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**THE CHANGING FACE OF BUSINESS**

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## **THE CHANGING FACE OF BUSINESS**

**At the end of the twentieth century, it seems natural to adopt a broad sweep and to consider how the face of business has changed over the past one hundred years. It goes without saying that it has changed, in some ways radically so. But it's worth stressing at the outset that business today is recovering some of the characteristics that it lost during the present century.**

**The most obvious of these characteristics is its international dimension. Nowadays, this is often referred to as 'globalisation', as if this were some wholly new phenomenon. In reality, the present internationalisation of business has been building up ever since World War II, in reaction against the protectionism that preceded that war and helped to cause it. Almost everywhere, governments, to varying degrees, have liberalised trade in goods and services and controls on capital flows, and in some cases have eased restrictions on movements of people as well. Moreover, modern 'globalisation' has yet to re-establish the degree of international integration that was achieved by the end of the nineteenth century, the century in which the ideas of Adam Smith about free markets and free trade were most fully reflected in public policy, especially in Britain. From this perspective, the twentieth century looks like a long detour for business, during which governments lost their way in the protectionist wilderness and, over recent decades, have slowly been getting back on track. It brings to mind a joke that circulated in Hungary under communism: "Question: What is socialism? Answer: The longest and most painful road from capitalism to capitalism".**

During that detour, the face of business – or the free enterprise system – acquired several scars which, though fading, are still evident. One hundred years ago a much larger share of the population was employed in the private sector than today. Then, government commanded only about 10 percent of the economy. During the twentieth century and until very recently, government spending has absorbed a higher and higher fraction of national income, not just in communist countries but in the Western democracies as well. There, it has sometimes gone as high as 60 percent of the economy; in New Zealand it is around 40 percent. After trending

downwards in the early 1990s the government spending ratio in New Zealand will have risen again for four successive years by the coming financial year, according to the government's projections. Yet even these massive levels of government spending underestimate the impact of government on society, which is exercised not only through spending and taxation but also through regulation and ownership. And although state ownership is going out of fashion everywhere, although more slowly in New Zealand than in many other countries, regulation is not, and is even increasing.

This rise of the state throughout the twentieth century was accompanied by a number of anti-business – or at least anti-market – doctrines that were to become extremely influential among intellectuals and the framers of public opinion generally. Although these doctrines are largely discredited today, they retain a powerful hold on the imagination and prejudices of academia, the media, and sections of the general public. Their influence is evident in the constant invasions by governments and courts into property rights and contracts freely entered into by responsible individuals. Organisations like the New Zealand Business Roundtable find themselves obliged to carry on a constant campaign to refute them in their many and recurring guises.

Several factors contributed to this shift of opinion against the market. By the end of the nineteenth century, the industrial revolution had quadrupled average wages in Britain and lifted the mass of the population from centuries-old poverty. Yet – as is the case, for example, in China today – material progress is never uniform, and the mythology of an impoverished factory proletariat and a rapacious and increasingly prosperous capitalist class also became firmly established in Britain, propagated in literature (especially certain novels by Charles Dickens) and in socialist propaganda. The counterpart myth in the United States was the alleged emergence of a class of so-called 'robber barons' who became fabulously wealthy as that country industrialised. Envy-based ideas, such as the fallacious notion that the poor are poor because the rich are rich, have always found responsive audiences. Thus, despite its phenomenal success in raising living standards in the previous hundred years, the capitalist system ended the century under a cloud. For many people the idea of business lost its primary connotation as the mundane matter of earning one's

living in the marketplace, and came to be identified with a dominant social class characterised by wealth and privilege.

