Inequality and Alienation in the Socialist Capital Market

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The case for the practical importance of markets is far stronger than the case for private ownership of capital, and the case for private ownership in general is far stronger than the case for the particular ownership arrangements that currently prevail in Western capitalism. Thus, John Roemer's effort in 'A Future for Socialism' to revive the market-socialist tradition of speculation about how alternative property arrangements might square equality with efficiency is promising.

I have some doubts, however, about the specific institutional proposals Roemer makes, and I want to explore two of them here. The first concerns technical difficulties in trying to advance socialist egalitarian goals by equalizing equity ownership in a liquid, national capital market. The second concerns potential effects of the recommended market arrangements on political motivation and culture that even a socialist determined to avoid utopian views of human nature should confront.

Both lines question the viability of achieving socialist goals through the limitation of ownership rights in a conventional capital market without more directly democratizing economic processes. The doubts resonate with what might be called a romantic or petty bourgeois socialist perspective centered on worker and community-controlled enterprise. While Roemer, following Oscar Lange, operates on the Walrasian terrain of perfect competition, the romantic perspective has more affinity, as both normative and prescriptive propositions, with the Williamsonian perspective of shared monopoly and relational capital.

I hope it is apparent that these remarks arise from great sympathy with Roemer's aims and deep admiration for his brilliant contribution to reopening and advancing the debate over market socialism.
Inequality

In Roemer's capital market, equity can be purchased only with coupons, not with cash. Every citizen receives an equal allotment of coupons at some point in her life, and the coupons, or shares purchased with them, escheat to the state on the citizen's death. People with cash to invest have to do so by purchasing debt (unless they start their own small businesses).

The goal is to constrain inequality in consumption opportunities by precluding inheritance and to constrain inequality in corporate ownership by limiting the use of cash to acquire shares, while maintaining a capital market that appraises corporate performance through the coupon price of shares. A major virtue of equality in corporate control is pressure for the reduction of 'public goods', such as pollution, through the reallocation of economic incentives.

I fear that the goals of equalizing consumption and ownership will prove vulnerable to opportunities for substitution that the capital market will likely generate.

Consumption

In a conventional capital market, an investor's valuation of shares is not affected by her consumption plans or her life expectancy. In the coupon economy, the investor will be strongly influenced by the latter and probably somewhat influenced by the former.

To take the clearest case, consider someone with a short life expectancy. Her self-interest is to maximize her income during the brief remainder of her life, and she does this by trading for stocks that promise the largest dividend payout during that period.

Managers can cater to this clientele (which also includes younger people who would rather not wait for their dividends) in a variety of ways. One is simply to accelerate the pace of dividends by cutting back on investment, deferring maintenance or selling off assets. Another is to spin off projects with shorter payoffs into separate entities represented by separate securities. For example, in the 1980s, oil company executives were urged to divide among entities with separate securities but common management their "cash cow" producing wells on the one hand and their more long-term drilling and exploration efforts on the other. A few undertook restructurings along such lines. Under the influence of the financier Carl Icahn, USX restructured so that its steel business and its non-steel assets, which were thought to have a more short-term payoff, were represented by distinct securities. Managers and investment bankers could package investments in myriad ways to satisfy almost any time preferences.

Such practices would be damaging to the aspirations of Roemer's program. First, the ability of the first generation of coupon recipients to capitalize shareholdings during its lifetime would create a major problem of intergenerational equity and jeopardize the long-term viability of the program. Secondly, the signalling function of coupon prices would be compromised by the fact that such prices will be functions, not just of expectations about profits, but of the varying time preferences of investors. Thirdly, the general effect would probably be to shorten undesirably the time horizon of investment planning.

It is hard to think of a rule governing income realization and dividend payments that would solve the problem. It would not be practical to distinguish the extent to which managerial decisions are motivated by illegitimate time preferences of investors. Moreover, proper investment and dividend decisions would require managers to make use of market-given discount rates that themselves would reflect to an indeterminate degree time preferences induced by the limitation of property rights.

In a recent amendment to the scheme in the book, Roemer proposes an ingenious response to the time horizon problem: require that citizens invest through mutual funds that in turn must have a representative age distribution of holders. This seems an improvement, but it still leaves problems.

