# Reviews

## *Good capitalism, bad capitalism, and the economics of growth and prosperity*

William Baumol

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Reviewed by Colin Crouch

Since capitalism became virtually the only form of economic system available, it has become both necessary and possible to distinguish between different forms of it. The task of doing so has usually fallen to political scientists, sociologists, and institutional economists. This book is notable for being a contribution to the study of the diversity of capitalism from the stable of orthodox neo-classical economics. It is also unusual in being, as its title implies, a normative account, dealing not just in terms of relative efficiency or appropriateness for different tasks, but making the fundamental moral evaluation of good and bad.

The authors distinguish four forms of capitalism: state-guided, oligarchic, big-firm, and entrepreneurial. The first two are 'bad' and identified with various parts of the ex-communist and developing world; the third is rather bad, and is associated with continental western Europe; the fourth is good, and is represented by the US and other US-friendly Anglophone countries – though to be viable it has to occur in some unspecified conjunction with the big-firm model.

That oligarchic capitalism of the kind that has developed in Russia and some other parts of the former Soviet Union is 'bad', whether in a moral or efficiency sense need not be disputed here. Western neo-liberal economists who advised authorities in that part of the world that the crucial thing was to privatise, and that markets would surely follow, and that social and political institutions and infrastructure were irrelevant provided that economic resources were privately owned, have had long enough to ruminate on their error. Certainly these authors have absorbed all those lessons.

State-guided or developmental capitalism is far more problematic. It has been the model pursued, in varying forms, in a large number of states from Latin America to South East Asia, and it has both remarkable successes and disastrous failures to its account. Western social democrats have a disturbing tendency to point to the state-led character of economic growth in such places as Taiwan, Singapore and South Korea as some kind of justification of their own political preference for big government. It is not. In most examples of this kind of capitalism, at least in their formative stages, state power was used to suppress dissent, sometimes brutally, and to protect local elites and their often uncompetitive economic interests, with highly inegalitarian consequences. The economic success of some of these cases simply shows us that 'bad' capitalism can be successful, something that both left and right are reluctant to accept.

The authors of the volume under review, being of the economic right, have the opposite problem of social democrats: they have to argue that the state has not really been so important to the success of these countries (pp. 142–3). They do this in a highly unconvincing way, claiming that while government might have been important in the early stages of growth, it is so no longer. There are two problems with this position. First, the fact that in later stages of development the state might reduce its role does not somehow wipe out the reality of its contribution in earlier stages. Second, even if the role of the government becomes less directive in later stages, it remains highly active. Most typically, a protectionist role in supporting local capitalists against foreign competition gives way to an encouragement of foreign direct investment. But this does not usually take the form of a move to pure market forces: the inward investors are wooed with various fiscal and legal privileges, and enjoy elite relationships with the political class and with sections of the local economic elite with whom they will collaborate rather than compete. State-guided capitalism, whether in its early protectionist form or its current FDI orientation makes happy reading for neither neo-liberals nor social democrats. The fact that currently by far the most important and most successful instance of such an economy, the People's Republic of China, maintains a socialist rhetoric and strong state controls alongside a growth of capitalist enterprises and continuing abuse of human rights demonstrates the separation of the attributes that we long to place in neat comfortable categories.

Baumol et al do acknowledge that few economies, including the US, are entirely free of some intervention by the state. In reciting examples from the US case they do however miss the extraordinarily important role played by the Defense Department and military contracts in the high-science and high-tech economies of southern California and elsewhere, including a continuing contribution in stimulating innovation in information technology. As so often with US economic observers, they simply do not perceive the military as part of what is normally defined as being part of government.

But for Europeans the most important contrast in the book is that between 'big-firm' and entrepreneurial capitalism. Europe (apart from its western Anglophone fringe) is deemed to be dominated by the former. It is considered to have given some success, when non-competitive European giant firms were able to exploit US technological achievements in the decades after World War II, but since then it has sunk into the torpor that its combination of soft labour rights and cosy relations between big firms and political elites produces. As usual with contemporary US imaginings of 'old Europe', anything that has been said about one part of it can be extended to the rest. Therefore, the fact that an obscure Frenchman has written a book accusing his fellow countrymen of laziness enables Baumol et al to define all western Europeans as lazy (p. 91). Their notion that Europe is dominated by large firms probably also comes from French stereotypes, but disconcertingly they apply it principally to Germany. This is so untrue that it would have prevented acceptance of their book for publication did they not all have such strong reputations as economists. The US is far more dominated by giant firms than Germany, which has a major medium-sized firm sector, that has been at the heart of much of the country's economic success. This error concerning the relative importance of large as opposed to medium-sized firms in the US and Germany is at the centre of much of their explanation of the different economic performance in recent years of the two sub-continents.

