

# CAPITALISM AND INEQUALITY: WHAT THE RIGHT AND THE LEFT GET WRONG

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**R**ecent 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 the 2012 U.S. presidential election and the 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, whereas 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 -- 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 twentieth century that finally enabled capitalism and democracy to coexist in relative harmony.

**I**n 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 seventeenth and eighteenth 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.

Commodification -- 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 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 gave rise, in turn, to new markets for information and to the business of gathering and distributing news. In the eighteenth 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 with 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 -- such as 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, therefore, 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, in which habits are developed that influence their subsequent fates as people and 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 eighteenth 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 eighteenth and early nineteenth 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. As opposed to in 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.

**A**t 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 nineteenth 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 nineteenth-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-nineteenth to the mid-twentieth century, de Vries has argued, 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. This posed a problem, because 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 a job 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 sketched out 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.

**I**n the twentieth century, the economist Joseph Schumpeter would expand on these points with his notion that capitalism was characterized by "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 nineteenth-century industrial capitalism led to the creation of new institutions for the reduction of insecurity, including the limited liability corporation, to reduce investor risks; labor unions, to further worker interests; mutualaid societies, to provide loans and burial insurance; and commercial life insurance. In the middle decades of the twentieth century, in response to the mass unemployment and deprivation produced by the Great Depression (and the political success of communism and fascism, which convinced many democrats that too much insecurity was a threat to capitalist democracy itself), Western democracies embraced 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 profits and wages to government purposes through taxation. The demographics of the postwar era, in which the breadwinner-homemaker model of the family predominated, helped also, 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 twentieth and early twenty-first 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 twentieth century, in every genre, are available on YouTube for free. Many of the great films of the twentieth 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 is more likely to be made of peers, with more equal levels of education and more comparable levels of economic achievement -- a process termed "assortative mating."

## **INEQUALITY ON THE RISE**

These postindustrial social trends have had a significant impact on inequality. If 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 men who are chronically unemployed sometimes 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 -- and 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 economist Brink Lindsey notes in his recent book *Human Capitalism*, between 1973 and 2001, average annual growth in real income was only 0.3 percent for people in the bottom fifth of the U.S. income distribution, compared with 0.8 percent for people in the middle fifth and 1.8 percent 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 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 U.S. 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 than 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 U.S. 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 fate 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 U.S. 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 with their own funds but also with 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 led 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 managers and employees, the result has been a constant churning that increases the likelihood of job losses and economic insecurity.

An advanced capitalist economy does indeed require an extensive financial sector. 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. These matters, which properly occupy financiers, have important consequences, and handling them requires intelligence, diligence, and drive, so 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 some unfortunate consequences, both in increasing inequality by raising the top of the economic ladder (thanks to the extraordinary rewards financial managers receive) and in increasing insecurity among those lower down (thanks to the intense focus on short-term economic performance to the exclusion of other concerns).

## **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 child care, 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 and playing of computer games).

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 percent 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 U.S. high school graduation rate is about 75 percent (down from a peak of about 80 percent in 1960), and roughly 40 percent of young adults are enrolled in college.

The Economist recently repeated a shibboleth: "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 a perverse product 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 post-industrial 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 the 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 don't, 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). There are examples of isolated successes with such programs, but 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. Now as ever, however, 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 eighteenth 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 postmarket 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 solve the underlying problems.

A second cure, using government policy to close the gaps between individuals and groups by offering preferential treatment to underperformers, may 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 impede the quality of the educational system, the work force, and the economy.

A third possible cure, encouraging continued economic innovation that will benefit everybody, is more 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 eighteenth 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.

For capitalism to continue to be made legitimate and palatable to populations at large, therefore -- including those on the lower and middle rungs of the socioeconomic ladder, as well as those near the top, 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 right needs to accept that they serve an indispensable purpose and must be preserved rather than gutted -- that 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 if nothing else, the enlightened self-interest of those who profit most from living in a society of capitalist dynamism should lead them to recognize that it is imprudent to resist parting with some of their market gains in order to achieve continued social and economic stability. Government entitlement programs 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, 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 may impede

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, since their priorities, traditions, size, and demographic and economic characteristics vary. (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 the rejection of both the politics of privilege and the politics of resentment and the adoption of a clear-eyed view of what capitalism actually involves, as opposed to the idealization of its worshipers and the demonization of its critics.

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