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TOWARD A THEORY OF STATE CAPITALISM: ULTIMATE DECISION-MAKING AND CLASS STRUCTURE*

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This paper represents the initial phase of a larger study which will present the outline of an analytical model of the structure and dynamics of the state capitalist system as it has evolved historically in the U.S. The model will attempt to synthesize the theoretical insights of Austrian economics and the concrete historical and sociological analysis of both Old Right and New Left critics of the status quo.

This initial paper focuses on two related problems: the identification of a key locus of ultimate decision-making within the state capitalist system and the presentation of an outline of the broader structural characteristics of this system. This paper in isolation offers a highly static, structural model of the system and our subsequent work in this field will focus on a description of the dynamic processes underlying the evolution of the system. This later work will involve a systematic application of the Misesian theory of interventionism and the Austrian theory of the business cycle in an attempt to understand how and why the state capitalist system evolves over time. Most importantly, this later analysis will reinforce our assertion, somewhat arbitrarily made at this point, that the state capitalist system is characterized by inherent instability.

In view of the broad scope of the problems covered, the analysis which follows will necessarily be highly summary, touching only on the basic outline of the argument, and the details will have to be supplied in lengthier studies which will follow this one.

I. THE CAPITAL MARKET AS A LOCUS OF ULTIMATE DECISION-MAKING

Introduction

The first half of this paper will focus on three fundamental propositions: (1) entrepreneurial decision-making constitutes a particularly important category of decision-making within any market system since it determines the nature and extent of structural transformations within the economic system over time; (2) as the market system evolves and becomes increasingly functionally specialized, the capital market will emerge as a significant locus of entrepreneurial decision-making; and (3) although this trend is inherent within the market system itself, the exogenous factor of state intervention in the capital market dramatically reinforces the capital sector's strategic position in the economy through cartellization and inflationary monetary policies. These propositions constitute our rationale for identifying the institutional embodiments of the capital market — and particularly the banking sector — as a locus of ultimate decision-making within the state capitalist system.

Entrepreneurial decision-making within market systems

One of the fundamental insights of the Austrian economists such as von Mises and Hayek — which emerged prominently in the historic debate with Lange and other economists over the merits of planning as an alternative to the market — was the essential role of the market system as a mechanism for gathering, transmitting and evaluating information[1]. The competitive market process originates in, and presupposes, the imperfect knowledge of its participants. Since the market process necessarily takes place over time, all the participants formulate their plans *ex ante* on the basis of the information then available to them and readjust these plans as subsequent events make additional information available to the market participants

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through the operation of the price mechanism.

Professor Israel Kirzner in his recent book *Competition and Entrepreneurship* has considerably enriched our understanding of the functioning of the market process by systematically focusing attention on the role of the entrepreneur[2]. Professor Kirzner identifies entrepreneurial activity as an alertness to previously unnoticed changes in the economic system as revealed through price discrepancies between particular products on the product market and the resources on the factor market required to supply the product. By acting on the basis of this alertness to price discrepancies, the entrepreneur captures entrepreneurial profits which alert other market participants to previously overlooked profit opportunities and provides them with the information necessary to provoke them to change their own plans so that they, too, might be able to share in these new profit opportunities.

Entrepreneurial activity is therefore the essential means by which the new information supplied by the operation of the price mechanism is disseminated among the participants of the market system. As a consequence of the dissemination of this new information, economic resources are shifted from existing uses to new ones as market participants seek to correct previous, mistaken decisions based upon imperfect information and attempt to coordinate their plans more effectively with other market participants on the basis of the new information available. Entrepreneurial activity therefore performs two related equilibrating functions within the market system: it disseminates new information and it stimulates a reallocation of economic resources. This reallocation of economic resources in the field of long-term capital investment results in the structural transformation of the market economies over time.

However, in order for entrepreneurship to be praxeologically significant, it must transcend mere mental alertness to new opportunities on the market. In order for price discrepancies to be really "seen", to be seen in a sense relevant for economic analysis, the entrepreneur must possess the means necessary to act upon this newly acquired information within the market. While Professor Kirzner, both in his book and in a subsequent paper on the same subject, stresses persistently that asset ownership is analytically *never* a condition for pure entrepreneurship[3], we believe that, for the purpose of "real world" economic analysis, entrepreneurial activity and asset ownership *are* inextricably linked — the former presupposes the latter. Exchange relationship, and particularly production activities, are firmly imbedded in time and the would-be entrepreneur must either possess, or acquire access to, the assets which he needs in order to act upon his alertness in the market. Either he already owns the capital necessary to act upon his alertness or else he must obtain the capital from some other source. In either case, capital ownership emerges as a critical dimension of entrepreneurial activity.

This additional dimension of entrepreneurial activity permits us to identify three characteristics which define entrepreneurship: (1) alertness to price discrepancies; (2) control, or ultimate decision-making, over the means required to act upon this alertness in the market; and (3) responsibility, or uncertainty-bearing, for the consequences of acting in the market on the basis of entrepreneurial alertness[4]. One implication of this analysis is that the entrepreneurial decision-maker — the one who decides to act upon a perceived price discrepancy — must, by definition, represent the ultimate decision-maker and must, similarly, reap the profit which results from superior alertness to price discrepancies on the market. Thus, entrepreneurial alertness cannot be hired since the employer, if he captures the profit which results from the superior alertness to price discrepancies in the market, himself becomes the only entrepreneur.

In the case of the individual alert to new entrepreneurial profit opportunities who must borrow the capital necessary to act upon his alterness, the lender, in deciding to risk his capital on the alertness of the borrower, in an important sense becomes a "partner" in entrepreneurial decision-making. The capital market must be conceptually distinguished from the labor market or any other factor market since the would-be entrepreneur does not confront an independently established, uniform market price for capital. In addition to the pure interest rate and the necessary adjustment for anticipated inflation, there is an additional variable component in the market interest rate which reflects the degree of uncertainty anticipated in each particular investment. The lender in the capital market, in the normal course of his affairs, questions prospective borrowers regarding the purpose of the requested loans. This line of questioning — what, why, how — immediately distinguishes in a non-trivial sense the capital lender from the supplier of any other factor of production.

The decision by the capital-owning lender regarding the degree of uncertainty involved in each investment is essentially an entrepreneurial decision and the consequent division of the entrepreneurial profit between the borrower and the lender supports the contention that both have become partners in the entrepreneurial decision-making process[5]. Frank H. Knight recognized this in the following excerpt from his book *Risk, Uncertainty and Profit:* "...it must often happen that entrepreneur ability will not be associated with a situation on the part of its possessor enabling him to make satisfactory guarantees of the contractual incomes promised. Under such circumstances it may be mutually profitable for him to enter into agreement with someone in a position to underwrite his employment contracts, but not himself possessed of the ability or disposition to undertake the direction of enterprises. The form of this partnership and conditions of division of the profit may be highly various"[6]. Since the capital-owning lender must make the ultimate decision whether to act upon the entrepreneurial alertness of the borrower and bears the uncertainty inherent in entrepreneurial activity, there is a strong *prima facie* case for believing that the lender in the capital market becomes the key entrepreneurial actor[7].

As Professor Kirzner points out, the concept of entrepreneurial activity is analytically distinct from the limited, Robbinsian image of the "economizing" market participant. The economizing market participant postulated by Lord Robbins acts to maximize goal satisfaction within a given ends-means framework whereas the concept of entrepreneurial activity recognizes the equally important function of identifying the relevant ends-means framework as an integral part of human activity. Although these two types of decision-making are quite distinct, each market participant acts in a wholly integrated manner, exhibiting both the decision-making characteristic of "economizing" activity as well as of "entrepreneurial" activity.

The capital market as a locus for entrepreneurial decision-making

The evolution of market economies, however, suggests that entrepreneurial activity may become increasingly concentrated within the capital market as the functional specialization of the economy becomes more pronounced. The natural inequality which distinguishes people from one another in every field of human endeavor, when combined with the varying location of natural resources, provide a powerful impetus towards specialization in any economic system. While a certain degree of specialization is possible even in primitive, barter economies, the emergence of money and a system of indirect exchange considerably widens the potential market available for every product and thereby vastly increases the scope for specialization and division of labor[8]. In particular, the emergence of a commonly accepted exchange medium gives rise to a variety of specialized institutions designed to facilitate the storage and handling of money[9].

As credit becomes an increasingly accepted method for financing commercial transactions, financial institutions possessing large accumulations of liquid capital gradually specialize in various forms of credit operations, including long, medium and short-term lending activity. The evolution of increasingly capital intensive production processes eventually gives rise to a new category of financial institutions — the investment banks — which specialize in raising the large sums of capital necessary to finance the expansion of production operations. Other financial institutions specialize in insuring large-scale commercial activities to minimize the risks to which corporations are exposed. In fact, one of the key integrative roles of the capital market within advanced market systems is to concentrate the burden of risk within specialized institutions which, because of the nature of their activities, are more capable of bearing it than other market participants. The entire complex of financial institutions constitutes an increasingly diverse capital market capable of servicing the changing financial needs of a highly specialized market economy.

