

Book Reviews

William J. Baumol, Robert E. Litan and Carl J. Schramm. *Good Capitalism, Bad Capitalism and the Economics of Growth and Prosperity*. New Haven: Yale University Press, 2007. 321 pp.

The central idea of the book is that Capitalism has many forms—some good, others bad, with entrepreneurial capital being the best. The authors argue that the spectacular economic performance of the developed world is owed to the ‘good capitalism’ practised over there and that the blame for the poor performance of many economies must lie with one or the other kind of ‘bad capitalism’, that these economies continue to practise. The authors identify policy tools that can help countries in making a transition from ‘bad capitalism’ to ‘good capitalism’.

The introductory chapter ‘Entrepreneurship and Growth’ gives an overview of the key elements of an entrepreneurial economy. In the next chapter, the authors question ‘Why Economic Growth Matters’ and convincingly rebuff those who question the virtues of growth. To those who put limits on growth the authors’ answer is: “the same process of technological advancement that undermined Malthus’ dire prediction about population growth may be able to quiet the concerns of modern day Malthusians who worry about disappearing energy”.

Chapter 3 conducts a comprehensive review of modern growth theories with special focus on innovation and institutions. After reviewing the work of Solow, the authors move directly to the influence of institutions on growth. They argue that institutions take time to develop and that growth depends on ‘home grown’ institutions. The long time required to develop growth promoting institutions may explain why dictators have been successful in Korea and Singapore in boosting growth, while the time horizon of the politician is shorter, at best extended up to the next elections. The authors’ emphasis upon ‘home grown’ institution is also a verdict against the Washington Consensus.

Chapter 4, the central part of the book, argues that capitalism has four types—state-guided capitalism, oligarchic capitalism, big-firm capitalism and entrepreneurial capitalism. The state-guided capitalism, in which government decides which sectors shall grow, has several downsides: excessive investment, picking the wrong winners, susceptibility to corruption and difficulties of ending support when it is no longer appropriate. Oligarchic capitalism differs from the state-led capitalism mainly in the impetus of its leaders. The oligarchic capitalism protects a very small fraction of the population, and perhaps only the ruler(s). Countries following this type of capitalism experience extreme inequality and corruption. The big-firm capitalism plays on the scale economies concept. However the big firms often engage in rent-seeking and thereby lose their competitive advantage. Entrepreneurial capitalism is focused on innovations. These innovations are usually small scale in nature, led by individuals and start up firms.

However, it takes big firms to mass produce and market the product of innovation. So the optimal combination of capitalism is a mix of big and small. This is the kind that characterises the United States more than any other country. But then this is the very kind of capitalism that caused the recent global financial crisis.

Chapter 5 'Growth on the Cutting Edge' describes the four key elements of the successful entrepreneurial economy. These include: ease of establishing a business, incentives and rewards for productive entrepreneurial activity, rule of law, antitrust institutions.

Chapter 6 suggests how the less developed economies may move away from state-guided and oligarchic varieties of capitalism to entrepreneurial capitalism. The developed economies have reached a high level of economic activity beyond which lies the prospect of stagnation and retreat. Chapter 7 provides suggestions on how to avert stagnation and retreat and recommends measures to sustain and mobilise growth for meeting the upcoming demographic challenges.

How the United States can maintain its unusual blend of big-firm capitalism and entrepreneurial capitalism in times to come is discussed in the next chapter. The authors suggest four broad preconditions for the right of blend of entrepreneurial and big-firm capitalism. The authors also believe that there is much to learn from the American experience.

In discussing the diversity of the capitalist economies the book provides thoughtful material for students of the phenomenon of economic growth. The importance of innovation in economic growth is not often mentioned in literature where the role of the entrepreneur is emphasised. Creation of an institutional setting which the book underlines as a necessity for sustaining entrepreneurship lends support to failure of governance in democracies like Pakistan where scant attention was paid to institution building

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