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Can We Fix Capitalism?

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Capitalism, Alone: The Future of the System That Rules the World
by Branko Milanovic
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Bruno Barbey/Magnum Photos

A migrant domestic worker from the Philippines, Hong Kong, 2015

For enthusiasts of capitalism, democracy and the market are said to be handmaidens. Both depend on the rule of law. Both express aspects of liberty, prizing opportunity and mobility. During the era of classical liberalism, which began in the late eighteenth century, free commerce and political freedom advanced in tandem. Monarchies gave way to republican rule; open markets replaced royal monopolies and inherited privileges. For about a century the franchise gradually expanded, and markets became the primary mode of commerce. The brand of democratic capitalism that emerged in the West after World War II included not just those earlier hallmarks but such liberal values as tolerance, compromise, and enlarged civic participation, as well as regulatory and social welfare policies to buffer the less savory tendencies of markets. Modern capitalism reflected a grand social bargain.

When communism collapsed in 1989, the fall of the Berlin Wall was heralded as ushering in a golden age in which liberal capitalism would be triumphant. Needless to say, things haven’t worked out quite as expected. The social compromises of the postwar welfare state have given way to more primitive forms of capitalism that in turn invite angry reactions by the citizenry. Demagogues have channeled this anger. Today, some form of capitalism is ascendant nearly everywhere. But liberal democracy is in big trouble.

Instead of creating a new golden age, corrupted capitalism has produced alliances between autocrats and oligarchs, epitomized by the regimes of Putin and Trump, who both reinforce societies that were already becoming less liberal and more unequal. This is the pattern not just in countries with weak or nonexistent democratic traditions, notably Russia and China, but in the very heartland of liberal democracy, the United States of America. Contrary to standard assumptions about liberalism, autocratic capitalism also coexists and interacts with enlarged global trade, making it harder to defend living standards in democratic nations that once protected their workers and citizens by regulating markets.

In a cycle of reactivity, ordinary people turn not to social democracy—now at its weakest point since World War II—but to the vicarious and counterfeit satisfactions of extreme nationalism. That in turn permits autocrats to pose as populist champions of a mystical People, diverting attention from the economy's concentrated wealth and rigged rules. This unexpected twist in the fraught relationship between democracy and capitalism is the signal event in the political economy of our age.

In *Capitalism, Alone*, the economist Branko Milanovic tries to make sense of what has occurred and what the future holds. The book is erudite, illuminating, and sometimes exasperating. Capitalism has prevailed, he writes: "One system will come to rule the entire globe." But what kind of capitalism? His story is divided into two parts. The first contrasts meritocratic liberal capitalism with the autocratic variety, which he terms "political capitalism." The second addresses how capitalism interacts with globalism.

Milanovic is well credentialed to take on this large and daunting subject. He spent much of his career as a senior economist at the World Bank, and most recently at the City University of New York. His 2011 book, *The Haves and the Have-Nots*, was a pioneering work of economic history on inequality in different eras and societies, and established him as one of the world's leading scholars on income distribution.

Milanovic is Yugoslav by birth. Having received his doctorate in a university system that was Marxist but relatively open intellectually serves Milanovic well. The Marxist lens is intermittently useful in coming to grips with what happened to capitalism, and Milanovic, far from a Marxist himself, also got a broad education in the classics. His new book is scholarly and festooned with data, but also narrative in style and engaging to read.

Milanovic chronicles the rise of authoritarian capitalism, both in nations that once epitomized liberal capitalism such as the US and in countries like China, which are partly capitalist but show no signs of turning liberal. Until recently, as the China scholar James Mann has observed, the widespread hope was that as China's economy became more capitalistic, the country would become "more like us." The reality is that we are becoming more like China.[1]

Milanovic's first section, on liberal capitalism, offers a smart assessment of how it once worked and why it is now under siege. In the heyday of managed, meritocratic capitalism, societies relied on several mechanisms to equalize income and opportunity. For Milanovic, "strong trade unions, mass education, high taxes, and large government transfers" were essential components. All of these have lost traction as capital has gained more power relative to labor, and globalization has spawned competition to cut taxes, slash wages, and reduce regulation. With more than half the US population attending university, higher education still produces income premiums but is not the equalizer it once was. There are policies that might restore a greater measure of equality by redistributing capital directly, but the political power of the rich makes such a prospect politically improbable.

