Press, 121.

[5] Pareto, Vilfredo. 1966. *Sociological Writings*, trans. Derick Mirfin. New York: Praeger, 115, 139–142 and passim.

[6] On public choice theory, see the collection of seminal articles by its most prominent exponent, Buchanan, James M. 1999. "*The Logical Foundations of Constitutional Liberty*." In *The Collected Works of James M. Buchanan*, vol. 1. Indianapolis: Liberty Fund.

they lack the relevant information or understanding of economic processes to make the best choices.

These analysts then contrast this inability to make informed judgments about matters of public policy with the ability of individuals to make informed decisions in the marketplace. Such marketplace wisdom is explained by Schumpeter as follows:

> In the ordinary run of often repeated decisions the individual is subject to the salutary and rationalizing influence of favorable and unfavorable experience. He is also under the influence of relatively simple and unproblematical motives and interests which are but occasionally interfered with by excitement. Historically, the consumers' desire for shoes may, at least in part, have been shaped by the action of producers offering attractive footgear and campaigning for it; yet at any given time it is a genuine want, the definiteness of which extends beyond "shoes in general" and which prolonged experimenting clears of much of the irrationalities that may originally have surrounded it.
>
> Moreover, under the stimulus of those simple motives consumers learn to act upon unbiased expert advice about some things (houses, motorcars) and themselves become experts in others. It is simply not true that housewives are easily fooled in the matter of foods, familiar household articles, wearing apparel.

But when voters seek their economic self-interest *through politics*, Schumpeter acknowledged, they tend to do so in a way that democratic theory rightly regards as corrupt and anti-social—that is, by placing their self-interest above the interests of the commonweal:

> [T]here are many national issues that concern individuals and groups so directly and unmistakably as to evoke volitions that are genuine and definite enough. The most important instance is afforded by issues involving immediate and personal pecuniary profit to individual voters and groups of voters, such as direct payments, protective duties, silver policies and so on. Experience that goes back to antiquity shows that by and large voters react promptly and rationally to any such chance.
>
> But the classical doctrine of democracy evidently stands to gain little from displays of rationality of this kind. Voters thereby prove themselves bad and indeed corrupt judges of such issues, and often they even prove themselves bad judges of their own long-run interests, for it is only the short-run promise that tells politically and only short-run rationality that asserts itself effectively.[7]

And along with this shortsightedness on matters of economic interest, Schumpeter notes that when it comes to larger issues of national and international policy, the likelihood of voters being either well-informed or thoughtful diminishes even further:

> [W]hen we move still farther away from the private concerns of the family and the business office into those regions of national and international affairs that lack a direct and unmistakable link with those private concerns, individual volition, command of facts and method of inference soon cease to fulfill the requirements of the classical doctrine [of democracy].
>
> …
>
> The reduced sense of responsibility and the absence of effective volition in turn explain the ordinary citizen's ignorance and lack of judgment in matters of domestic and foreign policy which are if anything more shocking in the case of educated people and of people who are successfully active in non-political walks of life than it is with uneducated people in humble stations. Information is plentiful and readily available. But this does not seem to make any difference. Nor should we wonder at it. We need only compare a lawyer's attitude to his brief and the same lawyer's attitude to the statements of political fact presented in his newspaper in order to see what is the matter. In the one case the lawyer has qualified for appreciating the relevance of his facts by years of purposeful labor done under the definite stimulus of interest in his professional competence; and under a stimulus that is no less powerful he then bends his acquirements, his intellect, his will to the contents of the brief. In the other case, he has not taken the trouble to qualify; he does not care to absorb the information or to apply to it the canons of criticism he knows so well how to handle; and he is impatient of long or complicated argument. All of this goes to show that without the initiative that comes from immediate responsibility, ignorance will persist in the face of masses of information however complete and correct ….[8]

Voters, precisely because so far removed from actual responsibility for their opinions, are open and vulnerable to emotional and irrational appeals. Take this incident reported by Peter Drucker in his *The End of Rational Man* (1939), in which he claims to have witnessed the enthusiastic response of a crowd to a National Socialist orator who proclaims, "We don't want lower bread prices. We don't want higher bread prices. We want *National Socialist* bread prices!"

[7] Schumpeter, Joseph A. 1950. *Capitalism, Socialism and Democracy*, 3rd ed. New York: Harper and Row, 258–261.

[8] Ibid., 261–262.

RESSENTIMENT AND OTHER DEMOCRATIC HAZARDS TO CAPITALIST GROWTH

But if the rational ignorance of the mass of voters is one threat to capitalism, the emotion most hazardous to capitalist economic growth is envy, or the more virulent desire to bring the high low that Nietzsche called *ressentiment*, a combination of jealousy and inferiority.[9] W. H. Mallock, Schumpeter, Hayek, and a variety of lesser lights have focused on the significance of entrepreneurial minorities in capitalist economic growth.[10] Whether by virtue of higher intelligence, stronger will, greater perseverance or risk tolerance, or superior resourcefulness in discovering new opportunities for the use of factors of production, the more entrepreneurial contribute disproportionately to capitalist innovation and growth. Yet this innovative minority can easily become a lightning rod or scapegoat for democratic discontent. Stigmatized by members of declining, older elites as greedy parvenus who do not know or respect the rules of the established game, they can also become the objects of mass resentment by the less successful or unsuccessful.

This problem presents itself most acutely when economic success coincides with ethnicity or religion. Just as economic success among nations is variable and influenced by a range of historical and cultural factors, so too is economic success *among* ethnic groups *within* nations. Greeks and Armenians in the Ottoman empire, ethnic Chinese in the Pacific Rim, Lebanese Christians in West Africa and Latin America, Parsis in India, Indians in East Africa, and Jews in a variety of contexts are all examples of mercantile and professional minorities who combine the transgenerational cultural transmission of knowledge about commerce with other advantages, often including translocal and transnational contacts and an emphasis on education.

