IN ESSENCE

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ECONOMICS, LABOR & BUSINESS

In Defense of Capitalism

THE SOURCE: "Recovering the Case for Capitalism" by Yuval Levin, in ***National Affairs***, Spring 2010.

The past two years have not been easy ones for capitalism. First, a crisis that seemed "almost designed to confirm the worst" about free enterprise shook the global economy. Then Washington's efforts to prop up banks erased longstanding boundaries between the public and private sectors. By last summer, the federal government essentially owned the nation's largest bank, insurance company, and automaker, and was creating winners and losers in massive business deals on a seemingly ad hoc basis. Capitalism is under attack, "not by socialist ideologues but by misguided technocrats," the ruling class of experts who think they can outsmart the collective wisdom of the market, argues Yuval Levin, editor of *National Affairs*.

The technocrats are the architects of two rising threats to capitalism: the decades-old cozy relationship between Washington and big finance and a welfare state expanded far beyond its core purpose of helping the needy, Levin writes. A case in point: Social Security benefits, once meant only to prevent poverty in old age, now flow in vast quantities to relatively affluent Americans. The debts racked up by the welfare state today mean that citizens tomorrow will have less freedom to use their own earnings as they see fit.

Government encroachments upon the free market are "expressions of a long-standing technocratic distaste on the left for the market economy, and especially for the democratic character of capitalism." To understand this "democratic character," Levin turns to capitalism's foremost explicator, Adam Smith (1723–90). Smith understood the free market as a system shaped by consumers pursuing their individual interests to the benefit of all—the opposite of the old mercantile economies, which served the needs of a few producers. In this sense, Smith's free-market ideal is inherently democratic, and has a profound moral purpose. Prosperity, in Smith's philosophy, isn't just an incidental convenience, but a "precondition for a decent society," Levin writes. A free market could put a comfortable life within the reach of most, thus fostering more generous behavior and "sympathy" among neighbors. "If our own misery pinches us very severely," Smith wrote, "we have no leisure to attend to that of our neighbor."

Capitalism is often criticized for being unjust to the poor, pushing inequality to an intolerable level. Levin allows that markets inevitably produce inequality, but unless you believe that "an equality of conditions is the essence of justice," it just doesn't make sense to dismantle an economic system that has provided more material progress for the poor (and the rich too, of course) than any other in human history.

A more serious criticism, according to Levin, is that capitalism "empties social life of any higher meaning." Our society is not one characterized by restraint but rather by excess. Smith believed that a free market could instill certain virtues—prudence, restraint, industry, and frugality—by making those virtues profitable. But Levin says that Smith "understated—and perhaps underestimated—the challenges of sustaining moral norms amid economic dynamism." Capitalism cannot provide sufficient moral authority on its own. Instead, we must rely on "deeper wells": family, religion, and tradition.

Levin's prescription: The government must take an aggressively pro-market approach, not to be confused with its current pro-business disposition, in which technocrats aid favored firms and sectors. Ultimately, the fight over capitalism is a struggle over democracy. Technocrats claiming authority based on science and expertise are bent on overturning the democracy of the marketplace. If they have their way, they'll undo our prosperity and the society built upon it.

ECONOMICS, LABOR & BUSINESS

Debt Karma

THE SOURCE: "Political Institutions and Foreign Debt in the Developing World" by Thomas Oatley, in ***International Studies Quarterly***, March 2010.

POOR COUNTRIES AND ENORMOUS foreign debt go hand in hand—that is, except for the one-third of all developing countries that regularly borrow from abroad and haven't wound up with a serious debt problem. What enables these all-stars to escape owing huge sums to foreign creditors? Democracy, theorizes Thomas Oatley, a professor of international political economy at the University of North Carolina, Chapel Hill.

The 40 most heavily indebted developing countries entered the 1990s owing an average of 220 percent of their gross domestic product (GDP). Research into why some countries ended up so far underwater has suggested that the key factor was simply bad luck: oil price shocks, recessions in industrial countries, weak commodity prices, high interest rates. But in his study of 78 developing countries from 1976 to 1998, Oatley sees little evidence that such factors have significant long-term effects. Political institutions, he finds, provide a much better explanation. Over a 20-year period, an average autocracy would rack up twice as much debt as a percentage of GDP as an average democracy.

What accounts for the variation? Autocracies, perhaps because of doubts about their long-term survival, borrow recklessly and spend unwisely, often wastefully. Their economies stagnate, leaving little tax base from which to draw revenue to pay back the debt. One such country, Zambia, increased its foreign indebtedness as a percentage of GDP by an average of nine points per year

EXCERPT

Keynes's Club

"Keynes is back." It is a familiar cliché, but also an enigma. Enigmatic, first, because [John Maynard] Keynes, the most influential economist of the 20th century, never really left. Like it or not, we live in a macroeconomic world elucidated by Keynes and those who followed in his footsteps. Even Robert Lucas, who won a Nobel Prize for his criticisms of conventional Keynesianism, said in response to the financial crisis: "I guess everyone is a Keynesian in a foxhole."

But enigmatic also because Keynes himself was never with us. From his vast writings, a few ideas were quickly distilled into analytical tools and policy prescriptions that became known as "Keynesianism."

This produced some stark differences between Keynes's ideas and those that bore his name. Once, after a wartime meeting with American economists, Keynes observed, "I was the only non-Keynesian in the room."

—**JONATHAN KIRSHNER**, author of *Appeasing Bankers: Financial Caution on the Road to War*, in ***Boston Review*** (May–June 2010)