Moreover, the promise of upward mobility is relentlessly undercut by the increasing capacity of the affluent to pass their status along to their children. Milanovic cites the work of the Harvard economist Raj Chetty and his network of colleagues, who have demonstrated that at elite universities there are more students today from the top one percent than from the bottom 60 percent. In addition to "legacy admissions," old-fashioned monetary legacies—bequests—reinforce a permanent upper class, as the rich pass on capital to their offspring. Liberal capitalism, Milanovic concludes, is "reneging on some crucial aspects of [its] implicit value system" via "the creation of a self-perpetuating upper class." That trend in turn threatens liberal capitalism's own survival, and makes it less appealing as a model for the rest of the world.

So far, so good. But when Milanovic turns to autocratic capitalism, his discussion is disappointingly binary. The book promises a taxonomy of capitalisms, of which there are indeed several strains, yet the discussion of what he terms political capitalism fixes on a single case. The entire focus is on China compared with the West. This is certainly a valuable contribution in its own right. But Milanovic omits Russia and India, both with rather different variations on political capitalism. He also leaves out the highly successful Asian economies of Japan and South Korea, nations that served as rough models for China's economic strategy. Both rely on substantial state guidance and the use of industrial groups or cartels to keep production at home and generate export surpluses. Unlike China, however, these countries are largely democratic and substantially meritocratic.

Often, reviewers comment that a wordy book could have been cut substantially. Given the breadth of Milanovic's knowledge, this book, at a scant 218 pages (plus appendixes and references), could usefully have gone a hundred pages longer.

The omission of Russia is especially unfortunate. Its capitalism is nothing if not political, but Russia differs dramatically from China. While Chinese political capitalism is an economic triumph, Russia's is not. Post-Soviet Russia is basically a petro-state. Its economy has largely failed to generate consumer export industries, the mainstay of China's success. Vladimir Putin has an understanding with the oligarchs; they can pursue corrupt enterprises as long as they throw some graft his way and don't make trouble for the regime. His net worth is said to be around $200 billion. In a taxonomy of capitalisms, it would have been interesting to have Milanovic's insights on why the Russian brand of autocratic capitalism fails while China's succeeds.

Even within the West, capitalism comes in several flavors. There is an extensive school of comparative analysis (not cited by Milanovic) called Varieties of Capitalism.[2] Egalitarian Scandinavia offers a model of consensual social bargaining based on strong yet collaborative unions; France relies more heavily on the state for both development and distribution, while in the US the market dominates with a thinner overlay of welfare spending.

Arguing that the whole world is now capitalist, he writes that today

> the entire globe now operates according to the same economic principles—production organized for profit using legally free wage labor and mostly privately owned capital, with decentralized coordination.

This may be a serviceable description of idealized capitalism, but it's an oversimplified description of the world's economies and a misleading summary of China.

In many Chinese industries, contrary to Milanovic's contention, the paramount goal is to gain worldwide market share even if that requires operating at a loss for a long time, not to pursue "production organized for profit." Free enterprises cannot withstand operating at a loss year after year, as many Chinese companies do. They can do it because the state provides extensive subsidies both to state-owned enterprises and to nominally private companies in targeted industries. It's also a stretch to characterize China's system as using "legally free labor." Much of the Chinese labor force is close to slave labor. Free unions are not permitted, and norms of compliance bind workers to enterprises; a troublemaker who protests abusive working conditions risks dismissal or arrest.

Nor is the Chinese system one of "decentralized coordination" by market forces in the spirit of Adam Smith. While some spontaneous enterprises do arise, China's entire economic system is based on extensive state planning. In some respects the system is capitalist, yet is a far cry from Milanovic's generalization that "we live in a world where everybody follows the same rules and understands the same language of profit-making." The essence of the US–China trade conflict, which has weirdly put President Trump on the same side as some liberal Democrats, is the valid complaint that China plays by drastically different rules.

A strength of the book is that Milanovic's intellectual breadth leads him to wide-ranging excursions into diverse subtopics, as varied as Marx's neglect of the third world, the pros and cons of a Universal Basic Income, and the question of whether artificial intelligence must lead to mass unemployment. A weakness of his digressions is that some of his observations contradict others, and a few are simply wrong. For instance, he flatly asserts that the poor non-Western countries were able to grow because Western investors included them in global value chains: "Today, for a country to develop, it must be included in Western supply chains."

But this generalization is contradicted by the actual experience of three of the most successful, formerly poor Asian nations—Japan, South Korea, and China. Each of them assiduously avoided the strategy of becoming branch plants for Western multinationals, in favor of developing their own world-class locally owned companies, industries, and suppliers. They did this precisely in order to attain competitive autonomy, from which they could then launch global exports. China does have some plants that supply Western corporations, but they are a secondary part of its strategy.