Such minorities often play a prominent role in the economic and thus social and cultural transformation of society—a process bound to disrupt settled hierarchies and ways of life. That role, combined with their disproportionate success and their salience as an ethnic "other," makes them frequent objects of *ressentiment*. Authoritarian rulers can manipulate such emotions, but even they are historically more likely to protect such useful minorities than are newly or recently created democratic regimes adopted in times of rapid capitalist transformation. Despoiling the merchant minority—either through informal violence or through the ballot box—may be the road to economic perdition, by destroying the knowledge, talent, and capital that make growth possible. But it offers short-term emotional satisfactions that have often proved irresistible in mass polities.[11]

Guilt is another emotion that has worked to impede the innovative minority's economic effectiveness. In a democratic culture, the successful themselves may find inequality of achievement culturally suspect. At some level, they may feel that their success is unjustified and unjustifiable. Under the impetus of such guilt, the government may spend substantial sums on programs that do little good or even harm, but that serve to assuage the guilt of the successful and demonstrate their good intentions.[12]

Such guilt also helps account for the appeal of the egalitarian ideal of "social justice." Hayek pointed out that the concept has no definable meaning, and that it often serves as a substitute for traditional religious content among those in search of some higher purpose. The mantra of "social justice," he argued, is easily manipulated by groups in search of allies whose support they need to increase their economic gains through political pressure.[13]

DEMOCRATIC POLITICS AND THE TEMPTATION OF INFLATION

Another more mundane, but possibly more insidious and lethal, hazard to capitalist growth posed by democratic politics is inflation. Currency inflation disrupts the informational function of prices. For if the monetary unit by which self-interested individuals determine the most profitable use of their resources is itself changing in unpredictable ways, economic calculation becomes more difficult, like trying to measure with a ruler that keeps changing in size.

When inflation occurs steadily and gradually, it is more easily factored into economic decision making. But such inflation becomes harder to maintain, the more democratic forces are allowed to influence governmental monetary decisions. In the short run, inflation is popular. It is one-way governments deal with the surfeit of economic pressures upon them. When

[9] As John Stuart Mill put it in *Considerations on Representative Government* (London: Parker, Son, and Bourn, 1861), 72–73:

Where there exists a desire for advantages not possessed, the mind which does not potentially possess them by means of its own energies is apt to look with hatred and malice on those who do …. [T]hose who, while desiring what others possess, put no energy into striving for it, are either incessantly grumbling that fortune does not do for them what they do not attempt to do for themselves, or overflowing with envy and ill-will toward those who possess what they would like to have.

[10] Mallock, William Hurrell. 1898. *Aristocracy and Evolution: A Study of the Rights, the Origin, and the Social Functions of the Wealthier Classes*. London: Macmillan & Co., Ltd., excerpted in Muller, Jerry Z. 1997. *Conservatism: An Anthology of Social and Political Thought from David Hume to the Present*. Princeton, N.J.: Princeton University Press; Schumpeter, Joseph. 1927. *"Die sozialen Klassen im ethnisch homogen Milieu"*, translated by Heinz Norden *as "Social Classes in an Ethnically Homogeneous Environment"* (1951) and excerpted as "Aptitude and Social Mobility," in Muller, *Conservatism*. On the theme in Hayek, see Muller, Jerry Z. 2002. *The Mind and the Market: Capitalism in Modern European Thought*. New York: Knopf, chap. 13.

[11] Reflecting on the rise of National Socialism, Friedrich Hayek noted in his 1944 *Road to Serfdom* (139–140):

In Germany and Austria the Jew had come to be regarded as the representative of capitalism because a traditional dislike of large classes of the population for commercial pursuits had left these more readily accessible to a group that was practically excluded from the more highly esteemed occupations. It is the old story of the alien race's being admitted only to the less respected trades and then being hated still more for practicing them. The fact that German anti-Semitism and anti-capitalism spring from the same root is of great importance for the understanding of what has happened there, but this is rarely grasped by foreign observers …. That in Germany it was the Jew who became the enemy … [was the] result of the anticapitalist resentment on which the whole movement was based … [much like] the selection of the kulak in Russia.

Amy Chua deals with tensions between democracy and disparate ethnic achievement in *World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability* (New York: Doubleday, 2003), while systematically ignoring the role of culture and human capital in explaining the success of what she terms "market-dominant minorities." On the subject of merchant minorities and their political vulnerability, see also Gellner *Nations and Nationalism*, 101–109; Kotkin, Joel. 1994. *Tribes: How Race, Religion, and Identity Determine Success in the New Global Economy*. New York: Random House; Slezkine, Yuri. 2004. *The Jewish Century*. Princeton, N.J.: Princeton University Press, 20–39; Chirot, Daniel, and Reid, Anthony, eds. 1997. *Essential Outsiders: Chinese and Jews in the Modern Transformation of Southeast Asia and Central Europe*. Seattle: University of Washington Press; and Muller, Jerry Z. 2010. *Capitalism and the Jews*. Princeton, Princeton University Press.

[12] Banfield, Edward. 1974. *The Unheavenly City Revisited*. Boston: Little, Brown, excerpted in Muller, *Conservatism*, esp. 351–357.

[13] Hayek, Friedrich A. 1976. *The Mirage of Social Justice, in Law, Legislation and Liberty*, vol. 2. Chicago: University of Chicago Press.

spending exceeds revenue, it is tempting for government simply to print more money to pay off its bills. Inflation also helps borrowers by diminishing the real value of their debts.

When labor unions use their political power to push up wage rates beyond the level of profits, the result may be bankruptcy and growing unemployment. Under such circumstances, governments may try to stimulate growth by injecting more and more credit into the economy. But that leads to an inflationary spiral, as workers demand higher wages and businesses raise their prices to keep up with the declining value of money. Eventually, this may get out of hand, as was the case in much of Western Europe and the Americas in the late 1970s and 1980s.[14]

In response to the agonies of inflation, democratic polities have adopted a variety of policies to remove control of the currency from democratic pressures. Many Western countries now insulate central banks from the influence of elected representatives and the constituencies they represent. The countries of the European Union, for example, have ceded control of their currency to the European Central Bank and are inhibited from excessive budget deficits by EU rules. A number of nations beyond the United States and the European Union have pegged their currencies to the dollar or the euro in an attempt to avoid the inflationary effects of their domestic politics.

