Good Capitalism, Bad Capitalism and the Economics of Growth

Not all capitalism is created equally, according to economists Baumol, Litan and Schramm in their book, *Good Capitalism, Bad Capitalism and the Economics of Growth and Prosperity*. Instead, the authors identify four different types of capitalist systems: entrepreneurial, big-firm, oligarchic, and state-directed—and the only thing these that four systems have in common is that they recognize the right of private ownership of property. Beyond this, they are very different systems who impact economic growth and prosperity with various results.

In his recent book, Richard Oldfield reviews the various ways he has lost money in the financial markets.

The first system, **entrepreneurial capitalism**, is one in which large numbers of the actors within the economy not only have an unceasing drive and incentive to innovate but also undertake and commercialize radical or breakthrough innovations. Entrepreneurial capitalism produces innovations such as the airplane, the automobile, the telephone, electricity, the Internet and other general purpose technologies that have improved living standards beyond anything our ancestors could have believed.

In entrepreneurial capitalism, a significant role is played by small, innovative firms. The authors use the word 'entrepreneur' to denote any entity, new or existing, that provides a new product or service or that develops and uses new methods to produce or deliver existing goods and services at a lower cost—a definition attributed to the nineteenth-century French economist Jean-Baptiste Say and used by Harvard economist Joseph Schumpeter. Put simply, entrepreneurs innovate. Innovation is the specific instrument of entrepreneurship, and it is the heart of entrepreneurial capitalism.

Big-firm capitalism is a system where the most significant economic activities are carried out by established giant enterprises. Ownership of such enterprises is widely dispersed among many shareholders, often including large institutional investors. The authors identify big-firm capitalism, primarily within Continental Europe, Japan, Korea, and pockets of other economies, including the United States.

In **oligarchic capitalism**, the bulk of the power and wealth is held by a small group of individuals and families. The authors note that this form of capitalism is easily confused with state-guided capitalism because in an oligarchic system the state also is apt to be heavily involved in directing the economy. Capitalism is defined as "oligarchic" when, even though the economic system is nominally capitalist and property rights protect those who own substantial property, government policies are designed predominately or exclusively to promote the interests of a very narrow (usually very wealthy) portion of the population, or what may be worse, the interests of the ruling autocrat and his/her friends and family. This form of capitalism, note Baumol et al., is unfortunately all too common in too many parts of the world, encompassing perhaps one billion or more of the world's population. It is prevalent in much of Latin America, in many states of the former Soviet Union, in most of the Arabic Middle East, and in much of Africa.

Even though the book's true audience is amateur investors, professional money managers are still likely to find many pearls of wisdom.

In **state-guided capitalism**, governments, not private investors, try to guide the market most often by supporting particular industries that it expects to become "winners." The authors note that in this type of capitalistic system, political leaders desire to take advantage of their power to extract wealth and other benefits from the winning industries and firms. State-guided systems should not be confused with central planning. In centrally-planned economies, the state not only picks winners, it also owns the means of production, sets all prices and wages, and provides essentially no incentive for innovation that benefits the individual.

The critical question then becomes: Which capitalistic system is best suited to fostering growth and prosperity, while dealing with the poverty issue? The authors argue that the best form of capitalism to promote growth and prosperity and deal with poverty is a blend of "entrepreneurial" and "big firm" capitalism. These systems constitute "good" capitalism. "Bad" capitalism is characterized by oligarchic and state-guided systems.

One interesting discussion in the book pertains to China and its development. The authors note that over the last two decades, leaders in China have found a unique way to introduce and encourage entrepreneurial activity in an economy that once was centrally planned. The Chinese model may be a unique case. Baumol et al., note that China has advanced despite not fully having two of the key ingredients for a successful entrepreneurial economy—effectively enforced property and contract rights, and a financial system that affords entrepreneurs access to capital to finance their ventures. The author's further argue that China's economic system will require further adjustments if the country is to enjoy sustained economic growth and prosperity in the years ahead.

Overall, we find the book to be a thoroughly enjoyable read, and we highly recommend it.