First, even if this scheme proved administrable, the time horizons of the funds would still be considerably shorter than the horizons under conventional capitalism. This is because under Roemer's scheme no one will have a horizon greater than her life expectancy, whereas under capitalism, which permits bequests, many will have longer ones.

Secondly, the administrative requirements of the age-mix condition seem daunting. The market creates strong incentives for non-compliance or sham compliance. Funds dominated by older people looking for 'cash cows' would have incentives to make side payments to younger people to allow them to achieve their age quotas. Young people with shorter life expectancies might be assiduously recruited. One thinks of the difficulties of enforcing 'set aside' contracting programs for minorities and women in which questions constantly arise as to whether the benefited firms are 'really' minority or female.

Thirdly, even if enforcement were perfect, the age-mix condition might not mitigate short-term pressures very much. If, as seems likely,
the bond market can offer young people plausible substitutes for long-term equities, then even young people with long horizons should be relatively indifferent as between short- and long-term payoffs in the mutual funds. If they get paid off earlier than their consumption plans demand, they can simply reinvest in the bond market. Thus, they would not provide much of a break on the short-term propensities of their elders.

It may seem unfair to press this objection, since the time horizon problem plagues any effort to limit inheritance, and any plausible socialism will have to attempt this somehow. But Roemer’s program seems vulnerable to the criticisms that, first, because of the time horizon problem, the optimal rate of inheritance taxation is probably considerably less than 100 per cent, and secondly, it seems administratively more practical to integrate limits on the transmission of equity at death into a single inheritance tax on all forms of property.

Ownership

Roemer touches on two types of ownership problems. One is the ‘agency costs’ of managerial self-indulgence at the expense of capital suppliers. The other is the ‘public bads’ that arise because of the incentives that share ownership gives the rich regarding the exercise of their political power.

For the ‘agency’ problem, Roemer relies on a combination of share market signals and bank control. In the proposal presented in the book, the issuance of coupons does not generate actual funds for the firms, and in this situation, as Louis Putterman explains, it seems unlikely the share price could perform much of a role. Managers would not care about the price, since a high price would not bring them any funds and dispersed shareholders would have little effective control. Banks would not care because, as creditors, their interests would often be different than those of shareholders. (Note that German and Japanese banks, which have good reputations as corporate monitors, hold substantial equity as well as debt.)

Roemer’s recent amendment that provides for funding the coupons so that the share price plays a direct role in determining the firm’s cost of capital, seems an improvement. Moreover, the introduction of mutual funds seems likely to improve the ‘agency’ problem by introducing potentially more effective monitors. Mutual funds have not been active monitors in the United States, but their monitoring activities have recently picked up, and some commentators are optimistic that, with legislative reform, they might prove more effective.

Agency problems surely remain, but they do not seem more daunting than they are under existing American capitalism.

The main focus of Roemer’s program is the problem of ‘public bads’ such as pollution. In Roemer’s political economy, the rich exercise power most directly, not over enterprises, but over the political process. The disproportionate share ownership of the rich under capitalism is important, not because it gives them control over enterprises, but because it gives them an interest in enterprise profits that leads them to exercise political control to permit enterprises to impose a large level of public bads.

Because the wealth of the rich gives them disproportionate political power, they are able to achieve public tolerance for a high level of public bads. Under market socialism, the rich continue to enjoy disproportionate political power, but since they have no more shares than anyone else, their incentives are different. Their gains from corporate profits due to public bads are lower relative to their share of the costs of the bads. Thus the rich support a lower level of public bads under market socialism, and the consequence is greater efficiency.

The problem with this argument is in the premise that the interests of the rich will be dramatically different when most of their wealth is no longer in corporate shares.

Under market socialism, the rich cannot use their cash for shares, but presumably they can buy as much as they want of other types of interests. Why is the accumulation of these other interests by the rich not a threat comparable to the accumulation of equity? Roemer does not say explicitly, but presumably the answer lies in an assumption that the other interests will carry a fixed, unconditional return of the sort conventionally associated with debt. If the return were literally fixed and unconditional, it would leave the holder indifferent to the conduct or profitability of the firm.