After a lifetime of reflecting upon the hazards posed by democracy to capitalism and liberalism, Hayek asked rhetorically,

> *Is there really no other way for people to maintain a democratic government than by handing over unlimited power to a group of elected representatives whose decisions must be guided by the exigencies of a bargaining process in which they bribe a sufficient number of voters to support an organized group of themselves numerous enough to outvote the rest?*[15]

Perhaps the answer to Hayek's characterization of the public choice critique of democracy is no. Perhaps there are no definitive solutions to the difficulties created by economic ignorance on the part of politicians and voters, the influence of the irrational forces of envy and guilt, and the rational but self-defeating forces leading to inflation. These may well be viewed as the inherent hazards of capitalist democracy.

But to regard the challenges posed by democracy to capitalism as problems is not to delegitimize democracy. As we noted, democracy and capitalism have in many times and places stood in mutually fructifying tension. Yet an awareness of these hazards is the necessary first step toward minimizing them.

KEYWORDS
Adam Smith, capitalism, democracy, Edmund Burke, Ernest Gellner, John Stuart Mill, Joseph Schumpeter, Mercantilism, Vilfredo Pareto

How to cite this article: Muller, Jerry Z. 2024. "The Threat of Democracy to Capitalism." *Journal of Applied Corporate Finance* : 1–6.
https://doi.org/10.1111/jacf.12599

[14] For an early analysis of this process, see Hayek, Friedrich. 1960. *The Constitution of Liberty*. Chicago: University of Chicago Press, 280–283.

[15] Hayek, Friedrich. 1979. *The Political Order of a Free People*, in *Law, Legislation and Liberty*, vol. 3. Chicago: University of Chicago Press, 4–5.

DOI: 10.1111/jacf.12602

Journal of
APPLIED
CORPORATE FINANCE

REPRINT

Capitalism and the Jews revisited

Jerry Z. Muller

Department of History, Catholic University of America, Washington, DC, USA

Correspondence
Jerry Z. Muller, Catholic University of America, Washington, DC 20064, USA.
Email: mullerj@cua.edu

This essay, first delivered as the 29th Annual Lecture of the German Historical Institute, Washington, D.C., on November 12, 2015, draws and expands upon themes explored in my book, *Capitalism and the Jews* (Princeton, 2010).

INTRODUCTION

At the beginning of the 20th century, German Jewish social scientists were greatly concerned with the subject of Jews and their links to capitalism.[1] Jewish scholars of Eastern European origin, writing in Yiddish or German, continued to engage with the subject in the interwar period.[2] After the Second World War, the study of Jewish economic history was continued, but now with heavy reliance on statistical data, by a small but distinguished group of scholars who had begun their education in interwar eastern and central Europe—a group that included Nobel laureate economist Simon Kuznets[3] and Arcadius Kahan.[4] Such exceptions aside, however, the subject of Jews and capitalism had been largely neglected in written accounts of both Jewish history and the larger history of capitalism that appeared in the decades after World War II.[5]

But much has changed in the last two decades, as a slew of talented historians in North America, Europe, and Israel have turned to the history of Jews and capitalism.[6]

Consistent with this recent work, my aim in this short essay is not so much to recount the central role of capitalism in Jewish history as to revisit and explore more fully the import of modern Jewish history in thinking about the history and dynamics of capitalism. This is hardly a new question; in one form of another it is been a topic of discussion for centuries. To be sure, that discussion has often been ideological and polemical rather than sober and scholarly. But the ideological element is itself an important part of the history of capitalism and the Jews.

I want to examine the issue from a conceptual altitude at which many historians are uncomfortable travelling. That is, I want to look for and try to convey some valid generalizations. There are of course exceptions to every rule; and to every generalization some historian is almost certain to object, "But it was different in Pinsk, or Posen, or Peoria, or Petach Tikvah." And no doubt it was. Nevertheless, from time to time it is surely worth trying to see the forest for the trees, not to speak of the weeds.

THE GERMAN DEBATE OF THE EARLY 20TH CENTURY

In some respects, the questions of capitalism and the Jews were derailed by a debate at the beginning of the 20th century between

[1] See, for example, Ruppin, Arthur. 1904. *Die Juden der Gegenwart* (Berlin). On Ruppin see Penslar, Derek J. 1991. *Zionism and Technocracy: The Engineering of Jewish Settlement in Palestine, 1870–1918* (Bloomington). In preparing this talk I have profited from reading in manuscript Jonathan Karp, "Jews in the Economic Trends in the Modern Period," a chapter that appeared in a volume of the *Cambridge History of Judaism*.

[2] Penslar, Derek J. 2001. *Shylock's Children: Economics and Jewish Identity in Modern Europe* (Berkeley), 160.

[3] See the essays collected in Kuznets, Simon. 2012. *Jewish Economies: Development and Migration in America and Beyond* (2 volumes) ed. Stephanie Lo and E. Glen Weyl (New Brunswick, NJ), and the useful introduction by Glen Weyl.

[4] Kahan, Arcadius. 1986. *Essays in Jewish Social and Economic History* edited by Roger Weiss (Chicago).

[5] Accounts of the capitalist accomplishments of German Jewry have provided a partial exception to this relative neglect. A steady stream of articles and books on various facets of German Jewish economic history have appeared, many under the auspices of the Leo Baeck Institute. For example, Fritz Stern's 1977 masterwork, *Gold and Iron*, explored the links and tensions between Junker power and Jewish finance in 19th-century Germany through the lens of the relationship between Bismarck and his banker, Bleichröder. See Stern, Fritz. 1977. *Gold and Iron: Bismarck, Bleichröder and the Building of the German Empire* (New York). Werner Mosse's two volumes on the German Jewish economic elite provide a detailed account of the most successful Jewish entrepreneurs. Mosse, Werner L. 1987. *Jews in the German Economy: The German-Jewish Economic Elite, 1820–1934* (Cambridge).

[6] See Jonathan Karp's book, *The Politics of Jewish Commerce: Economic Thought and Emancipation in Europe, 1638–1848* (Cambridge, 2008), which showed the centrality of economic issues to Jewish self-understandings and wider debates about the acceptability of the Jews in modern European societies. A younger generation of historians has produced a stream of works on the involvement of Jews in industries as varied as tavern keeping in Poland (Glenn Dynner), and the liquor trade in the United States Marni Davis), as well as ready-made clothing, banking, entertainment, and the salvage business. (Excellent collections of recent work include Reuveni, Gideon, and Wobick-Segev, Sarah, ed. 2011. *The Economy in Jewish History: New Perspectives on the Interrelationship between Ethnicity and Economic Life* (New York); Kobrin, Rebecca. 2012. *Chosen Capital: The Jewish Encounter with American Capitalism* (New Brunswick, NJ) and Kobrin, Rebecca, and Teller, Adam. 2015. *Purchasing Power: The Economics of Jewish History* (Philadelphia).

