Capitalism Redefined

Nick Hanauer, remarks to the OECD, Paris, Oct 16, 2018

Thank you very much for having me here. My co-author Eric Beinhocker and I have been great admirers of the NAEC initiative from its beginnings. The questions NAEC are posing are essential ones, and the OECD's willingness to challenge orthodoxy and stimulate new thinking is very heartening during these challenging times.

The financial crash of 2008 and the cruelly unequal recovery that followed have sparked crises of faith in the three social technologies that define the modern world: democracy, science, and markets. And with human civilization rushing headlong toward a global climate catastrophe, the timing couldn't be worse.

Brexit, Trumpism, and other nationalist movements throughout the world are undermining the institutions and global cooperation necessary to address many global priorities including limiting greenhouse gas emissions, while in the United States, even the science of climate change remains under assault. And while the financial markets may have recovered from their 2008 lows, market capitalism has not. The same policies and theories that crashed the global economy ten years ago are largely still in place. And while growth is back and unemployment is low across much of the Western world, a majority of households have not experienced those gains. A recent report by the U.S. Federal Reserve showed that the bottom 90 percent of the U.S. population are still poorer in real terms today than they were in 2007. Not just some or most, but <u>all</u> of the gains from the post-crash recovery have flowed to the top 10%. While the U.S. might be an extreme case, the impact of the recovery on households across the OECD has been mixed at best, and too many middle-class households remain a paycheck away from disaster. So how can we expect voters to focus on climate change, or any other significant global policy challenge, when their personal circumstances remain so insecure even a decade on from the crisis?

If we are to have a hope of addressing climate change and other global challenges—if the OECD is to fulfill its mission of helping governments work together to improve the well-being of all—if we are to prevent economic inequality and insecurity from undermining the social cohesion upon which Democracy and prosperity depends—then we must restore faith in the legitimacy of democracy, science, and markets. And I believe that the only way to do this is to drive a stake through the heart of the neoliberal religion that led us down the path of crisis and populism, replacing it with a new economic framework that is based on science but grounded in justice. Indeed, we must go beyond science. We must, as citizens, policy makers and business leaders, fully embrace our humanity and recognize that justice and inclusion are the cause of economic prosperity.

I am a practitioner of capitalism. I have started or funded 37 companies, many of which have been very successful. Among other things, I was the first outside investor in Amazon. And while I'm not an economist, I am a longtime student of economic theory. The most important lesson that I have learned from these decades of experience with market capitalism is that morality and justice that are the fundamental prerequisites for human prosperity and economic growth. The main purpose of my talk today is to prove that greed is not good.

You may be surprised to be hearing this “justice talk” from a capitalist. That is fair. I suspect that this may be because you all view the world I inhabit, the world of business and economics, as somewhat “morally challenged.” To be clear, contemporary American business and economic culture DOES have a moral framework: Neoliberalism. But I think it is safe to say that this framework is deeply at odds with 50,000 years of moral norms, cultural codes, and faith traditions.

Is that too harsh? Maybe. But the canonical moral expression of modern capitalism—“It was a business decision”—has far more in common with the movie *The Godfather* than with The Golden Rule. Let’s be honest: whenever you hear somebody say, “It’s not personal, it’s strictly business,” you know that really terrible things are about to happen to someone.

It is a sign of the times that one of the best known moral claims by a global business is Google’s: “Don’t be evil.” Look—at least they have a moral stance. But it *is* interesting to reflect on their credo. Put aside whether Google has lived up to it, or not. How did we get to the point where the highest standard one of the world’s most prominent companies will hold itself to is simply *the absence of evil?*

And how did we in much of the Western world get to an ethical position that insists that the only affirmative responsibility of a corporate executive is to maximize value for shareholders? And that *any* other responsibility beyond that is somehow damaging to society and its prosperity.

I believe that the root cause of the 2008 crash and the crises of confidence that followed can be found in our economic textbooks, and the two fundamentally flawed ideas upon which much of neoclassical economics rests. The first is a behavioral model grounded in the dubious assumption that human beings are “homo-economicus”: perfectly selfish, perfectly rational, and relentlessly self-maximizing. The second is a systems model that presents market capitalism as a Pareto-optimal closed equilibrium system in which no person’s situation can be improved without another person being harmed, and where all considerations outside of this closed system, such as the environment, are considered so-called externalities. It is these two concepts upon which much of the intellectual infrastructure of orthodox economics is built. My view is that these ideas are not just scientifically wrong- but worse- are corrosively *bad*—economically, politically, and *morally*. Let me say it more directly: *Homo economicus* must die, and so too, the idea of the economy as an optimal, closed, equilibrium system.

The last 40 years of research across multiple scientific disciplines has proven with certainty that *Homo-economicus* does not exist. Outside of textbooks and models, this is simply not how real humans behave.

