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Reflections on the 25th Anniversary of the Fall of the Berlin Wall: Part 1

It has been 25 years since the Berlin Wall ceased to divide East and West Berlin. After signifying the “hard border” between two competing world systems where East German security forces “shot to kill” their countrymen who tried to cross into West Berlin, suddenly, Germans were safely pouring across the dividing line. Although communism did not end as a political and economic system with this event, it signaled the end of its power. Essentially, the communism of the former Soviet Union is only practiced in North Korea and Cuba today, and the latter may be poised to jettison socialism and communism after the elderly Castro brothers pass from this earthly plane.

The fall of the Berlin Wall was a momentous event but like all such occasions, only the passage of time allows us to appreciate more fully the incident’s importance. In another 25 years, we will have an even more nuanced understanding of this event. But, a quarter century does offer us perspective we did not have in 1989.

In this report, we will examine the first of four important consequences from the fall of the Berlin Wall. These are:

- The End of Marxism
- The Collapse of the U.S.S.R.
- The Onset of the U.S. Unipolar Moment
- The Impact of German Unification

We will offer a simple conclusion this week and end next week’s report with market ramifications.

The End of Marxism

Marxism was a curious outgrowth of the Enlightenment. The Enlightenment was a European intellectual movement that sought to focus human behavior on reason, as opposed to tradition or religion. Based on this premise, it attempted to create universal values for human goals and behaviors. The American Declaration of Independence and the Constitution are based on the ideas of the Enlightenment. For example, the notion of “the pursuit of happiness” for each person was a radical departure from serving a king or a church.

The Enlightenment fostered the concept that people should pursue their self-interest based on reason. Adam Smith, following on the philosophic writings of David Hume, argued that if each person followed the path of self-interest that the economy, as if managed by “an invisible hand,” would lead to the most optimal outcome. This outcome occurred due to competition between parties; the collision of the interests of consumers and producers would lead to a price high enough to ensure ample supply and a price low enough to meet the needs of most households. The concept that allowing individuals the freedom to “pursue happiness” would lead to the most optimal outcome for society was truly radical. Up to that point, the general belief was that such self-centeredness was a vice. Smith and Hume’s position suggested it was a virtue.

Britain's economic success, driven by the industrial revolution and fostered by capitalism, led other nations to follow a similar path. Capitalism became the dominant economic system. However, it was not without flaws. As Hume noted, justice only occurs between equal parties. Absent an outside force (like government), the less powerful only have mercy and generosity to rely upon in economic, social and political situations.

A key outcome from the evolution of capitalism and the Enlightenment was that the universal values that emerged had the power to undermine the state. If "all men were created equal" and had universal rights, and the best outcome for society is to allow people to pursue their self-interest with minimal constraint, then states that repressed their citizens could be considered illegitimate. An interesting twist developed. Capitalists, who thrived in a world of free markets, secure property rights and the free movement of labor and capital, began to have more in common with each other than they did with the countrymen with whom they shared citizenship. In other words, a business owner in London tended to think like his contemporary in New York or Paris. However, that same English business owner may have less in common with the people who worked in his factory. This development came straight from David Hume's view of justice; the business owner viewed his foreign contemporaries as equals. He didn't feel the same way about his workers, who were not his equal. In this way, capitalism became an international, rather than a regional or national, phenomenon.

The less affluent faced a different set of circumstances. Perhaps the best way to understand this issue is that if one is not affluent, one needs the support of family and

friends to better survive. Lower income households need to band together with others nearby and thus are more inclined to view economic and social policies through the prism of immediate local impact as opposed to broader, more ephemeral, effects. If one has less income and wealth, the importance of place becomes much more critical. The capitalist, due to the power that wealth provided, was less dependent on local circumstances and relationships. Thus, he had less ties to a specific place compared to the less affluent member of the labor class.

Take free trade, for example. Capitalists view free trade as essential; it allows businesses to sell abroad and source production in the most favorable circumstances, which may involve moving that production outside the "home" country. In the long run, free trade improves efficiency and expands the general welfare. However, in the short run, jobs are often lost as domestic industries face the pressure of foreign competition. When economists discuss the short-term losses from trade, they usually argue that government should create policies to soften the adverse short-term impact from trade. In reality, these policies tend to fail to help workers adjust. The capitalists, being internationalist and favoring globalization, support free trade. Labor, more tied to place and with fewer resources to cope with job loss, tends to oppose it.

The Dickensian social conditions that existed in Britain and Europe in the 18th through the 20th century led to social reactions against capitalism. None were more powerful than the writings of Karl Marx.

Marx admitted that capitalism and capitalists had changed the world.

The bourgeoisie, during its rule of scarce one hundred years, has created more massive and more colossal productive forces than have all preceding generations together. Subjection of Nature's forces to man, machinery, application of chemistry to industry and agriculture, steam-navigation, railways, electric telegraphs, clearing of whole continents for cultivation, canalisation of rivers, whole populations conjured out of the ground – what earlier century had even a presentiment that such productive forces slumbered in the lap of social labour?'

Unlike the social reformers of the day, who tried to soften the impact of capitalism through charity or government programs, Marx instead called for revolution. Perhaps the most interesting position Marx took was that workers should mimic the *bourgeoisie*, and move beyond their local communities and nations and think internationally.

*Workers of the world unite! You have nothing to lose but your chains!*²

In a sense, Marx wanted to create an international consortium of workers that would rival the global power of the capitalists. Although Marxism had numerous other facets, this one is the key to our analysis.

The inability to create an international movement of workers was one of the fatal flaws of communism. Although the *bourgeoisie*, due to their adoption of human universality from the Enlightenment, could think in global terms, workers tended to remain tied to a specific place. The capitalists saw that free trade, open

immigration, secure property rights and free markets in the long run led to greater welfare. Workers found that these conditions in the short run often led to painful disruptions in their lives.