Two distinct characteristics of this capital market enable its participants to assume an increasing degree of entrepreneurial activity within the economy as a whole. First, the capital market by its very nature provides a large reserve of readily mobilizable capital funds which increases the flexibility and efficiency of response to price discrepancies by the financial institutions. Perhaps even more importantly, however, the financial institutions in the capital market develop highly specialized capabilities for the accumulation and evaluation of vast amounts of information regarding market activities and trends.

Money is a medium of exchange for the entire economy; it provides a mode of integration among highly diversified products, markets and regions, molding them all into a single, interacting and interdependent system. The financial institutions which specialize in the handling of the exchange commodity are therefore precisely those institutions which are most predisposed to adopt a "systems" perspective transcending individual industries or markets. In order for them to perform their function effectively, they must integrate information from all sectors of the economy and develop the alertness to price discrepancies which provides the basis for entrepreneurial activity. Possessing both this highly specialized alertness and the means to act upon price discrepancies revealed by this alertness, the financial institutions in the capital market naturally emerge as an increasingly significant locus of specialized entrepreneurial activity within the market system. Since banks are precisely those institutions specifically designed to act as intermediaries in *all* monetary transactions occurring throughout the economic system, it is natural that they should acquire an influential coordinating position within the capital market itself.

At this point, it is essential to elaborate in some detail the precise sense in which financial institutions, and particularly banks, perform their entrepreneurial function. The ultimate decision-maker in the advancing of capital over time is necessarily the original owner of fixed or circulating capital who determines at any given time the amount of capital that will be available for investment. Once this initial decision is made to choose future consumption over present consumption, the capital owners must also decide among every gradation conceivable in the investment opportunities that are available to them. In making this decision, the individual investor will choose between investment opportunities which are relatively secure, offering the prospect of stable returns, and investments which require considerable risk but, in contrast, may produce much higher returns. Thus, an entire range of gradations in investment opportunities may be distinguished, extending from "passive" saving in banking institutions to "active" investment directly in highly speculative industrial or commercial ventures.

In the case of capital owners who choose to deposit their money in banking institutions, two subtly differentiated levels of ultimate decision-making become discernible. First, the capital owner remains as an ultimate decision-maker in a passive sense since his investment decision is characterized by an orientation towards future consumption, rather than production. He has chosen the security of a reasonably predictable future income stream which will accrue to him over time. In his decision-making, he therefore approaches the role of a pure capitalist concerned exclusively with returns on intertemporal exchange and not with potential entrepreneurial returns. While the passive saver is nevertheless still engaged in a limited form of entrepreneurial decision-making, he has effectively reduced it to a minimum. Of course, the passive saver at any time retains the option of withdrawing his funds (within possible constraints imposed by time deposits) and either devoting them to present consumption, transferring them to another bank or engaging in more "active" forms of investment activity. To this extent, he does retain a passive form of ultimate decision-making authority.

The bank, however, also emerges as an ultimate decision-maker, but in a much more active sense, since it is directly involved in the allocation of loans to specific industrial and commercial ventures. Its decision-making is explicitly oriented towards production activity and it is this form of decision-making which actively determines the parameters within which the economic system will evolve. Active planning control is thus delegated to the bank as a financial intermediary who exercises it subject to the constraint that the depositor may eventually withdraw his funds. Banks serve as an institutional risk-bearing device for minimizing uncertainty for individual savers and for the economy as a whole. In return for this service, the banks and not their depositors reap the entrepreneurial returns on their investments.

This loan activity by banking institutions in the capital market is dependent on two forms of ultimate decision-making exercised by distinct groups of individuals. The saver who deposits his money with the banks retains a passive form of ultimate decision-making over the allocation of funds but delegates a much more active form to the banks who employ this ultimate decision-making authority to determine which producers and consumers on the loan market will receive the available circulating capital.

This line of analysis is not inconsistent with our earlier emphasis that entrepreneurial activity and asset ownership are inextricably linked. On an unhampered market, banking institutions would hold both time deposits and demand deposits as well as its own separate equity capital. In competitive banking, individual banks will recognize the desirability of synchronizing their pattern of liabilities with their changing pattern of assets to assure their capability of responding to all foreseeable contingencies. As a consequence, banks will always be the owners of the funds which are utilized for loans and will thus reap the entrepreneurial returns from the investment of their own assets.

The importance of the financial institutions as a locus of ultimate decision-making within a market economy increases in direct proportion to corporate growth which has historically been accompanied by a growing dependence on external financing. The importance of this role of the financial institutions is also greater for specific industries which are characterized by capital intensive production processes and lengthy lead-times in production since it is precisely these industries which are most heavily dependent on external financing.

None of this analysis should be construed as postulating an insidious process of monopolization of decision-making power within non-state market systems. In the absence of politically imposed barriers to entry, the unhampered competitive market process will act to ensure that financial institutions, just as any other market participants, will be constrained by the prospect of increasing competitive activity if they fail to perform as efficiently as possible[10]. In addition, financial institutions are clearly precluded from establishing a monopolistic control over the commodity with which they deal since money necessarily pervades the entire economy. Would-be entrepreneurs who perceive actual price discrepancies and yet who are unable to obtain the necessary capital for a specific project from specialized financial institutions can turn to an almost limitless variety of private savers or industrial capitalists.

These market factors effectively preclude the possibility that entrepreneurial decision-making could ever be monopolized by financial institutions. However, the market system does concentrate entrepreneurial activity and decision-making within the capital market because of the considerable benefits which are rendered by a certain degree of specialization. This process of specialization continues until an optimum degree of concentration has been achieved which will maximize the allocative efficiency of the market price mechanism. The evolution of the specialized functions of the capital market within the economic system thus epitomizes Herbert Spencer's insight that the market process generates two complementary processes: differentiation and integration. The decision-making within the capital market operates within the severe constraints imposed by the competitive market process and these constraints ensure that the decision-making process contributes to the optimum allocation of economic resources within the system. Thus, the decision-making exercised within the capital market reinforces, rather than undermines, the operation of the market price mechanism.

Having said this, it is logical to assume that the specialized capital market, by the very nature of its integrative role within the market system, will emerge as a strategic locus of ultimate decision-making. Joseph Schumpeter, in somewhat exaggerated terms, nevertheless dramatically captured the essence of the role of the capital market:

> The money market is always, as it were, the headquarters of the capitalist systems, from which orders go out to its individual divisions, and that which is debated and decided there is always in essence the settlement of plans for further development. All kinds of credit requirements come to this market; all kinds of economic projects are first brought into relation with one another, and contend for their realisation in it; all kinds of purchasing power, balances of every sort, flow to it to be sold... Thus the main function of the money or capital market is trading in credit for the purpose of financing development[11].

While the process of concentration of entrepreneurial decision-making within the capital market is constrained by the competitive market process, banking institutions are nevertheless susceptible to a persistent temptation to expand their asset base by pursuing inflationary policies. Murray Rothbard's analysis of banking practices in pure market systems suggests that the competitive market will check this inflationary tendency within narrow limits and tend to preserve full reserve banking policies[12]. In particular, the attempt by individual banks to engage in fractional reserve banking practices will eventually be frustrated by the clearing-house function performed by other banks. Any attempt to cartellize the leading banks will be exposed to the weaknesses characteristic of all cartels in pure market economies and will be further limited by the need to preserve customer confidence in the banking enterprises.

State intervention in the capital market: the Cartellization of banking

Banks have historically failed to achieve their inflationary objectives on a free market and, as a result, these financial institutions have ultimately turned to the political means embodied in the coercive state apparatus in order to implement their cartellizing and inflationary monetary policies. Historically, state intervention in the banking system has been one of the earliest forms of intervention in the market system.

In the U.S., this intervention initially involved sporadic measures, both at the federal and state level, which generated inflationary distortion in the monetary supply and cyclical disruptions of economic activity. The disruptions which accompanied the business cycle were a major factor in the transformation of the dominant ideology in the U.S. from a general adherence to laissez-faire doctrines to an ideology of political capitalism which viewed the state as a necessary instrument for the rationalization and stabilization of an inherently unstable economic order. This transformation in ideology paved the way for the full-scale cartellization of the banking sector through the Federal Reserve System. The pressure for systematic state intervention in the banking sector originated both among the banks themselves and from certain industries which, because of capital intensive production processes and long lead-times, sought the stability necessary for the long-term planning of their investment strategies. The historical evidence confirms that the Federal Reserve legislation and other forms of state intervention in the banking sector during the first decades of the twentieth century received active support from influential banking and industrial interests[13].

State intervention serves to reinforce considerably the inherent importance of the banking sector both within the capital market itself and within the economic system as a whole. Interventionist measures enforce cartel arrangements, insulate banks from the risks of failure and impose barriers to entry against potential competitors. One historian has perceptively summarized the consequences of the establishment of the Federal Reserve System in the U.S.:

> The trend in the national banking system until 1913 was toward a reduction in the bankers' balances and individual deposits in New York, and in favor of the relatively more rapid growth in the Midwest and the West. The Federal Reserve System, for the most part, stabilized the financial power of New York within the economy, reversing the longer term trend toward decentralization by the utilization of political means of control over the central money market[14].