Rather, *Homo sapiens* have evolved to be other-regarding, reciprocal, heuristic, and intuitive moral creatures. We can be selfish, yes—even cruel. But it is our highly evolved *prosocial* nature—our innate facility for cooperation—that has enabled our species to dominate the planet, and to build such an extraordinary—and extraordinarily complex—quality of life. We can be competitive too, particularly in groups. But history has been a competition amongst networks and systems of cooperation—whether they are tribes, villages, nation states, or businesses. Markets are systems that help create incentives to cooperate, and create competitions to be the best cooperators, and that in turn creates pressure to innovate new and better forms of cooperation. Neoliberalism fetishizes competition and selfishness as the cause of prosperity. But humans are not more competitive or selfish than lions. But lions cannot build guitars.

This emphasis on economic *cooperation* should not be controversial. In fact, it is a principle that is embodied in your organization's very name. I think we can all agree that an "Organization for Economic *Competition* and Development" wouldn't make much sense. That is because it is pro-sociality, not self-interest—cooperation, not competition—that is our economic super power.

Likewise, the latest interdisciplinary research and thinking makes clear that human social systems *never* reach equilibrium. This is because economies are not equilibrium systems. In reality, a capitalist economy is an ecology—a complex-adaptive non-equilibrium system that is both the product of culture evolution, and an evolutionary system in and of itself. It is through the evolutionary logic of the market, creating and sifting through new forms of cooperation, problem solving, and creating the huge variety of products and services that we enjoy today, that our shared material prosperity has emerged.

Economists are not wrong when they attribute the material advances of modernity to market capitalism's genius for self-organizing an increasingly complex and intricate division of knowledge, knowhow, and labor. But it's important to recognize that the division of labor was not invented in the pin factories of Adam Smith's 18th century Scotland; at some level, it has been a defining feature of all human societies since at least the cognitive revolution. But it is more than the cooperation that the division of labor requires, it is the division of knowledge that has been the defining feature of all human societies since at least the cognitive revolution. Even our least complex societies, small bands of hunter-gatherers, are characterized by a division of labor and knowledge—some may know more about toolmaking, others hunting, and others basket weaving. But they combine their knowledge, not through the "barter, truck, and trade" of arms-length market transactions, but through the networks of reciprocity, generosity, cooperation, and other-regarding moral behavior that all human societies are built on. And humans have evolved a trick that no other species has evolved—our shared knowledge can be collectively stored, retrieved, used, and modified through language and shared cultures. Culture is like cloud-computing, but instead of computers it is made out of human brains, a vast repository of shared knowledge that can be transmitted down generations. Through our prosocial behaviors and cooperation, we made ideas immortal. This is homo sapiens' special gift that has enabled us to conquer the planet, and will enable us to either destroy it or save it.

Viewed through this prosocial lens, we can see that the highly-specialized division of knowledge that characterizes our modern economy was not made possible by market capitalism. Rather, market capitalism was made possible by our fundamentally prosocial facility for cooperation, which is all the division of labor really is. As a social technology, capitalism's true genius is its unmatched ability to harness our prosocial nature in a positive feedback loop through which social and technological complexity can evolve at ever greater scale. Market capitalism is not the static zero sum game of Pareto optimality, in fact it is the ultimate constantly evolving virtuous cycle of increasing returns.

This dispute over economic theories is not just of academic interest. The stakes for our society are much higher. Many economists, while acknowledging their flaws, still defend *Homo-economicus* and Pareto-optimal equilibrium as “useful fictions”—handy tools for modeling and understanding the economic world. But these are much more than just economic models. They are also *stories* we tell ourselves about ourselves that give both permission and encouragement to some of the worst excesses of modern capitalism, and of contemporary social and moral life.

Humans are a storytelling species. It is through stories that we make sense of the world. Thus, if we accept that these stories are true—if we internalize that most people are mostly selfish—and that any gain for you is a loss for me—and then we look around the world and we see all of the unambiguous prosperity and goodness in it, then it follows logically, *it must be true, by definition*, that billions of individual acts of selfishness magically transubstantiate into prosperity and the common good.

If one believes it is true that humans really are just selfish maximizers, then selfishness *must* be the cause of our prosperity. And it logically follows that the more selfish we are, the more prosperity we create. The train of logic from *Homo economicus* leads us directly to an amoral world where greed really is good, generosity really is dumb, and the only possible purpose of the corporation is to maximize shareholder value, humanity and the planet be damned. If this sounds absurd it is because it *is* absurd. Many students when they first encounter Economics 101 have a gut reaction that “this can’t be right”, but when we tell this story over and over again in the classroom, in the boardroom, in the cabinet room, and in the press room, we learn to suppress our own intuitions and our own moral instincts and believe in this upside down world.

And likewise, if it is true that we live in a Pareto-optimal, Panglossian best of all possible worlds in which any change anywhere to improve the circumstances of the disadvantaged will diminish the commonweal and the common good, then logically, when we raise taxes on the richest, we will lower wages for the poor ; when we tackle climate change, we will slow growth; when we regulate bad corporate behavior we will reduce productivity; and when we raise wages, we kill jobs, and harm the very people we're intending to help.

Welcome to our dystopic neoliberal world.