Milanovic's book explicitly or tacitly raises four big, overlapping questions. One is the issue of the world's grossly unequal income distribution as an economic, ethical, and policy conundrum. The second is the challenge of China. For the most part, his view is that the West can't change China and shouldn't try, even if there is some negative spillover on our own societies as our wages and welfare states are undermined. The third is how to deal with the destabilization by free trade of national systems of managed capitalism, in which markets are necessarily regulated. The fourth and most fundamental of these questions is how to defend realms that embody extra-market values such as citizenship, into which global markets keep making incursions by making money count more than votes and by undermining such social stabilizers as collective bargaining.

In many ways, the most provocative part of the book is the section in which Milanovic addresses a dilemma with no intuitively correct answer: Should we look at the issue of economic inequality as a national or a global question? Most economists and concerned citizens assess it nationally. As Americans, we are troubled that our country has become one of economic extremes. Milanovic insists that the proper lens is global. Income inequality has increased within nearly every nation for the past three decades, substantially driven by globalization. Yet the rise of China, which lifted hundreds of millions of people out of poverty, has rendered the world as a whole more equal.

This cheerful formulation, however, sidesteps the issue of how globalization promotes inequality within nations and thus undermines national democracy. The increased entry of low-wage goods renders high-wage manufacturing labor in wealthy countries uncompetitive. Meanwhile, the greater license for capital in a globalized world promotes deregulation, corruption, the hiding of assets, and exorbitant income for capitalists. The result: greater disparities of income and wealth at both the top and the bottom, and unequal power to make the rules—producing yet more inequality. The consequences for political democracy are grave. As Louis Brandeis was said to have remarked, "We may have democracy, or we may have wealth concentrated in the hands of a few, but we can't have both."

Milanovic tends to dismiss the effect of globalization on wealth concentration and democracy within countries in favor of celebrating the rise of China as a gain for global equality. China's rising GDP, as he points out, has been responsible for about 95 percent of the global reduction in extreme poverty as defined by the World Bank. Milanovic quotes the egalitarian philosopher John Rawls, who argues that if we didn't know in advance where we would stand in the income hierarchy, we'd favor an income distribution far more equal than the one we have. Why, Milanovic demands, should that principle be applied nationally and not globally? As Rawlsians, don't we care about the world's poor and not just the poor in our own land? It's a good question.

Alexander Paul Englert

Branko Milanovic, Frankfurt, 2019

One persuasive rejoinder has been offered by the Harvard economist Dani Rodrik. Nations, he points out, are where policies are made. If we are going to have a socially tolerable income distribution within the polity, that project must be pursued nationally, since there is no global government and no global citizenship. There is an inevitable tension, Rodrik writes, between the policy sovereignty of democratic nations and the logic of globalization. He is emphatic on what should take priority (italics his): "*Democracies have the right to protect their social arrangements, and when this right clashes with the requirements of the global economy, it is the latter that should give way*."[3]

To me, Rodrik wins this notional debate with Milanovic. It's hardly accidental that the high point of the social democratic welfare state occurred in a period (roughly 1944 to 1973) governed by the Bretton Woods rules, which deliberately insulated nation-states from speculative movements of capital and left plenty of room for national regulation of capital, labor, and trade, precisely in order to decommodify major realms of human life. Rodrik's proposal, in his book *The Globalization Paradox,* is that we should go back to the "shallower" global integration of that era, in order to reclaim some policy space for nations to insulate themselves from the effects of exports from other nations that have labor standards barely above slavery, use export subsidies that violate the norms of free commerce, and rely on thefts of trade secrets. We could still have plenty of trade, but it might be buffered by tariffs or other standards to compensate for differences in social and regulatory policies.

Indeed, the era of the postwar boom had less trade but higher rates of growth, suggesting that the degree of trade openness is only one variable among many in the overall calculus of economic efficiency. China could still be mercantilist in its brand of authoritarian capitalism, but the fruits would be more directed to domestic improvements than global exports. That shift would make China slightly less able to export its system along with its products—itself a gain for democracy.