Most importantly, however, cartellization of banking activity permits banks to inflate their asset base systematically[15]. The creation of assets made possible by these measures to a great extent frees the banking institutions from the constraints imposed by the passive form of ultimate decision-making exercised by their depositors. It thereby considerably strengthens the ultimate decision-making authority held by banks vis a vis their depositors. The inflationary trends resulting from the creation of assets tend to increase the ratio of external financing to internal financing in large corporations and, as a consequence, the ultimate decision-making power of banking institutions increase over the activities of industrial corporations. Since the capital market naturally emerges as a strategic locus of ultimate decision-making in market economies, it is reasonable to assume that, by virtue of their intimate ties with the state apparatus, banking institutions will acquire an additional function within the state capitalist system, serving as an intermediary between the leading economic interests and the state.

Banking institutions similarly preserve their integrative function within the state capitalist system, transcending the narrow "interest consciousness" characteristic of representatives of specific industries and promoting "system consciousness" and "class consciousness" among members of the ruling class. As a result of all these factors, the banking institutions significantly expand their role as ultimate decision-makers within the capital market and, more generally, within the economic system, and they emerge as a key locus of ultimate decision-making within the state capitalist system. This is the result of a dual process which occurs within the state capitalist system: there is a process of concentration of ultimate decision-making within the banking sector and, even more importantly, this is accompanied by an increasing insulation of this decision-making activity from the countervailing competitive pressures inherent in a free market.

Whereas the concentration of ultimate decision-making which occurs in a pure market system does not have any significant operational consequences since it merely serves to reinforce the allocational efficiency of the market price mechanism, the impact of state intervention in the capital market does have serious operational consequences. Not only does the scope of ultimate decision-making expand considerably, but the constraints which ensure that decision-making in a pure market system will be responsive to the market price mechanism are gradually abandoned. To the extent that the market price mechanism continues to operate as an effective constraint, the information flow which it regulates will be progressively more distorted as a consequence of political intervention in the capital market and elsewhere within the economic system. In fact, the market price mechanism is gradually replaced as an allocational device by an increasingly centralized and arbitrary (from the market point of view) system of political decision-making. The result, of course, is a systematic distortion in the allocation of economic resources. It is at this point that the precise locus of decision-making assumes decisive importance since it permits the social analyst to indentify in whose interests the alternative system of allocation will operate.

State capitalism and finance capitalism: a comparison of the analytical models

Since the preceding analysis stresses the role of financial institutions as an increasingly strategic locus of ultimate decision-making within the state capitalist system, it would perhaps be useful at this point to compare this model of state capitalism with the more orthodox Marxist model of "finance capitalism". Such a comparison would be useful in highlighting the differences and similarities between the two models while at the same time permitting a more detailed statement of certain characteristics of the state capitalist model. As an example of the Marxist model of finance capitalism, this paper will focus on a series of articles written by Robert Fitch and Mary Oppenheimer entitled "Who Rules the Corporations[16]?" since these articles offer a recent and systematic exposition of the model as applied to the U.S. The Fitch and Oppenheimer analysis concentrates on two central propositions: (1) that banking institutions exercise a growing amount of control over the activities of industrial corporations and (2) that there is an inherent antagonism between the interests of the banking institutions and the interests of the industrial corporations.

The first proposition may, without much difficulty, be translated into the contention made by this paper that the state capitalist system is characterized by an increasing concentration and consolidation of ultimate decision-making power by the banking institutions. Fitch and Oppenheimer present extensive empirical data confirming the existence of several trends: (1) the sustained expansion of the assets of the financial sector in comparison with the rest of the economy, (2) the increasing concentration and merger of enterprises within the financial sector, emphasizing in particular the growing importance of the bank holding company, (3) the increasing dependence of industrial enterprises on external financing, and (4) the role of stock ownership and interlocking directorates as reinforcing control mechanisms by the banking institutions.

The model of state capitalism presented in this paper diverges fundamentally from the Fitch and Oppenheimer model of finance capitalism with regard to the second proposition: that an inherent antagonism exists between banks and industrial corporations. Paul Sweezy and James O'Connor in later articles in response to the Fitch and Oppenheimer analysis persuasively rebutted the contentions made by Fitch and Oppenheimer in support of this second proposition, and those interested are advised to consult these articles [17]. As one of their leading arguments in support of this second proposition, Fitch and Oppenheimer place great importance upon the fact that banks promote "new modes of capital accumulation" by acting as intermediaries in facilitating the shift of capital from low profit industries to high profit industries. Whereas Fitch and Oppenheimer regard this as a "decadent and destructive" process[18], this argument in fact supports this paper's analysis of the banking sector's entrepreneurial role as an intermediary in the transfer of capital from one industrial sector to another and does not necessarily imply that antagonism between banks and industrial enterprises exists on a class level. This is not to deny the possibility that localized conflicts of interest may frequently emerge between particular banks and particular industrial corporations over the perception of profit opportunities. However, such conflicts are limited and sporadic and are not a systematic characteristic of state capitalism.

One insight which the state capitalist model shares with the Marxist model of finance capitalism, particularly as elaborated by Victor Perlo and S. Menshikov, concerns the tendency for distinct financial interest groups to emerge[19]. However, the state capitalist model treats these financial interest groups as a symptom of the general tension existing between old and new economic groups within society. Changing conditions and increasing information concerning those conditions provide the basis for the emergence of new economic groups which challenge the established position of older groups that rose to prominence under a different set of conditions. These older groups generally tend not to adapt as readily to these new conditions and tensions naturally result as their positions are increasingly eroded by the newer groups.

In the final analysis, the Marxist model of finance capitalism suffers from two profound weaknesses which stem from its flawed economic analysis: (1) it does not adequately account for the crucial role of state intervention in reinforcing the position of the banking sector within the state capitalist system nor does it recognize the role of state intervention in transforming the character of decision-making activity within the banking sector and (2) it fails to identify the true nature of the inherent instability of the system.

Perhaps the most important insight of Austrian economic theory with regard to an analysis of contemporary state capitalism is that cartellization of the banking sector and the subsequent inflationary policies are incapable of producing the stabilization and rationalization so urgently desired by the leading economic interests in the system. Instead, it creates an inherent instability characterized by increasingly widespread distortions in the pricing mechanism. Rather than attempting to remove the original causes of these distortions, the response of policy makers has been to expand state intervention in the market system, thereby aggravating the original distortions even further. The Misesian theory of interventionism suggests that the initial intervention in the monetary system sets in motion a process of retrogression from a relatively free market to a system characterized by an increasingly fascistic set of economic relationships. But, the dynamics of retrogression within state capitalist systems canot even begin to be outlined here and it will therefore have to wait until a later paper. For the moment, let it suffice to say: it cannot, it will not last.

II. THE CLASS STRUCTURE OF STATE CAPITALIST SYSTEMS

Introduction

The first part of this paper identified the capital market as a repository of ultimate decision-making within a market economic system and described the tendency for many key decision-makers to resort to extra-economic methods, i.e. state intervention, in an effort to minimize unpredictability and insulate economic decision-making from the constraints of competitive market pressures. The rest of this paper will present a sociological analysis of the class structures which emerge and crystallize during this process of interventionism and "rationalization" of the economic system.

The circulation of elites in market systems

Decentralized and private ownership of the means of production constitutes the essential, identifying characteristic of the market system of ownership and of the market solution to the economic problem of relative scarcity[20]. Since all factors of production, including labor services and the ability to anticipate the future, are unevenly distributed, the conditions for specialization, the division of labor and exchange are met, and the market process is set in motion[21]. The price system and the market mechanism then become the principal means of social coordination.

Since all owners of the factors of production are unequal both in natural talent and in the ability to adjust to changing conditions, and since all market activity is necessarily future oriented, it is inevitable that at any moment there will be people and groups of people who are more adept at responding to the various aspects of changing conditions than other members of the population[22]. As conditions continue to change, further adjustments will become necessary and there is no *a priori* reason to believe that the people and groups of people who best adapted to previous change will also be best suited in adapting to subsequent changes. Of course, some will prove themselves consistently over time and important elements of inherited meritocracy must be acknowledged, although care must be taken not to over-emphasize them. Change often occurs in the most unexpected areas in a decentralized market system. Innovators, in the Schumpeterian sense, constantly arise from the most obscure corners of society to initiate and adjust to change in all areas of human endeavor[23].

Because of the uneven distribution of ability, elites will tend to emerge from the ranks of the better qualified through a natural process of emerging hierarchy in all areas of human activity. In all areas there will be natural leaders whose legitimacy is based on natural expertise and authority[24]. Once again, in the Schumpeterian sense, there will be the innovators and the imitators (and even more distant followers who are even too dull to imitate, just followers). The free market society, then, is a society of evolving (ascending and descending) elites or, as Vilfredo Pareto put it, a "circulation of elites". Since change is the fundamental characteristic of the free market society, the emergence of elites and their continuing circulation is both natural and desirable for it promotes optimization of both economic efficiency and social harmony[25].

