

Book Reviews

Allan H. Meltzer. *Why Capitalism?* USA: Oxford University Press. 2012. 145 pages. US \$ 21.95. Hardbound.

Why Capitalism? is written in response to the popular belief of “end of capitalism” that emerged in the aftermath of the 2008 financial crisis. In this book, the author criticises the anti-capitalism claim advocated by numerous writers who welcomed regulated markets and essential government intervention at the time of recession to fix the problems, which free markets cannot resolve by itself. While praising capitalism, the author argues that the success of capitalist system was inevitable over the last half decade in most of the countries. He believes that democracy along with capitalism is the best system since people, by their voting rights, choose their own tax rates and way of redistribution of wealth. Furthermore, according to him it is the only system, which faced many challenges, but not only survived but came out stronger and dominated the world. Theoretically, the author’s arguments, in this book are very attractive but in practice give rise to several questions.

The book is written following the sayings of 18th century German Philosopher Immanuel Kant. The author has also included ideas of Friedrich Hayek, Milton Friedman and Karl Popper to buttress his claims. It supports pure capitalism, which differs from democratic capitalism being practiced in most of the countries, which involves socialistic norms of governing. In a democratic capitalist system, median voter belongs to the middle class, whose main agenda is to redistribute wealth from high-income people to lower income people, collected mostly through taxes. Author tends to differ from this kind of system.

The book comprises six chapters, which address various issues such as the importance of capitalism, problems of regulations and the welfare state, the problem of big deficits and how to overcome the problem by taking different measures, post-war progress of capitalism, importance of foreign aid and questions on inflation return. Praising capitalism and criticising the critics of capitalism, the author argues that morality is important for any economic system but we cannot blame capitalism for individuals’ moralities. Moralities fall under the domain of individual behaviour. Rather, rule of law is what is important in the system which capitalism implements the best among others. He further clarifies the problem of efficiency and argues that people differ in their potentials, which leads to inequality and it is not the system *per se* which creates inequality.

Comparing different systems with the capitalist system, he argues that in general anti-capitalists commit three types of errors in understanding capitalism. Firstly, they ignore Immanuel Kant’s warning that humans are imperfect. Secondly, they ignore

differences among individuals and instead of focus on fairness, equality and justice in place of individual choice. The author admits that capitalism may not perform efficiently due to individual choices because individual choices are not part of the capitalism. Finally, according to the author, the critics of capitalism ignore the fact that the choice of ruler is enforced using fear and terror or through imprisonment and punishments, whereas these problems persist regardless of the system and therefore it is an undue criticism on the capitalism.

In the book, the author also criticises the socialist side of democratic capitalist countries, such as the USA, in which resources are redistributed by taxing people. He claims that these policies are adopted in order to please the voters. The voters do not know, in general, from where the money is coming. Similarly, the governments announce tax benefits without reducing the benefits. The author claims that during the era of slow growth the governments borrow money for these policies. These policies, in turn, give a gift of piling public debt in the long-run, with detrimental debt-service payments.

Writing against different regulations, the author asserts that regulations give control to the government sector in allocating resources, which is an inefficient outcome. Moreover, it invites corruption, arbitrary decision-making and circumvention from tax authorities. The author points out an interesting fact that regulations are generally made by lawyers who do not know the economic incentives, which those regulations can create. Therefore, the regulation procedures adopted by the democratic capitalism is flawed which creates inefficiencies in the system.

The author notes that large fiscal deficits have emerged and is creating numerous problems for several economies, including the United States. The author comprehensively reviews the main cause of increase in debt, i.e., continuous deficit and then proposes different possible solutions to mitigate the problem, which include cutting down foreign and domestic military spending, increasing tax revenues and try to achieve budget balance policies. Author also argues against the use of discretionary monetary policy, which is either due to budget deficit financing or other political reasons that creates surprise inflation in the economy.

Attributing the post-war progress to capitalism rather than to other forms of government, the author argues that capitalism is good for growth. Arguing in favour of rules, he believes that rules are good for growth but rules need to be changed with change in other circumstances such as rules of trade, finance and political stability that helps in fostering growth.

The author also comprehensively examines foreign aid-growth nexus. He argues that World Bank gives loans to several countries despite different levels of risk of the countries. For example, China is relatively more stable than Pakistan and Sudan. Furthermore, countries who ask for loans are more corrupt and have inherently weaker systems. The World Bank gives loans to all the countries without giving any considerations on how to promote growth, ease market constraints, and reduce corruption. In a nutshell, he concludes that capitalism disperses power and limits corruption. Moreover, foreign aid merely is not a good determinant to eradicate corruption and remove other obstacles of growth.

Bailing out was among the major characteristics of financial crisis which lead researchers/writer/readers to believe in the “end of capitalism”. The author asserts that

regulations are static in nature and markets are dynamic which change very frequently thus further reforms are needed to cope with the changing dynamics of the markets. Therefore, banks need to hold more capital to avoid bailout in the presence of financial/banking crisis.

In the last chapter, apart from talking about regulations, banking, and financial crisis, he also analyses inflation and gives several reasons why inflation will return. Increase in money supply due to political pressure to decrease unemployment is among the top reasons that create surprise inflation in the economy. Moreover, due to different episodes of surprise inflation, exchange rates (flexible) change frequently. Thus, he proposes a rule-based policy structure, i.e., dollar, euro, and yen should commit to inflation between 0-2 percent and any other country which wishes to import low inflation can follow any of the three currencies. He further adds that China can join hands with these three countries if it allows its currency to free float.

In the entire book, the author believes socialism is the only alternative system, which can combat capitalism. He compares different socialist countries with capitalist countries and concludes that capitalist countries enjoy higher growth and more freedom. However, the author fails to include other economic systems in his analysis, such as the Islamic economic system. Therefore, the author's support to capitalism as the best system that provides growth and personal freedom may be a biased statement.

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