In practice, however, this assumption is unrealistic in several respects. First, securities markets now offer an array of derivative instruments that can be packaged easily to replicate the financial characteristics of corporate shares. With a combination of purchases of call options and sales of put options, an investor can achieve the economic equivalent of shareholding without holding shares. Shutting down the derivative market will not be easy, both because it serves some useful hedging functions and because evasion of controls is relatively easy in this market. Since the holder has no direct relation with the corporation, his identity does not have to be recorded, and the market can easily move offshore.

Secondly, despite the stereotype, some debt explicitly provides for
conditional returns. An ‘income bond’ promises payment only if the firm has income, and it thus strongly resembles a profit interest. Thirdly and most importantly, even a nominally unconditional debt interest is implicitly conditional on the solvency of the firm. Moreover, even if the payment on debt is nominally fixed, the value and price of the interest will fluctuate with the risks to the firm’s solvency.

The debtholder’s concern about solvency is not especially intense where debt is small relative to the firm’s assets or where it is secured by claims on ‘redeployable’ assets that retain their value after the firm becomes insolvent. But unsecured creditors in firms with a lot of debt have strong concerns about solvency. These interests may differ from equityholders’ interests; because debtholders’ claims are senior, they may prefer more conservative policies than shareholders, who may capture most of the benefits of successful risk taking. But it is not clear that more conservative policies will generate less public bads. For example, adopting a new technology may be risky but have the potential of reducing negative externalities, say by polluting less, or creating positive ones, such as demonstrating the efficacy of the new techniques or increasing the skills of the workers who work with them.

More importantly, when the firm becomes leveraged to the point that characterized some of the more spectacular financings of the 1980s, the distinction between debt and equity holders becomes fairly academic. In such circumstances the debt claims on the corporation can only be served through a dramatic increase in corporate income that can only be achieved through risky policies. Since the market socialist regime will shift wealth from the equity market to the debt market, one would expect the consequence to be an increase in leverage. Even with derivatives prohibited, there is no reason to expect that the interests in firm conduct of the rich, as holders of risky debt in leveraged enterprises (plus some equity), will differ from their prior interests as holders of proportionately more equity.

Alienation

Roemer rejects attempts to found socialism on revolutionary character reformation designed to produce a more solidaristic ‘socialist person’. Part of the appeal of markets for him is that they are compatible with ‘ordinary’ self-interested motivation.

Now it seems entirely right that selfish behavior will not disappear spontaneously with the inauguration of socialism and cannot be extirpated through the coercive inculcation of virtue by the state. On the other hand, many socialists who recognize these points would want to insist that motivations are not given independently of economic institutions. People’s aims will be shaped in part by their experiences in the institutional settings in which they live.

This point suggests that in designing institutions we should take account of, not only their instrumental effects in satisfying given goals, but their constitutive effects in encouraging desirable motivations. (The distinction here is not between motives considered virtuous and desirable by the social architect and those held by ordinary individuals, but between the motives ordinary individuals, in reflecting on how society should be designed, would consider it good for society to foster and those on which they are currently patterning their private conduct.)

Traditionally socialists have objected to the capitalist market, not just because of its unequal outcomes, but also because its processes inhibit self-realization. The classic critique of this kind, of course, is Marx’s analysis of the ‘fetishism of commodities’. On one interpretation, the critique charges capitalism with inducing a kind of political blindness and impotence in its participants. The market produces an experience of social life as beyond human agency. Individuals see themselves as passive objects of an autonomous process. The way their own actions contribute to the production of the system and the ways they might collectively restructure it are systematically obscured.

The point is not simply that capitalist ideology has a misleading conception of the market, but that participation in the capitalist market generates a sense of passivity, isolation and self-absorption inimical to effective democratic citizenship. The (sometimes implicit) contrast is to participation in collective democratic decision making in which people address their fellow citizens in terms of norms of common good (as well as individual satisfactions) and make systemic political choices.

