

WHY CAPITALISM?

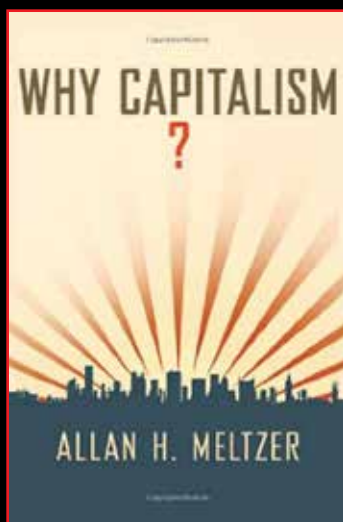
Allan H Meltzer
OUP USA 2012

Allan Meltzer is one of the greatest economists of his generation. I have admired Meltzer since I started studying economics in the early 1990s, and his work on monetary theory has had a very significant impact on the development of my own views.

His books on the history of the Federal Reserve and the reinterpretation of Keynes are among the most important books on monetary thinking written in the past 50 years. So it was with some excitement that I was looking forward to Meltzer's book *Why Capitalism?*, which was published in 2012.

Why Capitalism?, however, left me with mixed feelings. For free-market economists there is little to disagree with in the book – at least in the general sense. Meltzer argues strongly that the present crisis is not a result of the failures of capitalism and, instead, that the causes of the crisis are to be found in government failure. Whilst I do not disagree with Meltzer, a leftist or a centrist would not be convinced by his arguments. Furthermore, rather than explaining why a free-market system is so effective, in the way that Adam Smith, Hayek and Friedman did, Meltzer focuses on criticising government intervention. There is nothing wrong with his arguments, but the critics of the market will not be convinced.

However, whilst this might not be the book for the staunch critic of a market economy or for university students who have already read Hayek and Friedman, there is much in the book for the high-school student approaching the subject for the first time. Each chapter is well-written and easy to read. The areas chosen by Meltzer do not necessarily fit into a logical structure but each of them provides an overview of important areas studied in high-school



economics courses.

The strongest chapter in the book is Meltzer's discussion of the welfare state and regulation, where I particularly found his discussion of moral hazard in the global financial system insightful and convincing. Meltzer provides an excellent summary of his own work on the Asian crisis and how this related to the 2008 global crisis. Indeed, this part of the book could usefully have been much further extended given Meltzer's experience.

The chapter on foreign aid is useful and is a policy topic still under discussion in many Western countries. The undergraduate student should probably go straight to William Easterly's *White Man's Burden*, rather than reading Meltzer's quasi-review of Easterly's work. But the sixth form student who is relatively new to economics can benefit greatly from reading Meltzer's summary.

The third chapter on public deficits and the fifth chapter on why Meltzer thinks we are going to have high inflation seem to fight yesterday's war. Even though countries are struggling

A fascinating introduction to free-market thinking

with public deficits, it is much harder to find supporters for old-school fiscal stimulus today – other than Paul Krugman.

But, it has to be admitted that, in many high-school economics courses, Krugman is often treated as if he is a mainstream voice who has credibility in the field of monetary economics and public finance. Meltzer's summary of the alternative position will be a useful counterweight.

Meltzer's fear of inflation, however, does seem hard to justify. I would argue that the biggest risk to both the US and Europe is deflation. Indeed, Meltzer rightly warned against the risks of deflation in Japan in the 1990s and, in line with other monetarists such as Milton Friedman, he advocated large-scale quantitative easing. There is a striking contrast between that advice and warning about high inflation re-emerging as a result of the Federal Reserve's quantitative easing programme over the past five years.

My main criticism of *Why Capitalism?* is that it gives the impression that Allan Meltzer, like many other proponents of free-market capitalism, had grown overly confident after the fall of communism and the success of capitalism around the world. We felt that we had won the intellectual battle and, when the crisis hit in 2008, we were badly prepared to defend capitalism. *Why Capitalism?* is not that defence.

Nevertheless, for the student who is starting to study economics, it will provide a decent and highly readable introduction and a critique of some of the poorly formulated arguments of the left that so often pervade reading lists at this level.