Just as Schumpeter[26] discusses innovation concerning the entrepreneur and the business firm as leading to the health and progress of the economy, so too must there be a process of both the growth of new elites and the decline of old elites in all institutions and areas of social intercourse. Such processes ensure the health and viability of society as a whole. The free market society is a system in which there are neither interventionistic barriers or aids to the process of social innovation, to the free and dynamic process of the birth and decay of natural elites. Of course, this process of the rise and decline of elites takes time, thus ensuring the continuity which is also necessary to preserve a viable social organization[27].

Political intervention as the source of class conflict

As in the case of monopolies[28], political intervention in the market process of innovation and adaptation constitutes the ultimate source of both stratified class relationships and the consequent economic exploitation of one class by the other[29]. Political intervention inevitably transforms the market system from a matrix of purely "economic means" for the acquisition and preservation of wealth to a system far more infused with the principles and institutions of the "political means". These terms — "economic means" and "political means" were coined by the German sociologist Franz Oppenheimer[30] and are defined as follows: (1) the "economic means" involve the acquisition of wealth through one's own labor and subsequent voluntary exchange relationship while (2) the "political means" covers all other means of acquiring wealth. The latter therefore encompasses the direct or indirect expropriation of previously produced wealth either through direct coercion or through the threat of coercion. The prevalent means of expropriation (and hence exploitation) is taxation. Taxation is also the source of most other indirect forms of intervention which, in turn, lead to even greater exploitation.

While a free market society represents the institutionalization of the economic means, Franz Oppenheimer has defined the state as the organization of the political means. The introduction of the political means into a market system creates a system of state capitalism or, in Gabriel Kolko's terms, political capitalism, i.e., a market oriented system with increasing elements of monopoly and class privilege incorporated within it[31]. The state is antithetical to the free market and statist intervention produces a hampered market system: a system of monopoly privilege and the systematization of exploitation, class antagonisms and socio-economic disharmony of interests.

In fact, as long as the application of the political means continues, social evolution will be shaped by a process of class conflict. The state, as the institutionalization of the political means, necessarily generates a process of continuing class conflict since the political means, by its very nature, creates a series of negative sum relationships — that is, one individual or group gains only at the expense of another. This is in comparison to the economic means characteristic of market systems where all exchanges necessarily lead *ex ante* to increases of utility for all participants entering into them (otherwise the exchanges would never have been consummated in the first place)[32]. Antagonistic interests therefore emerge from the application of the political means between those who gain from the use of the political means and those whose wealth is expropriated[33].

The class structures of state societies are defined by the relationships existing between specific groups of individuals and the two modes of acquisition of wealth in society — the economic means and the political means. For example, the net beneficiaries from the application of the political means in society may be designated, quite appropriately, as the political class. This class encompasses all those individuals or groups of individuals whose position in society is dependent on the institutionalization of the political means. While such a class is defined primarily in economic terms, the concept also incorporates the more subjective notion of status — a dimension which becomes increasingly important in the shift from a contract society to a status society that is characteristic of the evolution of political capitalism. Within the broad category of political class, there are numerous distinct subgroups which will be outlined later in this paper.

The designated class position of any given individual does not necessarily imply a full understanding by him of his own class position — that he has a close similarity or identity of interests with others in his class. However, it seems reasonable to assume that individuals sharing certain objective interests will tend toward an emerging and at least hazy common "class consciousness". This is particularly true for producers within each industry and net beneficiaries of state intervention rather than widely dispersed consumers and net losers from state intervention[34]. As a consequence, there tends to be an uneven development of class consciousness in which the political class attains a critical advantage by developing a much more clearly defined awareness of their own interests and this in turn tends to promote a broad consensus within these classes regarding the measures necessary to protect these interests[35].

It must be stressed that the beneficiaries of the political means in a market oriented economy are dependent on the existence of the economic means in order to survive and prosper. The political means presupposes the economic means since the political means alone is unproductive and parasitic whereas the economic means can exist and, in fact, thrives best in the absence of the political means[36]. In view of the dependence of the political means on the economic means, the optimal strategy for the political class to pursue will not be to maximize short-term returns, but rather to promote as productive a system as possible, consistent with the preservation of its exploitative position in that system. The contradictions inherent in such a strategy epitomize the profound contradictions underlying the entire political capitalist system.

This parasitic relationship cannot persist indefinitely, for the political means inevitably distorts the price mechanism necessary for the successful operation of the economic means in an advanced market economy. Distortion of the price mechanism produces market dislocations which necessitate one of two actions: either the initial intervention through the political means must be eliminated or additional intervention will be introduced in an effort to remove the existing dislocation. The latter option will simply result in further dislocations within the market system, once again confronting policy-makers with the same dilemma[37]. The political means is therefore both parasitic and expansionist and its institutionalization in the state apparatus generates an ultimately unviable system characterized by inherent instability and deepening contradictions[38].

In the absence of a strong, persistent and widely held libertarian ideology, the transition from a market system to an interventionistic system (that is, from a non-fixed class society into a stratified class society) appears all but inevitable. For, although the unhampered market is the "natural" system for the individual (in the sense that it maximizes material welfare in a manner consistent with a normative moral code based on natural rights), it does not necessarily follow that the individual will naturally receive a "natural" social system[39].

The interaction of two fundamental sociological laws in human action in fact persistently militate against the free market society. The first is the basic praxeological law of human action, that human action will be undertaken only if it is anticipated that the actor will be able to substitute a more satisfactory state of affairs for his present, and less satisfactory, condition[40]. While an important methodological insight, the "action axiom" alone represents an otherwise innocuous observation. However, when it is combined with the second insight, "Epstean's Law", one begins to discern a compelling tendency towards increasing intervention in the market place by some at the expense of others — once again, however, this assumes the absence of a strong libertarian ideology. Epstean's Law, as formulated by Albert Jay Nock, states that "man tends to satisfy his needs and desires with the least exertion". It follows that, since expropriation requires the least exertion, then systematized exploitation (the organization of the political means) will tend to become a prevailing social relationship[41].

Until, and unless, the intellectual elite within society fully understands and appreciates the fact that the economic means characteristic of market systems is in the long-run best interests of all individuals in society, we will be very unlikely to achieve anything approximating a truly unhampered market system. There is not good reason, therefore, to trust in the gradualism of social evolution to achieve a free market, classless society. Instead, it is necessary to improve our understanding of the interventionistic, exploitative and stratified class system of state capitalism, for it is the one within which we shall be living for the foreseeable future and it is, more importantly, the one which we shall have to change in such a manner that it will not re-emerge in the future.

A class within a class: the ruling class as ultimate decision-makers

In analyzing the stratified class structures of political capitalism, it is necessary to focus on the distinct sub-groups which comprise this much broader political class. In the following section, each of these sub-groups will be enumerated and discussed briefly in turn. First, however, a narrower category should be isolated within the political class encompassing those individuals who act as "ultimate decision-makers" within the state capitalist system. This smaller group will be designated the "ruling class". The ruling class in turn covers two separate elements: a "narrow" ruling class and a "broad" ruling class.

The "narrow" ruling class is restricted to a relatively small number of individuals and families[42] who are truly "ultimate decision-makers" in the sense that they seldom become involved in the day-to-day problems of current policy formation and implementation. Instead, they are primarily concerned with defining the parameters of economic and political formation, from the international level right down to the national, state and often even local levels. In so doing, they determine what is "acceptable" to the system[43]. For reasons which were outlined earlier, these individuals and families comprising the "narrow" ruling class are to be found predominantly in the financial/capital-owning sector.

These individuals only rarely seek elective political office, although they are often appointed, usually for only relatively brief periods, to serve on "blue-ribbon" advisory commissions or in government positions. Although these individuals occasionally occupy prominent government positions, they usually prefer to remain far from the political limelight while occupying their positions as ultimate *economic* decision-makers. The actual development of the broad outlines of political policy generally occurs in the various research planning associations and university institutes and departments which are sponsored and underwritten by the economic elite[44]. By such underwriting, the parameters for the formulation of political/economic policy are subtly established and academics soon become adept at identifying with the interests of their employers.

Although these individuals form the nucleus of the ruling class, there is also a broader definition of the ruling class encompassing a group of individuals defined primarily by wider sociological criteria[45]. It is within this wider group that the concept of family networks (both financial and sociological)[46], and highly exclusive socialization processes become most relevant. Prep schools, colleges, marriages, social clubs, exclusive resorts, etc. coalesce to inculcate in their participants a largely subconscious value system which integrates and reinforces the ruling class as a distinct and highly exclusive group[47]. A definite "we"/"they" view of the world is developed; a definite set of class interests become "second nature" during the socialization process. This category includes wives, relatives and close associates of the ultimate decision-makers who, while not actively participating as ultimate decision-makers, provide essential links within the family networks.