In practice, communism became a godless religion that tried to preach working class universality to a group of people who were, due to their circumstances, tied to specific places. Communism was never able to overcome this hurdle; although conceived as an international movement, it steadily became expressed by particular national characteristics and failed to develop as a true international movement. Stalin's "socialism in each country" was an acknowledgement that Marx's international vision was untenable. Although this wasn't the only fatal flaw of communism,³ the lack of international character undermined its ability to offer a sustainable alternative to capitalism.

One of the key criticisms from contemporary Marxists is that capitalism breaks down communities and encourages "atomistic" human relations. However, this criticism probably misses the point. When a household acquires wealth, it also acquires power and becomes less dependent on friends and neighbors. A more affluent household can hire professionals for basic services, like child care, home maintenance, security, etc. The less affluent cannot afford such professional support and often rely on family, friends and neighbors for babysitting, watching one's home or apartment when one is away, etc. The real (and mostly unresolvable) debate is whether

³ There are several flaws of communism, but the more significant ones include (a) the inability to allocate investment due to the lack of capital markets, (b) the inability of Marxism to replace religion, and (c) the inability to prompt work effort without coercion.

¹ Marx, Karl, Engels, Fredrick, "Manifesto of the Communist Party," 1948

² *ibid*

everyone would behave like the affluent if they had the means, or if the characteristics that support a household becoming affluent, such as aggressively pursuing one's self-interest, would lead to wealth. If so, the less affluent are that way because they lean toward being communitarian. Again, this question is unanswerable, but it is generally the only arena where the Marxism versus capitalism debate continues. Simply put, it's the age-old question...are humans naturally social, or not? The contemporary Marxist criticism of capitalism is that it causes naturally communitarian people to become atomistic. However, it may simply be the case that there is a natural predilection toward both communitarian and atomistic behaviors in all people, depending on the circumstance, and perhaps, genetics.⁴

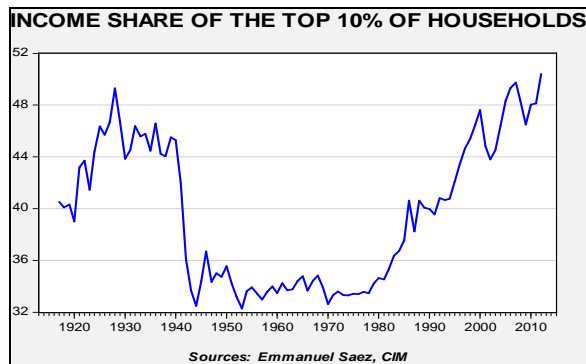
It is rather obvious the world is a better place now that communism is no longer considered a viable alternative. There is less of a chance of nuclear holocaust now that the U.S. and U.S.S.R. are not poised to attack each other. The conflict between the U.S. and Russia are not ideological but about power. However, the economic "contradictions" that Marx noted, which essentially boil down to the differences in power between workers and capital owners, remain mostly unresolved. Marx argued that if capitalism and the *bourgeoisie* were left to their own devices, eventually capitalists will control so much of the economy that there will be insufficient demand to absorb all the production the capitalists produced. This outcome would

⁴ The issue of communitarian versus self-interest runs deep enough that some researchers are seeking differences in brain patterns or genetics to try to determine the question. Simply put, the issues of regard for the community and the desire for freedom may be closely tied to the individual and may be beyond environment.

lead to persistent deflation and "a reserve army of the unemployed."

Thus far, Marx's dire forecast for capitalism has failed to develop. Governments in capitalist nations have tended to intervene to roughly balance the interests of workers and capital owners. However, policy is a blunt instrument; optimization of policy only occurs in academia. And so, in practice, government policy tends to oscillate. In some periods, governments support capitalists to expand the economy and reduce inflation. They usually reverse these policies and support labor when income and wealth inequality become too great to manage politically.

If there is a downside to the end of communism, perhaps it is that capitalist governments no longer face the threat Marx represented. From the Great Depression to the late 1970s, most Western governments supported workers to the detriment of capital. As inflation rose, a consequence of constraining the supply side of the economy, governments reacted by shifting support to capital. It could be argued that these worker friendly policies remained in place longer than optimal due to fears that allowing capital to become too powerful would foster favorable sentiment toward communism. In other words, the political leadership of the West had to prove to the world that it could create a better economic situation than communism for the masses. With the threat of communism lost, there is less political incentive to oppose the capitalists and support labor. This situation has led to rising inequality in the U.S. and elsewhere. As the chart below shows, U.S. inequality was rising during the 1980s but the trend has accelerated since the Berlin Wall fell in 1989.



Conclusions

Overall, the end of Marxism as a viable alternative for running an economy has probably led to the expansion of capitalism and growing inequality. After all, the unfettered introduction of new technology and globalization is congruent with the international tendencies of capitalism. The creation of the so-called “Davos man”⁵ is a

⁵ “Davos man” is named after the annual meetings in Davos, Switzerland. This person represents the global elites who have benefited from globalization and deregulation. He is usually a member of the management of a major international firm, or a figure from media, government, NGOs, etc.

reflection of capitalism at perhaps its most pure form.

The problem for capitalism is that the tensions that Marx discussed still remain. Capitalism does tend to foster inequality. The rising political tensions between populists and the establishment wings of both major political parties reflect this situation. The risk is that although Marxism has been discredited, the problems remain and new forms of addressing these issues may develop over time that will weaken capitalism’s grip on the global economy. We do not know what form this may take but the current trends in inequality, on a global scale, are probably not sustainable.

Next week, we will conclude this reflection, discussing the collapse of the U.S.S.R., the U.S. unipolar moment and the impact of German unification.

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