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Spotlighting
a seminal work
on freedom

The CONSTITUTION of LIBERTY

Friedrich A Hayek

University of Chicago Press/Routledge & Kegan Paul, London, 1960

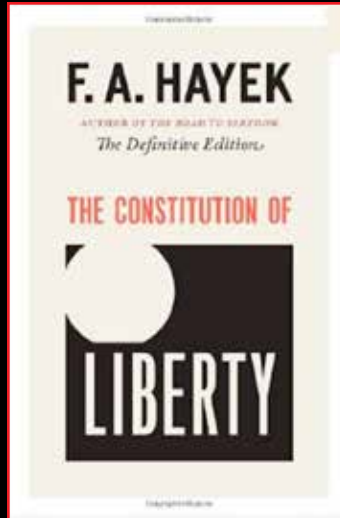
Does liberty need a constitution? Or, what might at first glance sound even more paradoxical, does it need a framework of rules for a free society to be established and to flourish?

F. A. Hayek's *Constitution of Liberty* addressed precisely this question, which has been fundamental for classical liberalism ever since its very inception.

The book was published a few months after Hayek's 60th birthday and is sometimes perceived as his most profound treatise on social philosophy. I am in agreement with this notion. Already in 1935 when debating collectivist economic planning, he distanced himself from "complete laissez faire in the old sense" and proposed instead to start a search for "the most appropriate permanent framework" for competition, which had been "sadly neglected by economists" over the preceding decades.

Very similar statements are contained in chapters 1 and 3 of *The Road to Serfdom*, as well as in Hayek's two presentations to the Mont Pèlerin Society in April 1947. In the mid-1940s he wrote to Henry Simons and Walter Eucken that he was intending to conceive a "positive complement" to his previously expressed critique of socialism and interventionism: whereas, until then, Hayek had expressed what he opposed, his positive programme would be about what he actively proposed. By 1953 such plans started to take shape.

What is the basic outline of the book? After an introduction in which Hayek explained that, although he still regarded himself "as mainly an economist", he had more and more realised that at that point in time the task of an economist should be "the recognition of principles that lie outside the scope of technical



economics or of any other single discipline" (p.3). And indeed, the treatise is not about "technical economics" and it has a truly interdisciplinary character.

Its 24 chapters are divided into three parts: "The Value of Freedom", "Freedom and the Law", and "Freedom in the Welfare State", the level of abstraction declining in the course of the book.

In Part I, Hayek established his conceptual basis, by defining meticulously not only his notion of liberty, but also of progress, reason, tradition, responsibility, equality, value and merit.

In Part II, both historically and theoretically, he argued for the absolute indispensability of the Rule of Law: rules being the only liberal way to circumscribe one individual's sphere of liberty vis-à-vis those of his fellow citizens.

In Part III, Hayek applied the principles of the first two parts to various fields of economic policy, ranging from trade unions, social security, taxation and redistribution, money, housing, natural resources to education and research.

Probably the most controversial sections have become the ones addressing social security, where he, after weighing different arguments, proposed a programme for "limited security", as opposed to the welfare state's "absolute security" utopia. His programme included "equal minimum income for all" (p. 259) as well as, intriguing for today's debates in the US, compulsory health insurance, within which the citizens can decide which of the competing agencies they would insure with (p. 286). This general idea is already contained in chapter 9, "Security and Freedom", of *The Road to Serfdom*.

Even though not a bestseller due to its academic character and style, *The Constitution of Liberty* received some prominent reviews by close acquaintances of Hayek such as Henry Hazlitt, Jacob Viner, Lionel Robbins and Ludwig von Mises. Although they were generally positive, they did criticise some important issues, with Mises being rather harsh precisely on Part III.

Hayek's impressive treatise shows to me that, even if liberals often agree on fundamental principles, there are different possible ways of applying these principles to the policy issues of the real world.

One debate within the liberal community was directly invoked by the famous postscript "Why I Am Not a Conservative". This has ignited debates, for example, about the political tradition of Margaret Thatcher. Was she to be seen as a Tory or rather, in Hayek's opinion, as a Whig? A debate which, to my knowledge, was unfortunately never resolved in a definitive manner.

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