The best known intellectual critic of capitalism in the nineteenth century was, of course, Karl Marx. Marx had attacked the classical political economists' idea of the market as a system of voluntary exchanges from which all parties benefited, and substituted his own analysis of the market as a mechanism of class exploitation. Equally influential was his argument that the free market was self-destroying: that competition led to monopoly as larger firms swallowed their rivals or drove them out of business. Among Marxist true believers, this was an indispensable part of the doctrine of the historical inevitability of the demise of capitalism and its replacement by socialism. But the idea was widely accepted also by many non-Marxist intellectuals, including some who were not necessarily hostile to business. Among them, the issue was how to manage the power of the giant corporations that had emerged as a new historical phenomenon. Their answer was *corporatism*: a political system in which corporations negotiated deals and wielded power with the other main social organisations, in particular trade unions and the government itself. The corporatist phase of the history of business, which dominated the middle decades of the twentieth century and was prominent until very recently in New Zealand – Mike Moore, for example, used to talk about "the negotiated economy" – is responsible for many of the current perceptions and misperceptions of business.

The most influential theorist of corporatism, though not necessarily the best known, was the economist Joseph Schumpeter. It is ironic that Schumpeter's best work highlighted the importance of entrepreneurship and innovation in the early phases of capitalism. Schumpeter spoke of the "gales of creative destruction" which the free market unleashed and which generated unprecedented wealth by continuously replacing existing ways of doing things with more productive ones. However, he took the view in his 1942 book *Capitalism, Socialism and Democracy* that the appearance of large corporations in the early twentieth century signalled that the age of the free market and the entrepreneur was over. The modern corporation, so he thought, was not subject to market forces. It was run, he claimed, not by entrepreneurs or shareholders seeking to maximise their profits but by managers with the power to dominate markets unchecked by the forces of competition.

This analysis of modern capitalism had profound implications for public life. Schumpeter put forward corporatism as an alternative to violent socialist revolution that would nevertheless deliver all the benefits of central planning. The state should become a kind of coordinating mechanism by overseeing the investment plans of corporations and, in cooperation with their managers, work to eliminate the business cycle. Meanwhile, it would co-opt the trade union movement and use it to discipline the workforce – Schumpeter made no secret of his admiration for the way that communist regimes had abolished the right to strike (since it so clearly undermined central economic planning) and then imposed official trade unionism on the workers. Such a system could become formally socialist by abolishing private property. However, this was hardly necessary for the success of central planning, since the industrial managers were effectively in control of their corporations regardless of whether these were legally owned by shareholders or by the state, and they could see the benefits of planning as a means of preserving their market shares.

The best-known populariser of corporatism in modern times has been John Kenneth Galbraith. He was better disposed to trade unions than was Schumpeter, seeing them as a necessary 'countervailing power' to corporations. But he was very successful in spreading the idea of an economy dominated by the producer power of corporations (using means such as advertising) as opposed to the consumer power of the general public. This idea is also propagated by commentators like Noam Chomsky, who is openly hostile to big corporations (though not to big government) and believes that they dominate the media in order to promote notions that reflect their own interests. (He seems not to have noticed that his latest television programme advancing this message amounted to an automatic refutation of it.)

Such ideas – the market superseded by planning, and corporations arranging the world to suit their own interests – have sunk deep into the way many people think about business. The trouble is, they are wrong. Monopoly is one of the most over-emphasised and abused concepts in economics. In the absence of state-conferred protection, the overwhelming majority of large businesses get large because they out-perform others in meeting consumers' needs. They can't get and stay large in competitive markets without consistently delivering value for the goods and

services they produce. The trouble arises when governments start granting protection and favours to businesses, and picking and backing industry 'winners' with subsidies. Such policies lead firstly to wealth-destroying interventions such as import licensing and producer boards and ultimately to fiascos such as the 'Think Big' projects of the Muldoon government or Asian-style crony capitalism. Judging by recent government statements about "fostering enterprise", opposition party statements about "industry policies" and *Business Herald* interpretations of Ireland's economic performance, we don't seem to have heard the last of them.