The taxonomy of the political class

The remaining sub-groups of the political class encompass a broad spectrum of all those, other than the ruling class, who derive and maintain their position in society from the institutionalization of the political means. None of these remaining sub-groups is an ultimate decision-maker within the state capitalist system, although they each represent subsidiary interest groups which help to establish certain social limits that the ruling class acknowledges in its decision-making. For instance, the ruling class would severely threaten its own stability if it sought to challenge the entrenched position of organized labor within the political/economic system. Although it will probably require some hard lessons during the course of consolidating its position within the political/economic system, the ruling class eventually learns that its position is best secured by preserving some flexibility, coopting "junior partners" who might otherwise threaten the stability of the system and generally perfecting the techniques of "repressive tolerance".

A prominent sub-group of the political class is the government bureaucracy. This group clearly derives both its position and its income from direct reliance on the political means and, while its influence in policy-making is often exaggerated, it does play an active and important role in articulating the policy options available to the ruling class. Although, over time, bureaucracies begin to acquire considerable autonomy and are eventually able to exercise substantial discretion in shaping the form, and occasionally even the substance, of specific policies[48], it is only rarely that the government bureaucracy will succeed in actually affecting the parameters of decision-making.

One particular branch of the government bureaucracy deserves special attention: the military. As virtually a state within a state, the military has emerged in the post-World War II period as a key intermediary between the state apparatus and the "private" sector. The sprawling military-industrial complex encompasses a broad range of corporations, and even entire industries, which retain their formal identity as "private" but which in fact are critically dependent on government subsidies and contracts for their continued existence. The influence of the military on ruling class policy-making has often been greatly exaggerated by the Left. While civilian control over the military remains effective, the military resembles any other bureaucracy which seeks to expand its position and it has developed powerful vested interests which it seeks to protect in the policy-making process. Thus, while the military has never successfully challenged the parameters of decision-making elaborated by the ruling class, the military has acquired an influential role in the formulation of specific policies designed to achieve the objectives of the national security paradigm of the ruling class.

To a somewhat lesser degree, the same conclusion regarding measure of influence applies to another sub-group in the political class: the politicians and the individuals who comprise the broad support structure for the politicians within the political parties. The prevailing pluralistic ideology insists that the elected politicians, within the broad constraints imposed by a democratic electorate and the Constitution, have considerable freedom in the formulation of government policy[49]. While there is an element of truth in this myth, it neglects the critical role of funding of both the political parties and specific political campaigns in determining who will get the various nominations and between whom the electorate is then permitted to choose.

While elected politicians have greater leverage in policy formation than the members of the bureaucracy, their success in the electoral arena is usually directly related to their ability to demonstrate at least a close similarity between their own ideology and the ideology of those who are funding their campaigns. Moreover, most politicians draw their policy ideas from the "establishment" policy research associations and universities, and their staffs are populated largely by those who have been trained in these various "think tanks" and who have proven their reliability in the past.

Another sub-group of the political class includes the owners and management of "private" corporations which derive a significant portion of income through reliance on the political means[50]. This reliance may occur in a variety of forms: either through government contracts or subsidies, state-enforced restrictions on competitive practices (tariffs, CAB, FTC and ICC regulation, etc.) or through the socialization of costs (government financed R & D, underwriting bankrupt corporations and banks, etc.)

One useful standard which may be employed in isolating and identifying this sub-group is the Calhoun criterion, i.e. determining which corporations are net tax payers and which are net tax consumers[51]. However, total reliance on this quantitative standard can be both inadequate and misleading. The criteria should be qualitative as well as quantitative so that instances of marginal assistance from the state may be identified which, although relatively minor in comparison with over-all income, nevertheless permit the firm in question to preserve or increase its competitive position on the market[52]. Since the criteria are necessarily qualitative as well as quantitative, the unique position of each corporation must be analyzed in detail to ascertain its precise position *vis a vis* the political means.

A further political class sub-group is that of organized labor. These unions critically depend on state-enforced arbitration legislation to maintain their privileged restrictive position in the labor market[53]. Of course, the role of minimum wage legislation in maintaining organized labor's position within the labor market has already been analyzed in detail[54]. Another less well-known, and yet highly important, device for strengthening the relationship between the labor movement and the state apparatus and the ruling class is government contracts, especially the highly lucrative construction contracts awarded at all levels of government[55].

The position of organized labor, while subordinate to the ruling class, is that of a junior partnership in much of political decision-making[56]. The evolution of this relationship between the ruling class and organized labor constitutes one of the central themes in the emergence of political capitalism both in the United States and in Europe where the position of organized labor is far more powerful than in the United States. In fact, in Europe and England the process of "demagogic plutocracy"[57] — the combination of rising democracy and falling old plutocracy consolidated in the form of a Social Democratic/Labor grand alliance — has dramatically strengthened the position of organized labor within the political/economic system. However, the labor unions in the United States have historically remained far more conservative than their European counterparts. They have focused their attention on narrowly defined economic issues concerning wages and working conditions and they have limited their participation in the political process to mobilizing rank and file support on behalf of "sympathetic" politicians through such political action organizations as COPE. The relatively conservative union leadership has been instrumental in containing the aspirations of the more radical rank and file minority, thereby assisting in the development of a relatively quiescent labor force and effectively forestalling any challenge to political capitalism from the Left.

Another sub-group of the political class covers the broad range of recipients of all state social welfare programs. While it is certainly true, on one level, that this group is dependent on the transfer of wealth through the political means, there is no *a priori* reason to be confident that welfare recipients, as a class, are necessarily net beneficiaries of the political means. At the very least, an unresolved ambiguity exists in this area and it is in fact possible that the position of the welfare recipient may deteriorate within the state capitalist system.

For example, minimum wage laws and restrictive labor legislation create a growing reserve of unemployed labor. This reserve naturally consists of the more disadvantaged groups in society — racial minorities, unskilled labor and youth in general. Thus, unemployed individuals who would presumably be employed on the free market are now "beneficiaries" of unemployment compensation and welfare programs designed to maintain their acquiescence. This is merely one example of the various policies which promote a growing dependency on government subsidy that has in turn led to the emergence of a distinct sub-society within the framework of state capitalism. This welfare sub-society is "serviced" by its own bureaucratic network which serves to reinforce dependency relationships within the society and the resulting system has appropriately been designated "welfare colonialism". Taxes, especially the more regressive types, are especially burdensome on the poorer strata of society so that the marginal aspirants trying to escape this welfare cycle are often pushed back down into the mire of disillusionment and dependency. This disincentive to seek and retain productive employment thus becomes very high[58].

The agents of ideological hegemony: legitimating the illegitimate

The final sub-group of the political class to be discussed in this paper performs a crucial intermediary role within the state capitalist system, coordinating and legitimating the social system. The term "agents of ideological hegemony" will be used to designate the members of an intricate network of intellectuals[59] both in a broad sense and a narrow sense[60]. These intellectuals are affiliated with a wide range of institutions — educational institutions, foundations, policy research associations and the media — whose primary function is the inculcation and reinforcement of the society's values and beliefs. Ultimately, these institutions are designed to ensure subservience to the prevailing authority by preserving the legitimacy of the ruling class.

Although the threat of coercion is inherent in the concept of the political means and therefore in the institution of the state[61], the stability and the success of the ruling class is critically dependent on the degree to which the population internalizes a "consensus" ideology compatible with the specific policies adopted by the ruling class. Such a consensus ideology maximizes "voluntary" support for various exploitative policies, thereby minimizing the reliance of the ruling class on physical coercion to attain its ends.

While it is necessary to avoid a mechanistic theory of crude economic determinism, it is nevertheless essential to stress that economic interest has been, and will continue to be, one of the central motivating factors throughout social history. After all, the concept of economic interest is an *idea*; it is an idea about how the individual relates both to nature and to society. The idea of economic interest and economic hegemony or exploitation is directly related to a sense of legitimacy and, as such, it is of key importance in determining all socio-economic and political relationships. Ultimately, the question of how individuals will relate to each other in economic matters and in the broader matrix of social organization (i.e., whether it will be exploitative or not) will be determined in this realm of ideas.

The agents of ideological hegemony are, thus, the critical variable in the transformation of class from the merely objectively defined socio-economic categories into cohesive groups acting on the basis of subjectively perceived identity of interests — from economic class to socio-political class. These intellectuals at once both clarify and mystify the idea of economic hegemony and stratified class relationship, adding both coherence and legitimacy to this idea of exploitative social relationship[62].

As the tasks of ideological hegemony become more complex and varied in a highly advanced industrial society, increasingly well defined hegemonic hierarchies emerge within the state capitalist system[63]. Thus, a very restricted network of institutions serves to reinforce the social and ideological cohesivesness of the ruling class itself while simultaneously preparing another generation of intellectuals to occupy positions within this network. Prep schools, Ivy League colleges, business research and policy institutions and periodicals such as *Fortune, Business Week,* etc. are just a few of the links in this network.

A distinct institutional network, benefitting from extensive socialization of costs, supplies the economy with a highly skilled and literate labor force inculcated with "technocratic" values. The evolution of the state-financed educational system has been profoundly influenced by the changing needs of the corporate economy and this intimate, if somewhat inefficient, relationship has been a prominent characteristic of state capitalist societies[64]. Compulsory education also inculcates a value system encouraging subservience and docility among unskilled labor and the lower strata of society[65].