Looked at purely economically, the rapid GDP growth in China is cause for celebration. A number of left-of-center economists, including Joseph Stiglitz, James Galbraith, Kevin Gallagher, and Rodrik himself in his more recent work[4] have urged fellow progressives to resist the temptation to engage in "China-bashing," and to cut Beijing some slack because of the gains in Chinese living standards. But doesn't it matter that China is a totalitarian one-party state, with no signs of becoming democratic, and that China's system has pernicious effects on Western liberal democracies? Even Hitler, after all, pulled Germany out of the depression, and he ran a very generous welfare state.[5]

Milanovic does address the tensions between the imperatives of citizenship and the benefits of greater economic permeability. However, he is a little too facile in privileging global economic convergence over the extra-economic value of democratic citizenship. For Milanovic, citizenship is largely instrumental, rather than existing in a realm that can't be reduced to a matter of economic efficiency. He calls citizenship "a legal construct that exists only in our minds." He introduces the term "citizenship rent," a rent being the economist's word for an excessive profit. An American who drives a taxi has a higher income than a taxi driver with the same productivity who does exactly the same job in Mexico, simply because of the higher average income in the US. For Milanovic, this disparity is an unearned benefit—an economic "rent." He writes (italics his), "*In an economic sense, citizenship is a joint monopoly exercised by a group of people who share a given legal or political characteristic that gives rise to the citizenship rent.*"

Well, yes, but this view of the subject suggests both the value and the limits of the economist's lens when it comes to areas where politics and economics intersect. There is an old joke about a tailor from New York who manages to get an audience with the pope. He comes home and his family gathers round, asking what the pope is like. The tailor replies, "He's a 40-regular."

Milanovic's discussion of citizenship in the context of globalization is on the periphery of a long-standing debate on which entire libraries have been written: How to think about realms beyond price that are subject to incursions by the market? Citizenship, by definition, is the domain of equality; the market is the domain of inequality. In principle we are all equal before the law; in practice our equality gets compromised by the power of the rich to make campaign donations and to retain expensive lawyers and lobbyists. The greater these incursions, the greater the toll on the reality and the credibility of equal citizenship. You can't really reduce citizenship to a question of economic rents without missing the whole point.

Karl Marx and Karl Polanyi both wrote about the tendency of capitalism to try to commodify nearly everything. The market keeps trying to price extra-market functions like election to public office or social goods such as clean air and water. Some eminent and mainstream economists have acknowledged the problem. Arthur Okun, chair of the Council of Economic Advisers in the late 1960s, wrote, "Everyone but an economist knows without asking why money shouldn't buy some things." The Yale economist James Tobin wrote tongue in cheek, "Any good second-year graduate student in economics could write a short examination paper proving that voluntary transactions in votes would increase the welfare of the sellers as well as the buyers."

The Protestant Reformation was partly a protest against the sale of ecclesiastical offices (the sin of simony) and the marketing of indulgences, meaning entry into heaven. Human beings were once commodities, as slaves. Prostitution, both literal and metaphoric, means the sale of something that in principle is not supposed to be bought and sold. Michael Walzer's classic *Spheres of Justice* [6] points to the necessity of what he calls "blocked exchanges."

Milanovic doesn't quite locate his discussion in this broader debate; he observes the collateral damage to citizenship caused by market economies but concludes that the purely economic imperatives of greater global income convergence should take priority. At points, Milanovic's professional training as an economist seems to be dueling with his sensibilities as a liberal humanist. He notes in passing that both low-wage trade and labor migration are culturally and politically disruptive, and that there is a tension "between the welfare state, access to which is based on citizenship, and the free movement of labor."

He also acknowledges the tendency of globalization to intensify what he aptly terms hypercommercialization and to promote corruption. He laments the excess commercialization of sport at the expense of norms of fair play; the commodification of many household activities such as cooking, eating, play, and child-rearing; as well as the gig economy and what he calls the "outsourcing morality," via tax havens and regulatory evasions. One of his subsections is titled "The Inevitable Amorality of Hypercommercialized Capitalism."

Yet in a remarkable lapse, Milanovic flatly declares, "We lack any viable alternative to hypercommercialized capitalism. The alternatives the world has tried have proved worse—some of them much worse." This assertion misses the history of Western social democracy. The political weakening of the social democratic model is another casualty of globalization, but for nearly half a century social democracy was precisely an attractive "viable alternative" to the hypercommercialism that Milanovic decries. The postwar era saw record growth in the West as well as increasing equality, one of the few times in world history that a basically capitalist economy squared that circle. Social democracy ceased to be *politically* viable only because capitalists reclaimed power that had been temporarily suppressed by an activist state and organized workers.

Much of Milanovic's discussion is ingenious but somewhat abstracted from real-world politics. His intellectual style is to lay out dilemmas and weigh different solutions, without paying sufficient attention to how these have played out in practice. Milanovic is a fan of what physicists were the first to call the "thought experiment," an exercise now embraced by many social scientists. You consider a puzzle and use deductive logic to come up with possible solutions. The trouble with this approach is that it operates entirely in your head.