Schumpeter and other corporatists failed to notice that decentralisation of the economy proceeded at the same time as centralisation; as some firms grew or merged to form giant corporations, plenty of small firms were being born as well. We now know that the alleged "separation of ownership and control" of business was another myth; large shareholders have always played an important part in corporate decision-making. Consumer sovereignty is real; most new consumer goods fail the test of the marketplace, despite the best efforts of advertising agencies. In other words, central economic planning in any of its guises doesn't work, whereas the competitive market does work, and only those firms that respond to market signals have any security.

All this is well established, but the images of business imprinted by refuted doctrines live on in some quarters. If we want a simple fact to put these images into perspective, take *The Economist's* measure of the significance of multinational corporations in the world economy. In its issue of 27 March 1993, it calculated that the top 100 multinational companies accounted for between 40 percent and 50 percent of all cross-border investments, but only represented about 16 percent of the world's productive assets. That is to say, the world economy consists mainly of small and medium-sized businesses; it always has done, and things are not likely to change. As far as New Zealand is concerned, even its largest businesses are quite small by world standards.

In the last two decades, the critique of corporatism has made great advances as the failures of corporatist policies became obvious and had to be replaced by new policies based on a better appreciation of the facts of economic life. By and large,

governments increasingly see their role as creating the background conditions for a successful market economy: providing law and order, enforcing contracts, balancing the budget, keeping prices stable, and making some educational and infrastructure investments that the private sector may be unable or unwilling to undertake. Most governments still have a great distance to go to get back to these core functions, and there are always temptations to backtrack in response to interest group pressures. But we are living today at a time when liberal ideas have regained the ascendancy and may continue to spread in depth and scope.

The spirit of what has been called modern democratic capitalism has always been best sustained in the United States. Nevertheless, the wealth-creating capacity of the US economy was seriously undermined by the regulatory intrusions of the New Deal, the expansive Great Society welfare programmes and a host of other dubious interventions by legislatures and courts. This mischief has been only partially undone by the reforms of the Reagan era, which the Clinton administrations have extended into areas like welfare. But at the turn of the century, and for all its flaws – many of them self-inflicted – the US or Anglo-Saxon model of capitalism is again showing the way as America extends its lead in productivity, technology and job creation. It stands out by comparison with the failed communist systems, the corporatism that has disfigured some Asian economies, and the struggling welfare states of Europe.

The prolonged boom of the 1990s has stimulated talk in the United States of a 'new economy' that may overcome the business cycle and deliver more or less permanent full employment and economic growth. The major features of this still hypothetical economy are a high level of technological sophistication; much greater flexibility in labour markets; plenty of venture capital to fund new business ideas; an ethos of enterprise encouraged by widespread share ownership; and a policy regime of low taxes (including low capital gains tax), low interest rates (underpinned by a balanced budget), light regulation, and welfare that moves beneficiaries rapidly into employment. As yet the United States only partly approximates this description, and it is naïve to think that the business cycle will ever be fully tamed. I do believe, however, that the vision of the 'new economy' has sketched the features of the emerging new face of business.

After spending most of the century under the cloud I described earlier, capitalism has become more popular in a number of senses. One is the spread and diversification of property ownership. Countries like New Zealand have long been 'property-owning democracies' in the sense that most homes are owner-occupied and most people can aspire to become a home owner. But real estate is a relatively immobile form of property that is only infrequently traded. Owners of stocks and bonds, on the other hand, can become engaged in business by trading them as often as they wish. The rise of private investment and superannuation funds in recent years has introduced indirect ownership of securities to many millions of people. As retirement income provision becomes more and more a private responsibility, these trends will intensify. Privatisation of former state businesses and the demutualisation of mutual companies and cooperatives are deepening investment markets. And all the while the numbers of self-employed are continuing to grow.

Managing a personal portfolio of investments may take time, but the rewards will be considerable in terms of new choices over lifetime career paths (including by financing investments in education and training) and new trade-offs between work and leisure. In such a world, the distinctions carved on the old face of business, such as that between 'bosses' and 'workers', will become increasingly irrelevant. More and more people will acquire a stake in a policy regime that is friendly towards an inclusive, popular capitalism as opposed to the privileged, corporatist version of the past.