Werner Sombart, Max Weber, and Georg Simmel about the role of religion in the *origins* of capitalism.[7] The fundamental institutional structures of modern capitalism would probably have developed very similarly were there no Jews around—and in that sense, Sombart was wrong. But Sombart was right to call social scientific attention to the issue of capitalism and the Jews, even if his evidence was often haphazard, his knowledge of Judaism deficient, his biological explanations crude—and even though his analysis was in some ways distorted by his distaste for both capitalism and Jews.

The issue was explored in a more balanced way by their colleague, Georg Simmel in his great work, *The Philosophy of Money*. Published in 1900, and thus 6 years before Weber's *The Protestant Ethic and the Spirit of Capitalism*—and over a decade before Sombart's controversial *Die Juden und das Wirtschaftsleben* (*The Jews and Economic Life*), Simmel's book would at first glance seem to have little to say about the questions that would so exercise Max Weber and Werner Sombart: the origins and rise of capitalism, and the role of Jews therein. But writing before *The Protestant Ethic* or *The Jews and Economic Life*, Simmel offered alternative answers to his two better-known successors while clarifying some confusion they sowed.

But for all its accomplishments, including its success in marshalling a remarkable range of historical data, *The Philosophy of Money* does not provide a genetic account of the "origin" of modern capitalism. The explanation for this omission seems to be Simmel's contention that there is no historical "break" that marks the beginning of modern capitalism. Rather, modern-day capitalism is best thought of as an intensification of processes of exchange that have been going on for a very long time. Simmel's working premise is that the greater intensity of monetary exchange itself brings about changes in mentality, and hence there is [actually] no need for the sort of cultural explanation offered by Weber and Sombart. As for the Jews, Simmel accounts for their disproportionate participation in early modern capitalism by focusing on their social, religious and political position in medieval Europe.

Unlike Weber, Simmel does not discount the significance of exchange in explaining the genesis and nature of capitalism. And unlike Sombart, Simmel does not think that an explanation based on the content of Judaism or the racial characteristics of the Jews is necessary to account for their success. On the contrary, Simmel's emphasis is on the way the business orientation of the Jews can best be explained by their historical condition, a condition shared by other groups we've come to call "mercantile minorities."[8]

Simmel emphasizes the reality that cultural and religious outsiders are attracted to financial and exchange functions because money provides them with opportunities otherwise closed to them by their exclusion from the dominant "inner" social circles. He accordingly puts Jews in the same category as Armenians in Turkey, Parsees in India, Huguenots in France, and Quakers in England, all groups whose commercial prowess illustrates "the correlation between the central role of money interests and social deprivation." Simmel also calls attention to the role of diasporas as leading to specialized expertise and success as traders and financiers, as opposed to involvement in primary production. Thus social exclusion and diasporic circumstances are the key factors in accounting for why Jews have tended to be drawn to the money aspects of the economy.

But in Simmel's account, such exclusion and specialization end up making Jews neither *marginal* to the process of capitalist development, as Weber suggests, or *central* to the genesis of capitalism, as Sombart portrayed them. Instead it makes the Jews disproportionately successful at a set of activities whose economic and social importance are central to the modern world.

JEWS AND ENTREPRENEURSHIP

The disproportionate role of Jews in capitalist economic development, and their disproportionate success in capitalist societies—not only in the realm of finance, but commerce more generally—and also in the learned professions, was already clear to Arthur Ruppin, a German Jewish social scientist who in 1904 published his study *Die Juden der Gegenwart* (The Jews of the Present).[9] Jews seemed to have a knack for commerce, Ruppin maintained, though they were not alone in this regard, nor were their talents confined to the realm of business. He thought that Armenians, Greeks, and Indians of the mercantile castes were often superior to Jews in business acumen. Nevertheless, he observed that "Jews have attained wealth and significance wherever they are not in competition [with these groups] and where the geographical, economic and political circumstances give free rein to their commercial acuity."[10] Such opportunities barely existed in Eastern Europe and Russia, where most Jews lived in terrible poverty when Ruppin wrote in 1904. But in countries like England, France, Italy, Germany, and the United States, those Jews who had lived for more than a generation were becoming prosperous through entrepreneurial activity.

Jews have been disproportionately involved in the entrepreneurial functions of creating new products, finding new markets for existing products, and pioneering new modes of sales and distribution. Many modern capitalist institutions, while not entirely or even primarily created by Jews, have had a disproportionate number of Jews as entrepreneurial innovators. The rise of department stores, which was an important marketing breakthrough that changed the nature of the shopping experience, was in good part a creation of Jews in Germany, England, and the United States. So too was catalogue shopping, as pioneered by Julius Rosenwald of Sears Roebuck. Above all we see Jews as innovators in the realm of information and entertainment: in the creation and expansion of newspapers, magazines, and news services like Reuters and Bloomberg; new forms of theater (such as burlesque and vaudeville, nickelodeons, and movie houses), professional sports, and of course, the film industry. In each

[7] See Muller, Jerry Z. 2011. "Kapitalismus, Rationalisierung und die Juden – Zu Simmel, Weber, und Sombart." In Nicholas Berg (ed.), *Kapitalismusdebatten um 1900 – Über antisemitisierende Semantiken des Jüdischen* (Leipzig), 23–48, as well as other essays in the same volume.

[8] Simmel, Georg. *Philosphie des Geldes*, 291–91; *Philosophy of Money*, 221–27. On Simmel's analysis of the Jews and their relationship to the money economy see Morris-Reich, Amos. 2003. "The Beautiful Jew is a Moneylender: Money and Individuality in Simmel's Rehabilitation of the the 'Jew.'" *Theory, Culture and Society* 20(4): 127–42; and Raphael, Freddy. 2003. "Die Juden und das Geld nach Georg Simmel." In Otthein Rammstedt (ed.), *Georg Simmels Philosophie des Geldes: Aufsätze und Materialien* (Frankfurt).