While direct state and ruling class subsidies play an increasingly important role in sustaining this hierarchy of networks, intellectuals often derive a significant degree of "remuneration" in non-monetary psychic income. The "court intellectual" who articulates and propagates the values of the ruling class acquires a high status position as well as a sense of participation in the exercise of power within the state capitalist society. It is nevertheless also true that the "court intellectual" usually seems to be much better endowed financially than his colleagues outside the political class and it would seem unrealistic to attribute this to mere coincidence.

The agents of ideological hegemony within the state capitalist system represent a highly mobile class — they shift from academia to the foundations, to government positions, to business research associations, and often to Wall Street itself, then back to the university to begin once again. In all of these moves the intellectuals promote a vital sense of cohesion and ideological coordination among the various sectors of the socio-economy.

Social stratification within the state capitalist system

The emergence of a political class around its strategic decision-making core — the ruling class — fundamentally alters the dynamic and spontaneous circulation of elites. The free market is a synonymous term for the process which generates socially necessary institutions. This "spontaneous" adjustment to changing conditions tends to generate the institutions and associated elites necessary to optimize the socio-economic harmony at any given time[66]. In contrast, interventionism by the state on behalf of the ruling class disrupts and distorts this free market tendency towards social equilibrium. Interventionism causes social maladjustment, bottlenecks, and retrogressive distortion in the socio-economic mechanism.

The ruling class, as the wielder and principal beneficiary of the political means, naturally seeks to consolidate its position further, relying on the protective intervention of the state to prevent the previously unhampered circulation of elites[67]. Since any social system that departs from the free market is inefficient and retrogressive, there is an inherent tendency for state capitalist societies, in time, to retrogress into increasingly static "caste" systems characteristic of feudal and militaristic societies[68]. Real social progress depends on the freely moving circulation of elites and the state capitalist system therefore constitutes a retrogressive social phenomenon[69]. Stratified class societies represent a futile attempt to suppress change. Since change is both a fundamental reality and a necessity in any social system, interventionist policies designed to halt or divert natural social change are dysfunctional and ultimately disastrous for the entire social system.

The ruling class in state capitalist systems must somehow counteract the inherent tendencies within such systems towards increasing stratification, declining social mobility and, ultimately, stagnation throughout the socio-economic system. Social mechanisms must be devised to preserve the existence and privileges of the ruling class while simultaneously permitting limited recruitment and advancement into the class to avoid internal atrophy and incestuous decay. In the absence of such regeneration, ruling classes have historically collapsed either through a process of gradual decay or through a widespread loss of authority, resulting in revolution[70].

The historical dilemma confronted by all ruling classes has been identified by Pareto as the "Persistence of Aggregates": old and obsolescent classes have been unwilling to listen to, to learn from, and to give way to the newer classes. The efficient and enduring ruling classes are precisely those which have been able to accomodate to change and new ideas while maintaining a continuity of control.

The "Foxes" and the "Lions": tension within the ruling class

Pareto distinguished between two different psychological types within ruling classes. First, there are the "Lions" who are inherently conservative, valuing stability in a static sense, and who are therefore antagonistic to change and "newcomers". The term "Persistence of Aggregates" clearly refers to the psychological attitudes most characteristic of the "Lions". The "Foxes" represent a second type, encompassing speculators who seek out innovation, thrive on change and are masters of Machiavellian manipulation. The term "instinct for combination" describes the "mind-set" of the "Foxes"[71].

In the circulation of natural elites in market systems, the interaction between the "instinct for combination" and the "persistence of aggregates" generates an optimum of both change and continuity, resulting in the proper amount of socially desirable and necessary "progress". However, the introduction of artificial barriers to the natural circulation of elites, and thus to the proper flow of socio-economic activity, creates a maladjustment of socio-economic relations. At any particular moment, there will be either too much continuity (excessive "persistence of aggregates") or too much discoordinating change (excessive "instinct for combination").

The "Foxes" and the "Lions" differ fundamentally regarding appropriate methods of government. For example, the "Foxes" of ascendant ruling classes recognize the importance of the management of recruitment to permit marginal social mobility into the ruling class. Such a strategy would seek to coopt the natural elites of society both to strengthen the position of the ruling class and to eliminate potential opposition. In contrast, "Lions" would prefer to *consolidate the ruling class as a self-perpetuating caste insulated from other social strata.*

The process of recruitment, however, often sets in motion various contradictions which intensify the dynamics of intra-class rivalry. The inability to manage the process of recruitment within acceptable limits may lead to excessive change in the opinion of the conservative "Lions". The new recruits, occasionally with some of the old "Foxes", may form the nucleus of a new ruling class. The response of the "Lions" will be to adopt a defensive policy of retrenchment, seeking to dismantle the recruitment mechanisms which were responsible for increasing ruling class heterogeneity and thereby intensifying intra-class tensions. If fully successful, such policies will generate a widening gap between the ruling class and the natural elites within society which will be progressively barred from entry into the ruling class. Cut off from infusions of new talent, the atrophying ruling class will experience increasing difficulty in maintaining social control, particularly as the rising natural elites are driven into opposition movements in increasing frustration over the obstacles to social mobility.

If, on the other hand, the "Foxes" prevail, they will replace the older "Lions" who are unable to adjust to changing social institutions. As the ascendant "Foxes" succeed in consolidating their position within the ruling class, however, they will increasingly display the psychological traits of their "Lion" predecessors as they too seek to defend their privileged social position against the challenge of rising new elites within the social system. The ruling class ideally strives to promote an optimal balance between change and continuity within the social system but, since this objective can only be attained in unhampered market systems, the system of state capitalism will ultimately prove unable to duplicate the market process and the natural circulation of elites accompanying this process.

The institution of the state, in fact, virtually ensures that the collapse of the traditional elites and the emergence of new ones will be surrounded by violence, for the institutionalization of the political means inevitably creates *coercive barriers to social mobility* which reinforce stratification, stagnation and frustration, culminating in outbreaks of violence. When social mobility is no longer permitted through a process of evolutionary change, revolutionary violence increases in importance as a mechanism for social mobility. The politicizing of economic relationships which emerges as a prominent characteristic of state capitalist systems leads to a disharmony of interests that is manifested in constant tension, confrontation and finally violence.

As Hayek perceptively notes, in these confrontations between the political class and the rest of society, and between the "Lion" and "Fox" factions of the ruling class, those who are most adept in the use of the political means (ultimately brute, naked force) will tend to rise to the top[72]. Once at the top of the social pyramid, they tend to become increasingly defensive against new "Foxes". As the members of the ruling class become more preoccupied with the protection of their privileged social position, they become less concerned with ensuring the smooth and productive operation of the social system. They become more vulnerable and lose their sense of legitimacy. The demise of the existing ruling class will eventually occur but, as long as the state apparatus institutionalizes the political means within the socio-economic system, new ruling classes will be prepared to try where others have failed.

III. CONCLUSION

A detailed analysis of the process of social stratification which occurs in all state capitalist systems is essential for an understanding of the dynamics of our present social system. The mechanisms for the consolidation of both the ruling class and the broader political class and the contradictions within the state capitalist system which ultimately assure the disintegration of the ruling class require a much more careful scrutiny than has just been undertaken. It is our hope that the analytical framework which we have elaborated will contribute to a more comprehensive understanding of the state capitalist system, thereby strengthening our ability to transform the system into one which more nearly satisfies our hopes, our needs and our strong sense of justice. As a leading social analyst of the last century noted, "the philosophers have only interpreted the world, in various ways; the point, however, is to change it"[73]. We seek to interpret the existing state capitalist system in order to facilitate the final dismantling of that system.

