



**GOOD CAPITALISM, BAD
CAPITALISM, AND THE
ECONOMICS OF GROWTH AND
PROSPERITY**

BY WILLIAM J. BAUMOL, ROBERT E.
LITAN, AND CARL J. SCHRAMM

NEW HAVEN, CONNECTICUT: YALE UNIVERSITY PRESS, 2007
321 PAGES

REVIEWED BY STEPHEN SLIVINSKI

This intriguing book — aimed mainly at the educated nonspecialist — rests on two ideas. The first is capitalism hasn't emerged in one specific form everywhere that it has taken root. Some countries exhibit forms of "bad capitalism" and others "good capitalism." The second is to define the best sort of good capitalism and which policy prescriptions can help bad capitalist systems transition to the good variety. Or, for that matter, ensure that the good capitalist economies don't backslide into the other category.

The characteristic that makes all of the types of economic systems described in this book worthy of the title "capitalism" is the right of individuals to hold private property. That, however, is where the similarities end. The mechanisms that direct the productive energies and investments in each capitalist system are what differentiate one form from another. Yet, teasing out which countries fit into each category can sometimes be a tricky task, and one that doesn't really have a precise answer over time. Indeed, most developed countries — including the United States — exhibit characteristics of at least two of the four forms of capitalism described in the book.

Looking at bad forms of capitalism, the first type is given the name "state-guided capitalism." A country subject to this system is one in which government, not private investors, decides which industries and firms will be winners in the marketplace and public policy is designed to "direct economic traffic," in the authors' description. Modern-day China is one of the best examples, although as the authors point out, even China does not exhibit a pure form of this sort of top-down capitalism and is slowly moving away from this model.

The second bad form is "oligarchic capitalism." It's similar to the state-guided version but the key element here is that most of the property and wealth is held by a few firms or owners. Another subtle difference between the two is that in oligarchic systems, the stated goal of public policy is patronage — think of Russia in the years immediately following the collapse of the Soviet Union, for instance. In a

state-guided system, however, the goal is presumably to maximize economic growth.

In turning to good forms of capitalism, the authors first describe what they call "big firm capitalism." Here, the economy is dominated by established large enterprises. What makes the firms in this model different from those in an oligarchic capitalist system is that ownership is widely dispersed among many private shareholders.

"Entrepreneurial capitalism" is the second form of good capitalism. In it, small innovative firms play the most significant role in the economy. Dramatic innovation distinguishes it from the incremental innovation that characterizes big-firm capitalism.

The authors don't jump to the conclusion that nations should aspire only to entrepreneurial capitalism. Instead, they suggest that the optimal capitalist system is a hybrid of both the entrepreneurial and big-firm versions. As they note, "no advanced economy can survive only with entrepreneurs (just as individuals cannot survive by eating just one type of food). Big firms remain essential to refine and mass-produce the radical innovations that entrepreneurs have a greater propensity to develop or introduce."

The book excels when it lays out the case for a new taxonomy of capitalism and how the world can be viewed more coherently in light of it. Additionally, many of the authors' policy prescriptions are sensible — such as tax reforms that encourage more risk-taking, or lowering barriers to trade and immigration to encourage economic competition.

But others might strike the reader as inconsistent with the arguments made elsewhere in the book. For example, the authors make a compelling case that an oversupply of regulation is what trips up developing economies interested in working their way into the ranks of the developed world. Yet they don't really grapple with the fundamental notion that once the government's power to regulate markets is let out of the cage — even in a good capitalist economy — it is often difficult to sufficiently leash it. This is a shortcoming mainly because some of their proposals rest on the idea that government policy can be used to keep the mix of big firms and small firms at an optimal level. But this mix is the result of a spontaneous process of market interactions, not one that can be predicted by policymakers or even the firms themselves.

Nor is it clear that a government entity could ever possess the ability to know what that optimal economic mix is or to keep the policymaking process free from undue influence by one coalition or another. In the final analysis, the lessons that economists have learned about how decisions are made in legislative bodies or how economic organizations emerge should influence the reader's appraisal of the policy approaches proposed in this book. **RF**