A similar, category-dissolving trend is the spread of contracting generally and in the labour market in particular. At one time employment was based on the notion of the master-servant relationship, in which the employer was deemed to 'control' the employee. The Employment Contracts Act went a long way towards establishing a regime of free contracting in the labour market and consolidating the shift from status to contract. The working relationship is increasingly understood as a matter of voluntary exchange: a far cry from past systems of industrial feudalism, hierarchical control and monopoly trade unionism.

A further feature of the new democratic capitalism is the 'feminisation' of business. Business is proving to be a major force for the emancipation of women. In New

Zealand as elsewhere, increasing numbers of women are entering the formerly mainly male preserve of top management. Others are finding compensation in small business. In the United States today, most new small businesses are headed by women; some surveys suggest they are more successful than those started by men. I think there is no more reason to expect similar distributions of men and women in all types and levels of business any more than in other walks of life – talents, preferences and career paths are likely to differ in systematic ways. But markets are powerful forces for penalising discrimination based on unfounded prejudices – for the purposes of business the colour of people's money is more relevant than the colour of their skin. Because they encourage a search for best value, competition and open markets check discrimination and will reveal where the sexes have particular advantages, and no doubt the same could be said for ethnic groups as well.

Bringing marginal groups into the mainstream workforce is one of the most encouraging effects of full employment in the United States. Flexible labour markets have enabled employers there to respond to rising demand for their products by creating more jobs as well as by increasing wages. Partly because of this, the welfare rolls are falling fast. As US economist David Hale put it in the *Financial Times* of 14 April 1997:

American companies would not usually be enthusiastic about hiring people from the welfare rolls. Their low skills are a barrier to productivity, they require a heavy investment in training – and the US does not have a tradition of apprenticeship. The government spends far less on worker training programmes than other industrial countries. But, given the current tightness of the labour market, companies have little choice but to hire people they would once have shunned. In Chicago, Milwaukee and other mid-western cities, businesses are being forced to recruit untrained workers, with the help of inner-city high school principals and church pastors, because there is no one else to hire.

The lesson for New Zealand, with a Maori unemployment rate now approaching 20 percent, should be plain.

In this way, business is succeeding where government programmes often do not. It's not difficult to work out why training undertaken by the private sector is likely

to be more useful than that provided by government, which is often motivated largely by a desire to mask true levels of unemployment. Welfare programmes based simply on handouts to able-bodied people have failed everywhere – they have given people a way to get by without having to do any work or go in for self-improvement. And government-mandated affirmative action programmes have often been shown to benefit allegedly disadvantaged people who are already employed and have prospects, rather than those who most need help.

Higher employment in the United States has contributed to a falling level of crime. The US Justice Department reports that since 1993 violent crime has fallen by more than 21 percent, to its lowest level in at least 24 years, while property crime is down 22 percent since 1973. Other factors have been at work as well, like better law enforcement and welfare reform, but it's obvious that the more opportunities exist for employment, the less attractive a life of crime will seem. Nor is it the case that the new jobs created in such spectacular numbers by America's economy in the 1990s are typically low-paid, unskilled and part-time: in reality, employment is increasing at all points on the income scale, in full-time as well as part-time jobs. Of course the United States does have 'working poor', but they are better off than in most other countries, and they surely have a better chance of working their way up the income ladder than they would elsewhere.

The benign social effects of a well-functioning free-enterprise system should be borne in mind when one encounters the standard moral argument against modern business, namely that it encourages an ethos of greed and selfishness as opposed to one of social concern and community. This argument is tenacious, perhaps because it is the last superficially plausible argument against economic freedom that remains, all the others having been silenced by experience. But it too deserves to be silenced. Greed, selfishness and envy, as well as more noble emotions, are part of human nature and therefore present in all economic systems. The issue is which systems check our baser motives and encourage the better angels of our nature, and on that score central planning, corporatism and political/bureaucratic arrangements fare badly. The exchange relationships of the marketplace socialise us into the elementary virtues, like self-discipline, cooperativeness and respect for others, that we all need to learn if we are to succeed in realising our goals.