[9] Ruppin, Arthur. 1904. *Die Juden der Gegenwart* (Berlin), 176.

[10] Ibid., p.178.

case, these forms of information and entertainment were virgin ground—outside the existing economic establishment, and hence a more promising site for innovation.

In recent years, the staff of the German Historical Institute in Washington, D.C. has developed a valuable biographical database of major American entrepreneurs of German immigrant origin. Of the 168 entrepreneurs in the database, 59 are of Jewish origin, that is to say about 35%. When you consider that roughly 3% of the German immigrants to the United States were Jews, their overrepresentation is by more than a factor of 10. That is no accident.

HISTORY AND HUMAN CAPITAL

The question of *why* Jews have been disproportionately successful is a fascinating and important one. One answer is the time-honored response of the anti-capitalist anti-semite: because Jews are more greedy, more underhanded, and more conspiratorial [they are more likely to succeed in commerce]. But the weakness of that answer by no means negates the importance of the question.

The answers must come from some variation of what economists now call "human capital" theory—a new name for an old thing—that is, an exploration of the historical sources of distinct cultural propensities within some human group, and the transmission of those propensities across time in familial and communal institutions. Another element of human capital is "social capital"—that is, social networks that create niches for ethnic minorities, especially in areas of trade and finance that require trust not available through formal institutions.

In this sense, then, thinking about the sources of Jewish economic success can be viewed as expanding the purview of economics or, more broadly, of a social scientific understanding of the micro-social sources of capitalist economic growth. But issues related to Jews and capitalism go far beyond those of economics, however broadly construed. Capitalism is too wide-ranging a subject to be left to the economists, or even to the economic historians. It has social, cultural, intellectual, and political facets as well as economic and technological ones.

Jews and commerce have long been linked in the culture of the West. Jews seem to have migrated to medieval Europe from the Islamic world primarily as merchants. In the high Middle Ages, Jews in Europe were permitted by the Church to engage in the stigmatized activity of lending money at interest precisely because they were regarded as outside the community of shared values. Ever since the Middle Ages, then, Jews were associated in the Christian West with the handling of money. It is no wonder, then, that with the growth of capitalism in early and late modern Europe, the intellectual evaluation of an economy in which money played a central role was often intertwined with attitudes toward Jewry.

For a variety of intellectuals in *modern* Europe, Jews served as the fleshly embodiment of capitalism.[11] Some intellectuals argued that only a society in which the reality of shared community was dead would encourage self-interested economic activities, of which money-lending was the notorious paradigm. Many intellectuals regarded Jews as the agents of the creative destruction characteristic of capitalism—which meant that their evaluations of both capitalism and Jews tended to reflect their relative assessments of the value of the creativity unleashed by capitalism and of the traditional forms of life and inherited privilege often uprooted by capitalism. In other words, thinking about capitalism and thinking about the Jews often went hand in hand.

Hovering above this association was, of course, the specter of usury, the condemnation of lending money at interest. This proscription was based on the presumed illegitimacy of all economic gain not derived from physical labor. This conception of economic activity was rooted in, and in turn, worked to reinforce, what might be described as a general, society-wide failure to recognize the role of knowledge and the evaluation of risk in economic life. It led to a pattern of thought—still very much with us today—that was quick to condemn first finance, and sometimes commerce more generally.

Viewed in this light, the doctrine of and ban on usury might be seen as grounded in a kind of "anti-human capital" theory. One of the great "discoveries" of economists in recent decades is that much of economic performance and economic growth cannot be explained by the traditional triad of land, labor, and capital—in the accountant's sense of money available for investment. Rather a good deal of it depends on what people carry around in their heads, on the knowledge, skills, know-how, and orientations they bring to economic activity.

THE ZERO-SUM SOCIETY: ARISTOTLE, AQUINAS, AND THE VIEW OF PROFIT

How does all of this relate to usury? Most classical writers saw no economic justification for deriving income from the merchant's role of buying and selling goods. Since the material wealth of humanity was assumed to be more or less fixed, the gain of some could be conceived only as a loss to others. Profits from trade were therefore regarded as morally suspect.

But of all forms of commerce, none was so suspect and so reviled as finance, the making of money from money. Aristotle regarded the lending of money for the sake of earning interest as unnatural. "While expertise in exchange is justly blamed since it is not according to nature but involves taking from others," wrote Aristotle, "usury is most reasonably hated because one's possessions derive from money itself and not from that for which it was supplied….. So of the sorts of business this is the most contrary to nature."[12]

With the recovery of Aristotle's thought in the high Middle Ages, the condemnation of usury would come to occupy a central place in the economic writings of Christian theologians and canon lawyers. This practice, which Aristotle had considered blameworthy, Christian theologians found sinful. Here they drew upon a verse from the 23rd chapter of the Book of Deuteronomy that had prohibited Jews from lending with interest to one another but

[11] The discussion which follows is adapted from chapter one of *Capitalism and the Jews*, "The Long Shadow of Usury: Capitalism and the Jews in Modern European Thought," where further references to the secondary literature can be found.

[12] Aristotle, *Politics*, ed. Carnes Lord (Chicago, 1984), book 1, chap.10.

allowed them to lend to non-Jews. "You may lend with interest to foreigners, but to your brother you may not lend with interest."

By the 12th century, Christian theologians had concluded that the term "brother" applied to all men and that the lending of money at interest was always sinful. The problem, however, was that this proscription was levied in an age that we now think of as the commercial revolution of the Middle Ages. And whenever you have commerce, you need credit.

So there was tension between theological precepts and the demands of economic life. One way the Church found to resolve this dilemma was, beginning in the 12th century, to prevent the evil of Christian usury by allowing Jews to engage in that forbidden economic activity. The reasoning here was that Jews were not subject to the prohibitions of canon law, and were condemned in any case because of their repudiation of Christ. Thus began an association of money-making with the Jews, an association that would further taint attitudes toward commerce among Christians. And it would continue to cast its shadow into the age of Enlightenment and beyond.