NOTES

1. For a more detailed presentation of this analysis, see Friedrich Hayek, "Economics and Knowledge" and "Socialist Calculation III, the Competitive 'Solution'" in *Individualism and Economic Order,* Routledge and Kegan Paul (London, 1949) as well as the excellent collection of essays in Friedrich Hayek, ed., *Collectivist Economic Planning,* George Routledge and Sons (London, 1935). In addition to the article appearing in Hayek's edited collection, von Mises has developed his argument on economic calculation in market systems in his book *Socialism,* Yale University Press (New Haven, 1951) and *Human Action,* Henry Regnery (Chicago, 1966).
2. Israel Kirzner, *Competition and Entrepreneurship,* University of Chicago Press (Chicago, 1973). See also Professor Kirzner's paper entitled "Capital, Competition and Capitalism" which is reprinted in *Champions of Freedom,* Hillsdale College Press (Hillsdale, Michigan, 1974) and which explores in greater detail his assertion that pure entrepreneurship does not require capital ownership. Two earlier studies which provide important contributions to the theory of entrepreneurship in market economies are Joseph Schumpeter, *The Theory of Economic Development,* Harvard University Press (Cambridge, 1961) and Frank H. Knight, *Risk, Uncertainty and Profit,* University of Chicago Press (Chicago, 1921).
3. Israel Kirzner, *Competition and Entrpreneurship, op. cit.,* pp. 44–45, 48–49, and Kirzner, "Capital, Competition and Capitalism", *op. cit.,* pp. 7–8, 9, 10, 11.
4. Frank H. Knight, *op. cit.,* is particularly useful in his insistence that ultimate control and ultimate responsibility are inseparable.
5. One possible measure of the extent to which each partner has engaged in entrepreneurial activity might be to focus on the subsequent division of entrepreneurial profits. The relative shares of entrepreneurial activity may vary from the extreme case in which the borrower succeeds in capturing virtually the entire entrepreneurial profit to the equally extreme case in which the lender succeeds in capturing almost the entire entrepreneurial profit. However, regardless of the distribution of the entrepreneurial profits, both partners are engaged in entrepreneurial activity.
6. Knight, *op. cit.,* p. 289.
7. Contemporary bankruptcy laws perform an important function in shifting a large burden of the risk to the lender of capital and it would be relevant to inquire how this situation might be altered in a pure market system. Lawrence White, a student in the Economics Department at Harvard, has written an interesting paper on this subject from an Austrian perspective entitled "Bankruptcy and Risk", March 25, 1975.
8. For an analysis of the importance of indirect exchange and money in market economies, see Ludwig von Mises, *Human Action, op. cit.,* pp. 398–471; Ludwig von Mises, *The Theory of Money and Credit,* Henry Regnery (Chicago, 1953), pp. 29–37; and Murray N. Rothbard, *Man, Economy and State,* Van Nostrand (New York, 1962), pp. 160–200. See also Rothbard, "Egalitarianism as a Revolt Against Nature", *Modern Age,* Fall 1973.
9. Ludwig von Mises, *The Theory of Money and Credit, op. cit.,* pp. 261–277 discusses the functions performed by banking institutions in a market economy.
10. See G. J. Stigler, "Imperfections in the Capital Market", *Journal of Political Economy,* June 1967 for a refutation of a variety of conventional views regarding the imperfections believed to hamper the operation of the capital market.
11. Schumpeter, *op. cit.,* pp. 126–127.
12. Murray N. Rothbard, *What Has Government Done to our Money?* Pine Tree Press (Santa Ana, California, 1964), pp. 22–26. Rothbard also cites Amasa Walker, *The Science of Wealth,* Little, Brown and Co. (Boston, 1867), pp. 139–141, 126–232 for an excellent discussion of the problems of fractional reserve banking.
13. Four essential studies exploring the emergence of political capitalism and the leading role of business interests in the elaboration and implementation of this ideology are Gabriel Kolko, *The Triumph of Conservation,* The Free Press of Glencoe (New York, 1963); James Weinstein, *The Corporate Ideal in the Liberal State,* Beacon Press (Boston, 1968); Robert Wiebe, *The Search for Order, 1877–1920,* Hill and Wang (New York, 1967). A more recent collection of highly illuminating essays is available in Ronald Radosh and Murray Rothbard, *A New History of Leviathan,* Dutton (New York, 1972).
14. Gabriel Kolko, *op. cit.,* pp. 252–253.
15. For a brief discussion of the significance of the Federal Reserve System in permitting member banks to expand their asset base, see Murray N. Rothbard, *America's Great Depression,* Van Nostrand (Princeton, 1963), pp. 29–33. In his study, *What Has Government Done to Our Money? op. cit.,* pp. 36–38, Rothbard stresses the consequence of government intervention which permits banks to refuse to pay their obligations while continuing in operation. Sam Peltzman has published an interesting attempt to measure the impact of the Banking Act of 1935 in restricting entry into commercial banking in "Entry in Commercial Banking", *Journal of Law and Economics,* No. 8, October 1965, pp. 11–50. He concludes that without this regulation entry into commercial banking would have been 50–100% higher than it actually has been.
16. These articles appeared in a three part series in *Socialist Revolution,* Vol. 1, Nos. 4, 5 and 6, Summer 1970,

September-October 1970 and November-December 1970. This was followed by a "Reply" to various criticisms of the original series of articles which appeared in *Socialist Revolution*, January-February 1971.
17. James O'Connor, "Question: Who Rules the Corporations? Answer: The Ruling Class", *Socialist Revolution*, January–February 1971 and Paul Sweezy, "The Resurgency of Financial Control: Fact or Fancy" *Socialist Revolution*, March–April 1971.
18. Fitch and Oppenheimer, *op. cit.*, Part III, pp. 47–75.
19. Victor Perlo, *The Empire of High Finance*, International Publishers (New York, 1957) and S. Menshikov, *Millionaires and Managers: Structure of U.S. Financial Oligarchy*, Progress Publishers (Moscow, 1969).
20. Ludwig von Mises, *Socialism, op. cit.*
21. Murray N. Rothbard, "Freedom, Inequality, Primitivism and the Division of Labor", *Modern Age*, Summer 1971; Rothbard, "Egalitarianism as a Revolt Against Nature", *op. cit.*; Knight, *op. cit.*; Ludwig M. Lachmann, "The Role of Expectations in Economics as a Social Science", *Economica*, February 1943; L. M. Lachmann, "Professor Shackle and the Significance of Time", *Metroeconomica*, September 1959.
22. H. A. Hodges, *The Philosophy of Wilhelm Dilthey*, Routledge, and Kegan Paul (London, 1952); R. G. Collingwood, *The Idea of History*, Oxford University Press (London, 1946); and Ludwig von Mises, *Theory and History*, Yale University Press (New Haven, 1957).
23. Schumpeter, *op. cit.*; J. A. Schumpeter, *Capitalism, Socialism and Democracy*, Harper and Brothers (New York, 1942); and Kirzner, *Competition and Entrepreneurship, op. cit.*
24. S. E. Finer, "Pareto and Pluto-Democracy: The Retreat to Galapagos", *The American Political Science Review*, June 1968; S. E. Finer, *Pareto: Sociological Writings*, Praeger (New York, 1966); F. Kolegar, "The Elite and the Ruling Class: Pareto and Mosca Re-Examined", *Review of Politics*; J. H. Meisel, *Pareto and Mosca*, Prentice-Hall (Englewood Cliffs, N.J., 1965); J. H. Meisel, *The Myth of the Ruling Class: Gaetano Mosca and the Elite*, University of Michigan (Ann Arbor, 1962); Robert Michels, *Political Parties*, Collier Books (New York, 1962); and Gaetano Mosca, *The Ruling Class*, McGraw-Hill (New York, 1939).
25. Ludwig von Mises, *Human Action, op. cit.*
26. J. A. Schumpeter, *The Theory of Economic Development, op. cit.*
27. The circulation of elites over time is illustrated by the popular maxim: "from shirtsleeves to shirtsleeves in three generations".
28. Herbert Spencer, *Social Statics*, A. M. Kelley (New York, 1969); Isabel Paterson, *The God of the Machine*, Caxton Press (Caldwell, Idaho, 1943); Gabriel Kolko, *The Triumph of Conservatism, op. cit.*
29. Albert Jay Nock, *Our Enemy the State*, Free Life Editions (New York, 1973); Franz Oppenheimer, *The State*, Free Life Editions (New York, 1975); Murray N. Rothbard, "The Anatomy of the State", *Egalitarianism as a Revolt Against Nature and Other Essays*, Libertarian Review Press (Washington, 1974); and Murray N. Rothbard, *For a New Liberty* (New York, 1973).
30. Oppenheimer, *ibid.*
31. Gabriel Kolko, *op. cit.*
32. Carl Menger, *Principles of Economics*, Free Press (Glencoe, 1950) and Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics", in M. Sennholz, *ed.*, *Freedom and Free Enterprise*, Van Nostrand (Princeton, 1956).
33. Rothbard, *ibid.*, and L. Robbins, *The Economic Basis of Class Conflict*, Macmillan (London, 1939).
34. L. Robbins, *ibid.*
35. Hilaire Belloc, *The Servile State*, T. N. Foulis (London, 1912).
36. It should be stressed that the elements of this analytical model are rarely encountered in their pristine purity in the "real world". Instead, historical class formations usually represent varying mixtures of the political means and the economic means. The historian and social researcher must resolve the empirical question of the extent to which a particular class in any given historical period relies on either of these two methods for the acquisition of wealth. It is useful, however, to isolate the distinct elements of this analytical model in their purest form in order to describe their unique characteristics and thereby achieve a deeper understanding of their interaction in various historical epochs.
37. The interventionist dynamic is occasionally disrupted, and even temporarily reversed, by certain crisis periods in which the contradictions inherent in earlier interventionist measures confront the ruling class with the necessity of repealing these earlier measures, e.g., the acute housing shortage resulting from New York's rent control legislation confronted policy makers with the option either of repealing this legislation or authorizing massive state intervention in the housing market in the form of public housing projects. The fundamental social transformations that would have resulted in the latter option made it unacceptable. Usually, however, policy makers will be reluctant to admit the mistake of their earlier intervention (mainly for political reasons) and instead will adopt further interventionist measures to "cure" the previously caused distortions.
38. For a more detailed investigation of the nature and effects of interventionism, see Walter Grinder and John Hagel, "From *Laissez-Faire* to *Zwangswirtschaft:* The Dynamics of Interventionism", delivered to the Austrian Economics Symposium, University of Hartford, June 1975. See also Ludwig von Mises, "The Middle of the Road Leads to Socialism", *Planning for Freedom*, Libertarian Press (South Holland, Illinois, 1962) and F. A. Hayek, *The Road to Serfdom*, University of Chicago Press (Chicago, 1944).
39. Of course, any system which interferes with the market process embodies inherent contradictions which progressively hamper the functioning of the social system over the long run. Hence reality is a strong teacher and market oriented reforms will probably accompany each cumulative crisis but, in the absence of a continuing libertarian ideology, even the harsh lessons of reality will soon be forgotten and the interventionist dynamic will resume its relentless course. F. A. Hayek, *Individualism and Economic Order, op. cit.*; Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth" in Hayek, *ed.*, *Collectivist Economic Planning, op. cit.*; and Murray N. Rothbard, "Lange, Mises and Praxeology: The Retreat from Marxism" in Hayek, Harper, *et. al.*, *eds.*, *Towards Liberty*, Institute for Humane Studies (Menlo Park, California, 1971).
40. Von Mises, *Human Action, op. cit.*; Ludwig M.