He devotes a good deal of attention to labor migration in this fashion. He writes, "If both (i) globalization and (ii) big income differences between different parts of the world exist, workers will not remain where they were born." Labor migration is efficient in the sense that it allows lower-wage workers to migrate and produce in wealthier countries where they will have higher living standards, rather than staying home and producing for export. There may be no overall significant difference economically in such countries, but as Milanovic notes, the arrival of foreign workers and economic refugees is more disruptive culturally.

Milanovic considers possible remedies, but none seems satisfactory to him. For instance, we might have different tiers of citizenship or limit the benefits a country allows to noncitizens. Several countries already do this, but it makes the political backlash against increased migration no less explosive. The harder line that the Danish Social Democrats have lately taken on immigration has only partly stemmed their losses to the right-wing populist party. The alternative, Milanovic writes, is to prevent migration entirely—"not a desirable outcome in any way."

While the EU has been limiting the flow of refugees from outside the Continent, its constitution requires member nations to freely accept labor migrants from anywhere in the union. Low-wage workers from Bulgaria or Latvia are free to move to Paris or Berlin. Between 1989, when borders opened, and 2017, Latvia has lost 27 percent of its population and Bulgaria almost 21 percent.[7] This is social and political dynamite in both the sending and receiving countries—as in the antiglobalist revolt in Britain. Yet the word "Brexit" does not appear in Milanovic's account.

As a consequence of his deductive method, many of Milanovic's proposed solutions are provocative but narrow, and often lacking a grounding in real-world politics. He writes, for instance, that "social democracy and the welfare state emerged from the realization that all individuals go through periods when they are earning nothing but still have to consume"—as if this insight came from some seminar room. In reality, the emergence of the welfare state was the result of extensive political struggle. As a virtuoso economist, Milanovic is superb when he is compiling and assessing data. But his qualitative and historical excursions are not always as strong.

On first reading, the book seems hobbled by contradictions. Milanovic is ambivalent about globalization, celebrating its economic effects on the world's poor but worrying about its destabilization of liberal democracy. The kind of globalization we have, he writes with resignation, "makes [corruption] inevitable." As for policy, he suggests more progressive taxation, increased education funding, public financing of campaigns, and a kind of "citizenship light," in order to "allow migration without provoking nationalist backlash." But elsewhere in the book, he has already told us that these remedies are either insufficient or politically unlikely.

Yet on second reading, the inconsistencies are a kind of strength. Milanovic lets the reader in on his tentative and necessarily incomplete attempts to answer some of the thorniest questions of political economy. You get the sense of a fertile mind trying to puzzle all of this out. Some of the contradictions in his thinking simply reflect dilemmas with no easy resolutions. Milanovic contradicts himself—and the book is large with multitudes. This is not the sort of inquiry that should be tied up in a neat ribbon.

The book is a reminder of the need for a richer reunion of politics and economics emphasizing the connections between the two. Ugly new economic realities are a function of the redistribution of political power; that, in turn, has ugly political consequences, reinforcing an economy that many citizens experience as oppressive. If we are to comprehend the new chaotic era of rampant autocratic capitalism, much less find our way back to a decent democratic liberalism, we need to reclaim the discipline of political economy. Milanovic is a superb technical economist with something of the temperament of an ethicist. That alone makes him special among economists. Yet when it comes to addressing the politics of how to navigate these shoals, the book is often abstract and thin.

In my own work as an editor, reading articles by writers from a variety of scholarly traditions, I'm often struck by how leading economists or sociologists or political scientists, working on similar problems from different disciplines, are unfamiliar with one another's work. This is a casualty of the fragmentation of the social sciences, and it impoverishes discourse. Albert Hirschman, educated as an economist, spent the latter part of his career as a moral philosopher. He read widely across disciplines, puckishly calling himself a "trespasser." If we are to make sense of the great questions of our age where politics meets economics, we need more trespassers.

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1 James Mann, *The China Fantasy* (Viking, 2007). ↩

2 See Peter A. Hall and David Soskice, *Varieties of Capitalism* (Oxford University Press, 2001). ↩

3 Dani Rodrik, *The Globalization Paradox* (Norton, 2011), p. xix. ↩

4 See, for example, Dani Rodrik, "Is Global Equality the Enemy of National Equality?," Center for Economic Policy Research (London), Discussion Paper 11812, January 2017. ↩

5 See Götz Aly, *Hitler's Beneficiaries: Plunder, Racial War, and the Nazi Welfare State* (Metropolitan, 2007). ↩

6 Basic Books, 1983. ↩

7 Ivan Krastev and Stephen Holmes, *The Light That Failed* (Pegasus, 2020), p. 37. ↩