FROM THE CHRISTIAN BAN ON USURY TO THE MARXIST INDICTMENT OF CAPITALIST PROFIT

The notion that usury was immoral expressed in sophisticated terms a sentiment widespread among peasants and workers in most times and places—namely that only those whose labor produces sweat are engaged in "real work," and that all others essentially live off the work of those who sweat. Indeed, this sentiment might be thought of as furnishing what one might call the "deep structure" of Marx's thought. In Marx's notebooks, we find him quoting Luther's tirades against moneylenders. As Marx comments, Luther "has really caught the character of old-fashioned usury, and that of capital as a whole."[13]

The argument of Marx's masterwork, *Kapital*, rests on the *labor theory of value*. And the labor theory of value asserts that capital is fundamentally unproductive. Thus, the chapter on *Capital* entitled "The General Formula of Capital" has one main point: that capital is money that makes money, even if in a capitalist society it does so through the intermediary stage of the merchant who buys and sells commodities, or the industrialist who buys and sells labor. Or in Marx's resonant image, "The capitalist knows that all commodities—however shabby they may look or bad they may smell—are in faith and in fact money, internally circumcised Jews, and in addition magical means by which to make more money out of money."[14]

All the traditional prejudices against usury were now reformulated as a critique of the market in the age of industry. The book is replete with images of capitalism as parasitism. For Marx, as for Aristotle, and Luther, money—now rechristened "capital"—is fundamentally unproductive. Those who wield it do so at the expense of others. Indeed the Marxist theory of "exploitation" acquires much of its resonance from its continuity with the notion that capitalists, like usurers, grow rich by not working, by unjustly living off the work of others.

Marx was by no means the first to connect the critique of capitalism with the traditional stigmatization of usury—nor was he the last. One finds versions of this argument on the right as well as on the left. We find the same stigmatization of financial activity in the musings of the Nazi economic theorist, Gottfried Feder, author of *A Manifesto on Breaking Monetary Interest Slavery*. The official platform of the Nazi party, of which Feder was the arbiter, called for "the breaking of interest slavery," once again echoing the condemnation of usury.

Tracing the long shadow of usury casts an unexpected light on the history of thinking about capitalism and about the Jews. And that shadow takes a variety of forms. For better and for worse, the image of the Jew and the evaluation of capitalism have been deeply intertwined, and the histories of anti-capitalism and anti-semitism are closely connected. In 2014, the *Economist* magazine reported on a then-recent study showing that, in the areas of Germany with the highest historical rates of anti-semitism, people tended to be more suspicious of finance. As a result, they invested less in the stock market, and so their returns on their investments were lower.[15]

Though I will not explore this topic in depth here, I will just note that all of this affected the ways in which Jews thought about *themselves*. Some thought that their link to commerce and finance was to be applauded (as liberal thinkers from Montesquieu through Friedrich Hayek argued). But a great many other Jews regarded the connection between Jews and commerce as a source of shame and formulated plans to move Jews into other fields, such as crafts and agriculture.

RESPONSES TO RELATIVE JEWISH SUCCESS IN CAPITALIST SOCIETIES

Now let me descend from the level of ideas and ideology to the realm of behavior, political and economic.[16] Here one of the most significant trends is that Jews were particularly *good* at capitalism. As Ruppin noted in 1904, they tended to prosper wherever they attained the degree of civic equality that allowed them to engage freely in market activity. And that, in turn, led to reactions both positive and negative. For Jewish economic success led to very different degrees of Jewish economic *salience*, depending on the economic capacities and commercial orientations of the larger society. And that in turn led to very different *reactions* to Jewish economic success.

Britain and the United States were already highly commercial societies in the 19th century, in which most capitalist development was carried out by non-Jews. These were also societies in which commerce tended to be taken for granted, and anti-capitalist sentiments were relatively weak. So in the United States and Britain,

[13] Marx, Karl. 1965. "Theorien über den Mehrwert." In *Marx-Engels Werke* (Berlin), Vol. 26, part 1, p. 525.

[14] "Der Kapitalist weiß, daß alle Waaren, wie lumpig sie immer aussehn oder wie schlecht sie immer riechen mögen, im Glauben und in der Wahrheit Geld, innerlich beschnittene Juden sind, und zudem wunderthätige Mittel, um aus Geld mehr Geld zu machen." *Kapital*, MEGA, vol. 2, part 6, II, p. 172, my translation.

[15] "Another cost of bigotry: New research finds a link between persecution of Jews and distrust of finance," *The Economist*, October 18, 2014.

[16] The section that follows is adapted from Chapter 2 of my book *Capitalism and the Jews*, "The Jewish Response to Capitalism," where further references can be found.

Jews could be economically successful without being particularly conspicuous, except in those new industries into which Jews moved in search of opportunity, such as the movie business.

In Eastern Europe, by contrast, capitalism was a newer phenomenon. The non-Jewish majority was typically composed of landowners and peasants, neither of them particularly adept at market activity. In these regions, Jews often *were* the commercial class, leading to a close identification of capitalism with the Jews. And since jobs in the government sector were usually closed to Jews, they turned to vocations in the competitive market, from commerce and finance to the classic professions of law, medicine, and engineering. Germany fell in between the Western European and Eastern European patterns. The Jews were by no means the dominant portion of the commercial classes, but their rapid rise was conspicuous.

The salience of Jews in the economic life of central and eastern Europe in the last decades of the 19th century and the early years of the 20th is hard to overstate. Werner Mosse's study found that on the eve of the First World War, Jews comprised about a third of the German corporate elite, most of whom made their money in commerce or finance.[17] By the 1920s, 54% of owners of commercial establishments in Hungary were Jews, and Jews comprised 85% of the bank directors and owners of the country's financial institutions. In imperial Russia, moreover, despite the obstacles placed in their path, Jews played a disproportionate role in the organization and ownership of major industries, including textiles, sugar refining, flour mills, saw mills, grain and timber, banking, transport, and mining. By 1916, according to a contemporary Russian economist, Jews constituted 35% of the Russian mercantile class. Jews also comprised much of the entrepreneurial class in interwar Poland.[18]

No group was more committed than the Jews to acquiring higher education and the professional occupations that higher education made possible. By the early 20th century, especially in the capitals and larger cities of central and eastern Europe, such as Vienna, Warsaw, Prague, or Budapest, Jews made up 5%–10% of the population, but sometimes comprised a majority of the lawyers, engineers, pharmacists, and architects.