Lachmann, "On the Method of Interpretation", *The Legacy of Max Weber,* Glendessary Press (Berkeley, 1971); and Murray N. Rothbard, "Praxeology as the Method of Economics" in M. Natanson, *ed., Phenomenology and the Social Sciences,* Northwestern University Press (Evanston, Ill., 1973), Vol. II, pp. 311–339.

41. Albert Jay Nock, *Memoirs of a Superfluous Man,* Regnery (Chicago, 1964).
42. E. Digby Baltzell, *Philadelphia Gentlemen: The Making of a National Upper Class,* The Free Press (Glencoe, Ill., 1958); G. William Domhoff, *Who Rules America?* Prentice-Hall (Englewood Cliffs, N.J., 1968); G. William Domhoff, *The Higher Circles,* Vintage (New York, 1971); and Ferdinand Lundberg, *America's Sixty Families,* Vanguard Press (New York, 1937).
43. Gabriel Kolko, "The Men of Power", *Roots of American Foreign Policy,* Beacon Press (Boston, 1968) and G. William Domhoff, *The Higher Circles, op. cit.*
44. David Eakins, "Policy Planning for the Establishment" in Radosh and Rothbard, eds., *A New History of Leviathan, op. cit.*; David Eakins, "Business Planners and America's Postwar Expansion" in William A. Williams, *ed., Corporations and the Cold War,* Monthly Review Press (New York, 1968); and David Eakins, "The Development of Corporate Liberal Policy Research in the United States, 1885–1965", unpublished Ph.D. thesis, University of Wisconsin, Madison, 1966.
45. G. William Domhoff, *Who Rules America?* and *The Higher Circles, op. cit.*
46. Baltzell, *Philadelphia Gentlemen, op. cit.*; Stephen Birmingham, *The Right People,* Little, Brown and Co. (Boston, 1968); G. William Domhoff, *The Higher Circles, op. cit.*; Lundberg, *op. cit.*; S. Menshikov, *Millionaires and Managers, op. cit.*; and Victor Perlo, *op. cit.*
47. Cleveland Amory, *The Last Resorts,* Harper and Row (New York, 1952); Baltzell, *op. cit.*; Birmingham, *op. cit.*; G. William Domhoff, *The Bohemian Grove,* Harper and Row (New York, 1974); G. William Domhoff, *The Higher Circles, op. cit.*; C. Wright Mills, *The Power Elite,* Oxford University Press (New York, 1956).
48. Raymond Aron, "Max Weber", *Main Currents in Sociological Thought,* Basic Books (New York, 1965); J. A. Schumpeter, *Capitalism, Socialism and Democracy, op. cit.*; Max Weber, *The Theory of Social and Economic Organization,* Oxford University Press (New York, 1947); Ludwig von Mises, *Bureaucracy,* Yale University Press (New Haven, 1944).
49. J. H. Meisel, *The Myth of the Ruling Class, op. cit.* and G. W. Domhoff, *The Higher Circles, op. cit.*, especially chapter 9.
50. Seymour Melman, *Pentagon Capitalism,* McGraw-Hill (New York, 1969); Seymour Melman, *The Permanent War Economy,* Simon and Schuster (New York, 1974); Murray Weidenbaum, *The Modern Public Sector,* Basic Books, (New York, 1970); and H. L. Nieburg, *In the Name of Science,* Quadrangle (Chicago, 1966).
51. J. C. Calhoun, *A Disquisition on Government,* P. Smith (New York, 1943) and Murray N. Rothbard, *Power and Market,* Institute for Humane Studies (Menlo Park, 1970).
52. These broadened criteria are essential to isolate and define the precise relationship existing between the state and an ostensibly "private" corporation such as Dow Chemical Company which emphasized that its contracts for the manufacture of napalm account for less than 3% of its total revenue.
53. Sylvester Petro, *Labor Policy of the Free Society,* Ronald Press (New York, 1957) and Murray N. Rothbard, *Power and Market, op. cit.*
54. Yale Brozen, "Is Government the Source of Monopoly?" *Intercollegiate Review,* 1968; Milton Friedman, *Capitalism and Freedom,* University of Chicago Press (Chicago, 1961); J. M. Peterson and C. T. Stewart, Jr., "Employment Effects of Minimum Wage Rates", American Enterprise Institute pamphlet, Washington, 1969; and Murray N. Rothbard, *Power and Market, op. cit.*
55. Other prominent examples of government contracts include the interstate highway network, the Albany Mall, the World Trade Center Towers, etc., etc., *ad infinitum.*
56. Ronald Radosh, "The Corporate Ideology of American Labor Leaders from Gompers to Hillman", in James Weinstein and David Eakins, eds., *For a New America,* Random House (New York, 1970); Ronald Radosh, *American Labor and United States Foreign Policy,* Vintage (New York, 1970); and Murray N. Rothbard, *Power and Market, op. cit.*
57. S. E. Finer, *Pareto: Sociological Writings, op. cit.* and Vilfredo Pareto, *Mind and Society* (New York, 1935).
58. F. Piven and R. Cloward, *Regulating the Poor,* Pantheon (New York, 1971); Pechman, "The Rich, the Poor and the Taxes They Pay" *The Public Interest,* Fall 1969. Preliminary studies by an Institute of Policy Studies research group in low income areas in Washington, D.C. also indicate that these areas pay out more in taxes than they receive in welfare benefits. Of course, purely quantitative studies of transfers in this field suffer from the same limitations characteristic of such studies in other areas of the economy.
59. A. Gramsci, *The Modern Prince and Other Essays,* International Publishers (New York, 1957); Bertrand de Jouvenel, *On Power,* (Boston, 1969); and J. A. Schumpeter, *Capitalism, Socialism and Democracy, op. cit.*
60. F. A. Hayek, "The Intellectuals and Socialism", *University of Chicago Law Review,* Spring 1949.
61. De Jouvenel, *On Power, op. cit.*
62. Murray N. Rothbard, "Anatomy of the State", *op. cit.* and a brilliant but, as yet, unpublished manuscript by Murray Rothbard, "A Parable for Our Time".
63. James Gilbert, *Designing the Industrial State,* Quadrangle (Chicago, 1972) and G. William Domhoff, *The Higher Circles, op. cit.*
64. Joel Spring, *Education and the Rise of the Corporate State,* Beacon Press (Boston, 1971).
65. *Ibid.* and Edgar Z. Friedenberg, *Coming of Age In America,* Random House (New York, 1963).
66. Ludwig M. Lachmann, "On Institutions", *The Legacy of Max Weber, op. cit.*
67. This defensive role of political interventionism is best identified and explained by the "Brozen-Friedman-Kolko Thesis", an unified thesis which may be developed from the following works: Brozen, "Is Government the Source of Monopoly?", *op. cit.*; Milton Friedman, "Occupational Licensure", *Capitalism and Freedom, op. cit.*; and Gabriel Kolko, *The Triumph of Conservatism, op. cit.* See also Vilfredo

Pareto, *Mind and Society, op. cit.* and Gaetano Mosca, *The Ruling Class, op. cit.*

68. Herbert Spencer, *Social Statics, op. cit.*
69. A retrogressive social phenomenon is defined through a comparison between existing conditions and the conditions which probably would have prevailed had the intervention not taken place. It would be misleading to compare the present conditions with earlier conditions since, for other reasons, there in fact may have been an improvement on this level.
70. Gaetano Mosca, *The Ruling Class, op. cit.*
71. Raymond Aron, "Pareto" in *Main Currents in Sociological Thought, op. cit.* and S. E. Finer, *Pareto: Sociological Writings, op. cit.*
72. F. A. Hayek, *The Road to Serfdom, op. cit.*
73. Karl Marx, "Theses on Feuerbach", *The Economic and Philosophical Manuscripts of 1844,* International Publishers (New York, 1965).