Socialists influenced by such views have been concerned to expand the scope of democratic collective decision making over social life both by democratizing enterprises internally and by narrowing the range of impersonal markets. To those opposed to pervasive centralized planning, the challenge has been to show how this can be done in a substantially decentralized economy. One traditional socialist response to this challenge has recently been resurrected in, for the most part, non-socialist rhetoric by some recent theorists of industrial policy. Its typical prescriptions include increased investment in the relatively non-mobile factors of production (people, infrastructure), attempts to break up mass markets through the diversification and
specialization of goods, and an emphasis on competition through innovation rather than cost (especially wage) cutting.\textsuperscript{9}

Such programs attempt to create local economies of small institutions linked by concrete relational networks structured so as to give them a measure of immunity from the corrosive volatility of the surrounding markets. The convergence of political and economic logic in this strategy is expressed in the basic maxim of Transaction Cost Economics that ‘nondeployable’ investments are often best protected through ‘governance structures’ rather than contracts and markets.\textsuperscript{10}

From this perspective, Roemer’s system raises at least two major concerns: first, the coupon capital market seems likely to generate a lottery culture that would stunt citizen capacities for political participation; and secondly, on Roemer’s analysis, the coupon regime creates powerful disincentives for political participation.

The Lottery Culture

The coupon regime turns the entire citizenry into players in the stock market. Finance theory teaches that most people should not be stock pickers. It is not in their interest to do so (since they assume, without compensation, risk they could avoid by buying into a diversified mutual fund), and they contribute nothing to the efficiency of the market by doing so.\textsuperscript{11} Indeed millions of new lay stock traders would probably exacerbate the volatility of the market and its casino-like features.

At worst, the popular capital market would resemble current state-operated lotteries where manipulative publicity encourages the masses to make investments with negative present values by manipulating superstitious hopes of getting rich quickly and without work. Lottery markets represent in the most extreme form some of the psychological qualities that the ‘fetishism of commodities’ argument deplores: the sense of impotence and irrationality that comes with the feeling that one’s fate is in the hands of a process beyond human control and the sense that one’s fate is radically separated from one’s fellows’.

There are two objections here. One is that by leaving so much of existing capital markets intact Roemer forgoes an opportunity to extend collective control over the investment process. Another is that the expansion of participation in what for many will be a psychologically corrosive process will diminish citizens’ capacities for effective participation in other spheres of collective decision making.

A more mundane but still important problem is that many citizens will take more risk than is in their interests. Presumably a securities commission will prevent outright swindles, but it seems impractical to prevent middle- or low-income people from betting the store on high-risk projects, though such practices seem objectionable either on straightforward paternalist grounds or what might be called second-order paternalist grounds – the probability that society will feel compelled to bail out the improvident.

Of course, not everyone will want to pick stocks. Most will probably prefer to turn their coupons over to mutual funds, and Roemer’s amended program requires them to do so. However, if given the chance, some mutual funds will create lottery conditions by trying to attract coupons through promises of fantastic returns, as recently occurred in Eastern Europe, with sometimes catastrophic consequences.\textsuperscript{12}

No doubt others will behave responsibly, and some will simply index to the market. If everyone invested in responsible mutual funds, the system would work plausibly, but that raises the question of what value the coupons add. Ordinary citizens have no plausible role to play as stock pickers. It seems almost as unlikely that they can play any plausible role in monitoring the funds. (If the funds have sectoral or specialized investment plans, then picking funds has much of the difficulty of picking stocks; on the other hand, if they are diversified, there is no substantial basis for choosing among them.)

So why not forget about coupons and have government-owned funds with independent budgets and competition between them? (Some such system may be emerging now in China.) Such funds could be designed either to provide income to the government for public expenditures or to maintain individual accounts to fund consumption (for example, retirement) benefits to particular citizens.

Alternatively, what about funds entrusted to participatory institutions such as unions, industrial associations, occupational groups and local governments? Such funds could be hemmed in by ERISA-type regulation, especially to the extent they were intended to facilitate retirement saving. Of course, coupons might find their way into such funds, but it would seem preferable to have the payments made (by employers, the government) directly to them.\textsuperscript{13}

Disincentives to Participation

The second set of concerns arises from one of the most striking and original suggestions of Roemer’s analysis. Roemer’s formal modeling
of the welfare of rich and poor in the coupon and capitalist economies confirms that the poor are better off under the coupon system. But the comparison suggests a startling conclusion about the relation between economic welfare and political power under the two systems. While in the capitalist economy the welfare of the poor, as one would expect, increases fairly steadily in proportion to the political power of the poor; in the coupon economy, over a wide range of political possibility, the welfare of the poor decreases as they gain political power.¹⁴