If the economic performance of Jews in central Europe in the late 19th and early 20th centuries was striking, their economic success in the United States would eventually become equally remarkable. Jews moved quickly out of manual labor, in which many first-generation immigrants had been engaged, and into proprietorship, management, and professional and technical fields. By the mid-20th century, Jews were massively overrepresented in the free professions, such as law, medicine, and accounting. At the beginning of the 21st century, over half of Jewish men and women were in professional jobs, as compared to only one-fifth of non-Jewish White men and women.[19] A detailed study from 2005 showed that Jewish household income in the United States is 70% greater than that of non-Jews, Jewish per capita income is 95% higher, and the net wealth of Jews is several times higher than the national average.[20]

[17] Mosse, Werner. 1987. *Jews in the German Economy: The German-Jewish Economic Elite, 1820–1935* (Oxford), cited in Rubinstein, W. D. 2000. "Jews in the Economic Elites of Western Nations and Antisemitism." *Jewish Journal of Sociology* 10(1 and 2): 5–35, 9–10.

[18] Rubinstein. "Jews in the Economic Elites of Western Nations and Antisemitism." 6,9.

[19] Chiswick, Barry R. 2010. "The Economic Progress of American Jewry: From Eighteenth-Century Merchants to Twenty-First-Century Professionals." In Aaron Levine (ed.), *The Oxford Handbook of Judaism and Economics* (New York), 642–3.

EXPLAINING ACHIEVEMENT

There are a number of ways of accounting for this disproportional achievement. For one thing, Jews had more experience with commerce than most other groups, and that helps explain why they tended to be better at it. As already noted, Jews' preference for market-oriented occupations can be traced back to the Middle Ages, when they were *pushed* out of other economic activities—such as farming and artisanry, from which they were sometimes excluded by the Church and by the religious nature of artisanal guilds.

But likely even more important were the factors that *pulled* Jews toward commerce. One of these was the simple fact that Jews on average had much higher rates of literacy, which gave them a comparative advantage when it came to commerce.[21] The suspicion of merchants and commerce so prominent in Christian tradition was lacking among Jews. In the Middle Ages, some rabbinic authorities wanted to encourage Jewish men to devote as much time as possible to study. The authorities therefore encouraged the pursuit of commerce rather than crafts on the grounds that it was less time-consuming and so left more time for religious studies. In sum, when compared to Christianity, Judaism *was* more favorably disposed toward commerce.

But more important than the *content* of Judaism were the *contexts* in which Jews found themselves. Often enough, when we look from the late Middle Ages on, we find that those Jews most eager to take up new economic opportunities did so not because they were following religious dictates, but because they were unconstrained by religious authority. It seems, for example, that Jews began to lend money at interest in medieval Europe before that practice was legitimated by rabbinic authorities. In other words, Jewish law *followed* Jewish practice, rather than the other way around.[22] In the early modern Atlantic world, merchants of Spanish and Portuguese Jewish origin (some of whom had been forced to convert to Christianity) engaged in commerce in ways and in places that were not sanctioned by rabbinic authority, or followed economic opportunity regardless of rabbinic preferences.[23] Today, in both the United States and Israel, the most Orthodox are the least likely to attain (or even aspire to) economic and professional success. If the most religious are the least economically successful, it is difficult to point to the *content* of traditional Judaism as the major source of Jewish economic achievement.

[20] Smith, Tom W. 2005. *Jewish Distinctiveness in America: A Statistical Portrait* (New York), 6; also Barry Chiswick, op cit).

[21] A theme most fully developed in Botticini, Maristella, and Eckstein, Zvi. 2012. *The Chosen Few: How Education Shaped Jewish History, 70–1492* (Princeton).

[22] See on this Salo Baron, "Economic History," *Encyclopedia Judaica*; Haym Soloveitchik, "The Jewish Attitude in the High and Late Middle Ages (1000–1500) in Diego Quaglioni," Todeschini, Giacomo, and Varanini, Gian Maria, eds. 2005. *Credito e Usura fra Teologia, Diritto, e Amministrazione* (Rome), 115–27; and Toch, Michael. 2013. *The Economic History of European Jews. Late Antiquity and Early Middle Ages* (Leiden).

[23] Kaplan, Yosef. 1995. "The Religious World of a Jewish International Merchant in the Age of Mercantilism: The Embarrassment of Riches of Abraham Israel Pereyra." In: *Religion and Economy: Connections and Interactions*, ed. Menachem Ben-Sasson (Jerusalem), 233–51 (Hebrew).

Instead, we must look to political, social, and economic history for the sources. In pre-modern European societies, Jews were outside the feudal order of serfs, landowning nobility, and merchants and artisans organized into exclusive guilds. The roles they assumed were largely those of middlemen between producers and consumers: a commercial ladder ranging from peddling and hawking (selling from a horse and cart), through pawn-broking and money-lending, through inter-regional and inter-national trade. Worldly survival meant the ability to cultivate a rational economic ethos, based on pursuing profit, assessing risk, exploring new markets, and minimizing consumption with the aim of accumulating capital. These were the value orientations and character traits with which they entered the modern capitalist world.

Another key part of Jews' cultural ethos has been dubbed by the sociologist Victor Karady "religious intellectualism."[24] Theirs was a religion-oriented to continuous contact with texts: a culture of handling books, reading them, and reflecting upon their messages. This was an essential element of Jewish religious culture and one that distinguished them from most other mercantile minorities. No wonder, then, that when the learned professions were opened to them, Jews excelled in them. This heritage of religious intellectualism may help explain a widely noted phenomenon—namely the tendency of modern Jews to invest heavily in the education of their children. As the labor economist Barry Chiswick has noted, some groups, including the Jews, may have a greater "taste" for education because their rates of economic return on schooling are greater, either because of the orientations conveyed in their homes or innate ability.[25]

All of this was a recipe for what economists now call "cultural capital." Jews tended to possess the behavioral traits conducive to success in a capitalist society. They entered commercializing societies with a stock of "know-how" from their families and communities about how markets work, about calculating profit and loss, about assessing and taking risks. Most importantly, though hardest to specify, Jews demonstrated a propensity for discovering new wants and for bringing underused resources to the market. They tended to be on the lookout for new opportunities, reaching out to underserved markets (as peddlers for example), or creating new products, or new forms of marketing.