It seems that for contemporary Americans Europe really has become the dark continent, less capable of being understood than even China. For example, at one point (p. 63) the authors erroneously state that the German government owns banks; it is certain *Land* and city governments that hold shares in banks, a distinction that the authors do not consider to be relevant. However, they do see as important steps towards a market economy the fact that in China some levels of economic regulation are being decentralised to levels below the central government (p. 146).

Now, if I go on to complain about authors who cannot distinguish the Swedish from the Spanish, or the Dutch from the Italian economies, readers will protest that I cannot expect US economists to know anything about the smaller European countries. But, I can then reply, how come they know so much about Ireland, which is smaller than the Netherlands and all the Nordics? The answer of course is that the Irish speak English, and they are generally believed to have developed an economy that conforms to the authors' conception of the US model. This kind of ethnocentricity is really not what we should expect from the scientific discipline of economics. True, they do devote a few lines to Denmark – but mainly because they have learned that the hire and fire of labour is easy there. They know nothing of the general high performance of the Nordic countries in high-tech innovation of the kind that they see as a monopoly of Anglophones.

There certainly are comparisons to be made between the US and German economies from which the latter emerges poorly. These concern such issues are the relationship between university research and economic innovation, and the relative tolerance of unsuccessful risk-taking. The authors have some transitory remarks to make about these issues, but their central pre-occupation is elsewhere. For them two attributes characterise the success of the US economy: the high level of inequality resulting from the high rewards flowing to successful entrepreneurship; and an ability to sack workers easily. This constitutes their concept of entrepreneurial capitalism, which, when combined with a certain admixture of big-firm capitalism, constitutes good capitalism. They do discuss the importance of labour skills in a few pages (pp. 268–72), but in the rest of the book labour has for them only one quality: the ease of getting rid of it. Otherwise, all economic progress is attributable to the high rewards that can be attained by entrepreneurs.

This formula for success raises two problems, one of which Baumol et al discuss, the other of which they completely ignore.

The former concerns the balance between extreme rewards for success and the maintenance of true market competition, which partly takes the form of the problem of how strong should be the rights of intellectual property. What happens when successful entrepreneurs become monopolists and use the enormous wealth that the US model permits them to acquire in order to buy political power that enables them to protect their defeat of market competition? This is what one might call the Microsoft problem, bearing in mind that it is the European Commission, not US anti-trust law, that has enabled some challenge to be made to the monopoly privileges enjoyed by that and some other market-dominant corporations. The authors discuss these issues in a highly interesting and balanced way (pp. 241–7). That they cannot find a clear answer is not their fault, because the problem is impossible to resolve through any formula. This is where they come to their formula that one needs some kind of mix between entrepreneurial and big-firm capitalism, which is probably the case. The former protects innovation; the latter ensures that success earns its rewards. The problem with their formulation is that they consider that the US's superiority over western Europe lies in the fact that its economy is less dominated by large firms than the latter – when in reality, where several important European economies are concerned, exactly the opposite is the case.

Second, and completely outside the discussion of this book, is the solution that has to be found to the problem: given an economy dependent on mass consumption, but a working population with highly insecure labour market conditions, what will sustain the consumer confidence that the former requires but the latter denies? The answer, where the US, UK and some other economies are concerned, has been a constantly expanding market for mass credit, in particular credit on residential property. For some decades now US workers have faced static or declining real wages and fear of dismissal, but have carried on spending, because they have been able to remortgage their homes or take on extended credit-card debt. It has been this, more than anything else, that has kept the US and UK economies buoyant when German, Japanese and some other consumers have produced vicious spirals of economic decline by refusing to spend in a context of economic uncertainty. The development of highly sophisticated markets in risk and in expanding ranges of derivatives has been at the centre of this Anglo-American success story.

The authors of this volume are entirely silent about this aspect of Anglo-American entrepreneurialism, though they must have known of its existence, its entrepreneurial quality, and its role in the relative success of these against the western European and Japanese economies since the mid-1990s. They even at one point (p. 66) acknowledge the role of the US federal government in sustaining the two secondary mortgage firms, Fanny Mae and Freddie Mac.) Were they uncomfortable about actually spelling it out as a desirable and sustainable model of economic behaviour? Did they even perhaps perceive that by the time their book was published, this component of the model might have unravelled and its inherent instability have been revealed?

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