But if, instead, we accept a prosocial behavioral model that correctly describes human beings as uniquely cooperative and intuitively moral creatures—and a non-equilibrium systems model that correctly views the whole of human prosperity as much, *much*, greater than the sum of its parts—then logically, the golden rule of economics must be *THE* Golden Rule: Do business with others as you would have them do business with you. This is a story about ourselves that grants us permission and encouragement to be our best selves. It is a virtuous story that also has the virtue of being true.

This virtuous story leads to a common sense observation. In the technological economy of the 21st century, growth and prosperity is created not from capital accumulation, but through a virtuous cycle between *innovation and demand*. Innovation is the process through which we solve human problems; consumer demand is the mechanism through which we distribute, incentivize, inform, and fund innovation. And it is economic *inclusion*—the full economic participation of as many people as possible as innovators, entrepreneurs, workers, and consumers—that drives both innovation and demand.

Think about it: Life isn't dramatically better today than it was in 1800 because we are allocating 19th century resources like horses and carriages more efficiently. Life is better today because people have effectively cooperated to create motorized transport, life-saving antibiotics, indoor plumbing, the Internet, and many other innovations. Life is better today because our economy has evolved new and better solutions to human problems.

Evolution is an algorithm for discovering adaptive solutions, and it operates on the economic world in much the same way it does on the biological—by selecting for innovations that endow an advantage within the context of the current environment. Innovation is the process of creating new adaptations, and consumer demand is the process of selection. And just as in the biological world, diversity is the key to sustaining a robust and resilient economy.

The more people we include in our economy, the more people can specialize their knowledge and know-how; and the more specialized knowledge and know-how our society accumulates, the more it creates. It is through the recombination of specialized knowledge that new innovations evolve. And crucially, the more cognitively diverse the innovators—the more people simultaneously attacking a problem from as many different perspectives as possible—the faster our problems are solved. That is the science of innovation: innovation is driven by diversity, not sameness.

But a solution unconsumed is a problem unsolved, and so diversity is crucial to the selection process as well.

Market capitalism is an evolutionary system in which products and services adapt and compete for consumer dollars; the more successful an adaptation is within the market, the more widely it propagates throughout the economy as a whole. And since consumer demand is literally the force of selection within this process, the more robust and diverse our consumer base, the greater the diversity of products and services the market can produce and sustain. Demand inclusion—the capability of diverse consumers to instantiate their diverse consumer demand—selects for a diverse marketplace of cultural and technological adaptations, the "meme pool" from which all future products and services will evolve. And the greater the memetic diversity within the economy, the exponentially greater the design space of potential combinatorial adaptations, making possible an ever faster pace of innovation, productivity, and demand.

It is in this context that we understand consumer demand—that is, selection—to be as much a part of the innovation process as innovation itself. For it is only through consumer spending that businesses ultimately determine which innovations prove fit at solving consumers' problems.

This is why unjust and *exclusive* economies never succeed in the long-run. It may be possible to have an exclusive, highly unequal society that creates wealth for an elite through resource extraction. But eventually the resources run out and such a society will collapse. Only a just society that robustly and deliberately includes people- as consumers, workers, and innovators, can create the evolving networks of knowledge and complexity that are the foundations of prosperity.

One can see this even more clearly if one asks what prosperity really is. As the OECD has shown in its work, the notion of prosperity is not always well-captured by metrics such as GDP. We argue that what truly makes us prosperous is when we solve human problems, when we do things that meet real human needs, that improve the lived experience of real human beings. From curing cancer to a crunchier potato chip, every legitimate enterprise is in the problem-solving business, and because trade is reciprocal—you need a potato chip, I need a profit—every solution consumed is a mutual problem solved. But as our modern technological economy grows more prosperous, it's problems inevitably grow more complex, and this requires ever greater degrees of social, economic, and technological complexity in order to sustain this virtuous cycle of innovation and demand.

Capitalism is the greatest problem-solving social technology ever invented. But knowing *that* capitalism works is different than knowing *why* it works. And contrary to today's economic orthodoxy, it is reciprocity, not selfishness that guides it—indeed—as if by an invisible hand. It is social reciprocity that builds the high levels of trust necessary for large networks of people to cooperate at scale. And it is only through these networks of highly-cooperative specialists that the complexity that defines our modern economy can emerge.

I started my remarks by saying that we need a new economic narrative grounded in science, but anchored by justice. That is because, as we've learned with climate change, if you really want to change people's minds, science alone is rarely enough. Stories shape the way we understand the world, not facts. And the best stories have a moral heart.

One of my county's greatest moral leaders, Dr. Martin Luther King once said, "the arc of the moral universe is long, but it bends toward justice." In the same way, thanks to the relentless evolutionary logic of human societies, the arc of the economic universe bends towards complexity. And these two arcs make a larger virtuous circle that is anchored by justice and inclusion. This creates the trust which enables the cooperation, which produces the knowledge and complexity from which all human prosperity emerges.

Today's Neoliberal orthodoxy teaches us that inclusion and justice are luxuries to be afforded, if and when we have economic growth. But this view is wrong and backwards. Justice and inclusion are the principle mechanism by which market economies create growth.

Ultimately *it is our humanity,* not the absence of it, that is the true source of economic growth and human flourishing.

That is the moral of our story, and we hope it will be your story as well. Thank you.