Social networks also played an important role. Jews were spread out across many countries but to some extent felt bound by a common language and sense of shared fate. Under circumstances affording little if any reliable institutional redress of commercial disputes (and that has been the reality in most times and places before the 20th century) people are more likely to engage in distant commerce with those they think they can trust, and the shared religion of Judaism seemed like the most reliable indicator of trustworthiness. Of course, trust is a relative thing, and it is sometimes betrayed.[26] But it worked well enough, often enough, to be an important factor in allowing Jews to engage in trans-regional and international trade.

[24] Karady, Victor. 2004. *The Jews of Europe in the Modern Era* (Budapest).

[25] Chiswick, Barry. 1988. "Differences in Education and Earnings Across Racial and Ethnic Groups: Tastes, Discrimination, and Investments in Child Quality." *Quarterly Journal of Economics* 103(3): 571–97.

[26] As Francesca Trivellato shows in her book, *The Familiarity of Strangers: The Sephardic Diaspora, Livorno, and Cross-Cultural Trade in the Early Modern Period* (New Haven, 2009).

It is often noted that, as a discriminated against minority, Jews often sought out economic "niches" in which they could find opportunities. But however valid, that generalization misses another key aspect of Jewish "resourcefulness" and success: their ability to *abandon* mature or declining economic niches in a timely fashion. In a dynamic capitalist economy, long-term success is a function not only of getting *into* a potentially rising business at the right time but also a readiness to get *out* of a declining business or sector before you go bankrupt.

As business strategists and financial economists have long advised their corporate clients, economic failure is the predictable outcome of sticking to niches in which one once had a comparative advantage but no longer does. In the United States, for example, a substantial number of first-generation immigrants from Eastern Europe rose from the ranks of workers in the clothing trades to become entrepreneurs in the clothing trades. But as significant is the fact that many such entrepreneurs abandoned manufacturing shortly thereafter for more promising opportunities. By the second generation, if not earlier, they had moved into other forms of retailing, and then into real estate and the professions.[27] In the long run, then, ongoing economic success depends on not having too strong a commitment to any particular business or profession, and a willingness and even disposition to entertain "options."

Regardless of how we account for Jewish commercial success, by the late 19th century, the salience of Jews' economic success in societies undergoing capitalist development created psychological and political effects, as Jews became an object of envy and resentment. Jewish awareness of the resentment aroused by disproportionate Jewish success led to a variety of strategies, of which the most important was, arguably, Zionism.

THE RELATIVE NEGLECT OF AN UNCOMFORTABLE SUBJECT

As I suggested earlier, the relationship of Jews to capitalism is important for understanding not only modern Jewish history but many elements of the modern history of capitalism. Hence my opening claim that my subject—the intertwining of these two histories—has received less attention than it merits. Let me conclude with a few thoughts on why I think the subject continues to be neglected.

For Jews, Jewish economic success has long been a source of both pride and embarrassment. The fact that Jewish economic success led anti-semites to condemn capitalism as a form of Jewish domination and exploitation, or attributed Jewish success to unsavory qualities of the Jews themselves, or simply the fact that success aroused envy, has led a great many Jews to downplay the reality of Jewish economic achievement, especially in the decades after the Holocaust.

For economists and economic historians, the extent to which modern capitalism has been and continues to be shaped by older

[27] Godley, Andrew. 2000. "Cultural Determinants of Jewish Immigrant Entrepreneurship in the US and USA and British and American Culture." In Mark Casson and Andrew Godley (ed.), *Cultural Factors in Economic Growth* (Berlin), 125–41; 133. Ruppin was well aware of this phenomenon, Ruppin, 189–90.

cultural predispositions is a source of puzzlement at best, and generally dismissed. It simply does not fit into the categories in which those economic historians who have adopted the armature of econometrics are predisposed to think. In recent decades, economists have added the concept of "human capital" to their kitbag. But they prefer to think of it in terms of measurable criteria such as years of schooling. To the extent that human capital involves character traits and varieties of "know-how" that are not provided by formal education, it becomes methodologically elusive.

The subject is also a source of discomfort for a number of political camps.

For nationalists, especially in Eastern Europe, the fact that modern nationalism had fateful consequences for the Jews precisely because the Jews were so *good* at capitalism was itself a source of embarrassment. In the late 19th and 20th centuries, many nationalist movements sought to restrict Jewish citizenship and legal equality out of the perception (partly well-founded) that Jews excelled at capitalist activity compared to their non-Jewish countrymen. For many nationalists, in countries from pre-revolutionary Russia to Poland, Hungary, and Germany, the "real" nation was defined in good part over-and-against the Jews. When economic life was conceived of as a zero-sum game, in which the gains of some could only come at the expense of others, the gains of the Jews were made responsible for the psychic or material pains of the "authentic" members of the nation. The extent to which the fellow-feeling between gentry, artisans, peasants, and industrial workers was forged in a shared and cultivated antipathy to the Jewish "other" is a part of national history that nationalists would rather forget.

For Jews of the Marxist left, capitalism was by definition a system of exploitation and inequity. Who would want to be associated with *that*? So, for them, Jewish economic success was a matter to be overlooked or explained away.

For liberals, the reality of differential group achievement under conditions of legal equality is something of a scandal, an affront to egalitarian assumptions. It casts a shadow of doubt on the shibboleth of "equality of opportunity." For if it turns out that the ability to take advantage of opportunity is deeply influenced by cultural traits with long historical roots, and transmitted in the private realm of the family and the cultural community, then inequality of outcome cannot be attributed merely to legal discrimination. Nor can it be eliminated by formal, public institutions such as schools.

For all these reasons, the exploration of Jews and capitalism has tended to be left to apologists, ideologues, and anti-semites. But it need not be that way. As I have suggested in these pages, there are promising trends among historians, economists, and sociologists—trends that, by shedding light on the manifold links between capitalism and Jews, hold out the promise of increasing our understanding of both.

KEYWORDS
anti-semitism, capitalism, Glen Weyl, Jews, Marx

How to cite this article: Muller, J. Z. 2024. "Capitalism and the Jews revisited." *Journal of Applied Corporate Finance* :1–7. https://doi.org/10.1111/jacf.12602