Compare the United States and its economic dynamism and falling unemployment and crime rates with France, where business is perhaps more unpopular than in any other Western democracy. There, misguided welfare and labour market policies are locking out of the workforce a huge share of the population under 25 years old. The result is rising social tension and a steady flow of recruits to xenophobic political parties. The French bureaucratic elite likes to view the free market as the 'law of the jungle' – something to be civilised by judicious intervention – and to contrast its social model with what it regards as the individualistic, 'devil take the hindmost' approach of the Anglo-Saxons. One would like to think that the lesson in the different outcomes was self-evident; sadly, it seems not to be.

One reason why the potential of a free enterprise system to promote social cohesion and mutuality remains underestimated is that entrepreneurs are largely barred from entering the market for the delivery of social services. The private service sector is growing rapidly, aided by the Internet and other democratic technologies that can drastically cut transaction costs and lubricate markets. Imagine what business could do if it had unhampered access to the markets for the finance and provision of education, health care and disability services. For this to happen, the present government monopolies in these areas will have to be exposed to potential competition from private entrepreneurs.

Some of this speculation about the changing face of business may sound somewhat implausibly upbeat. It's true that I have been painting an optimistic picture of developments. But there are grounds for optimism. Going into the next millennium, we can see liberal ideas continuing to spread, even though they have yet to take root in some parts of the world. Economic freedom is also a powerful force for greater political freedom. We can see democracy and greater recognition of human rights steadily advancing in regions like Latin America and Asia. And as the nations of the world become ever more closely drawn together through trade and other business links, the prospects for global peace are also advancing: I think it is still the case that no two countries in which McDonald's operates have ever been to war with one another.

A very important reason for optimism in my view is the evidence that younger people by and large do not share the hostility towards business displayed by many of their elders. The people who articulate suspicion of business – journalists, teachers, academics, bishops, lawyers, and so on – largely belong to that generation (the 'baby boomers') that got its university education in the 1960s. Like elites through the ages, too many of them have learned nothing and forgotten nothing since their formative years – not even in the face of the collapse of communism. But they have largely failed to pass on their collectivist ideology to their children, who have been contemptuously called 'Generation X' for failing to mirror their parents' prejudices. My impression is that younger people are generally uninterested in statist philosophies and the machinations of politics. The idea that Washington – or for that matter Wellington – could be described as Camelot would be greeted with derision by most of them. Big government is seen as the dead hand of the past, not the wave of the future. If its allure continues to fade, this could well be the natural and welcome long-term effect of the collapse of the Berlin Wall.

Some evidence for this impression comes from a report in *The Economist* of 17 January 1998. The American Council of Education has sponsored an annual survey of college entrants since 1966. In that year (when many of today's intellectuals were undergraduates), 60 percent of students thought it important "to keep up to date with political affairs"; by 1997 this figure had fallen to 25 percent. This trend is not universal; for example young people in France seem to have inherited the statist opinions of their parents. But New Zealand resembles the United States in having undergone a programme of economic reform which has reined in the public sector and significantly increased the share of young people who work in the private sector. The long-term consequences of this could be profound. The more people who work in business, the more normal it will become and the more it would be taken for granted.

This, for me, would be the ideal state of affairs: business becomes the everyday activity of life, so long as people want and need to work to support their lifestyles, their income and their retirement. There is surely no more personally rewarding and socially valuable vocation than meeting other people's needs. Business is just

the nation in its working clothes. Insofar as we all wear working clothes, as well as other clothes on other occasions, it is simply the sum of the faces of all of us.