Roemer explains the increase in welfare by the fact that the coupon economy remedies externalities resulting from a collective action problem: the inability of the poor collectively to decide not to sell their shares to the rich at the outset. But the strange relation of economic welfare and political power results from another collective action problem under the coupon economy. In the coupon economy, the poor, through individually rational decisions, borrow more than their collective interest dictates. This borrowing has the consequence of making them dependent on firm profits to pay off their loans and hence compels them politically to support higher levels of public bad. The rich, who in the aggregate have a comparatively lower stake in firm profits (because they are fewer and shares are equally distributed), thus become 'a force for reducing the public bad' and everyone benefits as the rich gain increasingly disproportionate power until they approach total control of the government (α = 0.68).¹⁵

Surely this situation is intolerable to democratic aspirations. While both economies have the familiar problem that individual incentives for political participation are low, the capitalist one at least has the virtue of collective incentives for the poor; their collective welfare seems likely to increase through collective participation. But the coupon economy punishes participation by the poor and rewards them for giving up the political struggle to the rich.

On this particular modeling, the coupon economy thus has the opposite tendency from the one socialists who have previously advocated individual rights in capital have sought to create. They have seen property as a means of giving people a 'stake' in the economy – something to protect from bad political decisions and that benefit from good political decisions – that would motivate participation in politics.¹⁶ But coupon rights seem likely to motivate passivity and privatism. Only a very narrow and uncompromising utilitarianism could reject a strong disincentive to political participation as a major cost.

Moreover, if we look at the system dynamically, the model suggests that in many variations, the welfare gains to the poor from instituting the coupon economy would not be stable. For example, we might imagine that the economy would be implemented in circumstances of popular mobilization in which a high degree of democracy is also achieved, so that the political influence of the rich is only slightly disproportionate. In these circumstances, the efforts of political organizations of the poor will be counter-productive; the organizations will become discredited, and the poor, passive and demobilized. Once the rich achieve great power they may be able to change the rules of the game and appropriate from the poor. The poor can try to remobilize but they will be less organized than the rich are now or than they themselves were earlier. If the poor can foresee this danger from the outset, they would be unwise to agree to the Roemer system.

Conclusion

I think Roemer is on the right track in trying to redefine property rights and preserve a role for markets in his reimagined socialism. However, a liquid, national capital market is not the most promising setting for institutionalizing socialist goals. For both practical and idealistic reasons, I would favor reforms that, rather than trying to universalize participation in conventional capital markets, seek to expand control over investment decisions by organizations – unions, trade associations, governments – that are structured to afford political participation.

Notes

3. Putterman, Louis, 'Comments on A Future for Socialism', paper presented at the conference on A Future for Socialism; see this volume, chapter 9, pp. 151–70.
15. ibid., pp. 70, 72.

Roemer’s Market Socialism: a Feminist Critique
Nancy Folbre

John Roemer offers a new low-fat recipe for socialism, very different from one that clogged the economic arteries of the state socialist countries and contributed to their collapse. In nouvelle left economics, markets (everywhere in fashion) are a key ingredient – and I think they should be. I agree with Roemer’s claim that market competition promotes the kind of dynamic efficiency crucial to economic health, and I welcome his emphasis on egalitarianism as a key element of the socialist vision.

But Roemer’s confidence in markets is excessive, and his approach to egalitarianism is disturbingly incomplete. Ironically, the most obvious shortcomings of his approach reflect the legacy of the Marxian orthodoxy he otherwise rejects. Largely preoccupied with differences among groups defined by differential ownership of the means of production, Roemer underestimates other forms of collective identity and action such as those based on nation, race, gender, age and/or sexual orientation. His approach is class-centric.

Perhaps because he focusses on the ‘productive’ sector of the economy, he slights the problems of the contemporary welfare state. Treating it in a cursory fashion as simple ‘redistribution of income’, Roemer overlooks important problems and sidesteps current political debates over the appropriate organization of education, health care, social insurance and family life. In these respects, Roemer’s priorities are eerily reminiscent of Lenin’s: socialize the ‘commanding heights’ of the economy first, then address other problems of social inequality.

In contesting these priorities, I will argue that the market-socialism debate would be enriched by more attention to the feminist and anti-racist literature, but will also express my affection for a central aspect of the socialist feminist tradition: its critique of the selfish proclivities of ‘rational economic man’. Roemer fails to specify any