



A SPECIAL MEETING

THE MONT PELERIN SOCIETY

1980 | 2020

JANUARY 15–17, 2020

**FROM THE PAST TO THE FUTURE:
IDEAS AND ACTIONS FOR A FREE SOCIETY**

CHAPTER FOURTEEN

**CAPITALISM, SOCIALISM AND NATIONALISM:
LESSONS FROM HISTORY**

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Capitalism, Socialism and Nationalism: Lessons from History

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I

Joseph Schumpeter was pessimistic. ‘Can capitalism survive?’ he asked in his book *Capitalism, Socialism and Democracy* (1942). His answer was stark: ‘No. I do not think it can.’ He then posed and answered a second question: ‘Can socialism work? Of course it can.’¹

Perhaps the Austrian-born economist’s pessimism was simply the effect of teaching at Harvard. (By temperament a conservative who was hostile to the New Deal and allergic to Keynesianism, Schumpeter gradually tired of the ‘cocoon’ on the banks of the Charles, and came very close to moving to Yale on the eve of World War II.)² Yet Schumpeter offered four plausible reasons for believing that socialism’s prospects would be brighter than capitalism’s in the second half of the twentieth century, even if he signaled his strong preference for capitalism in his ironical discussion of socialism.

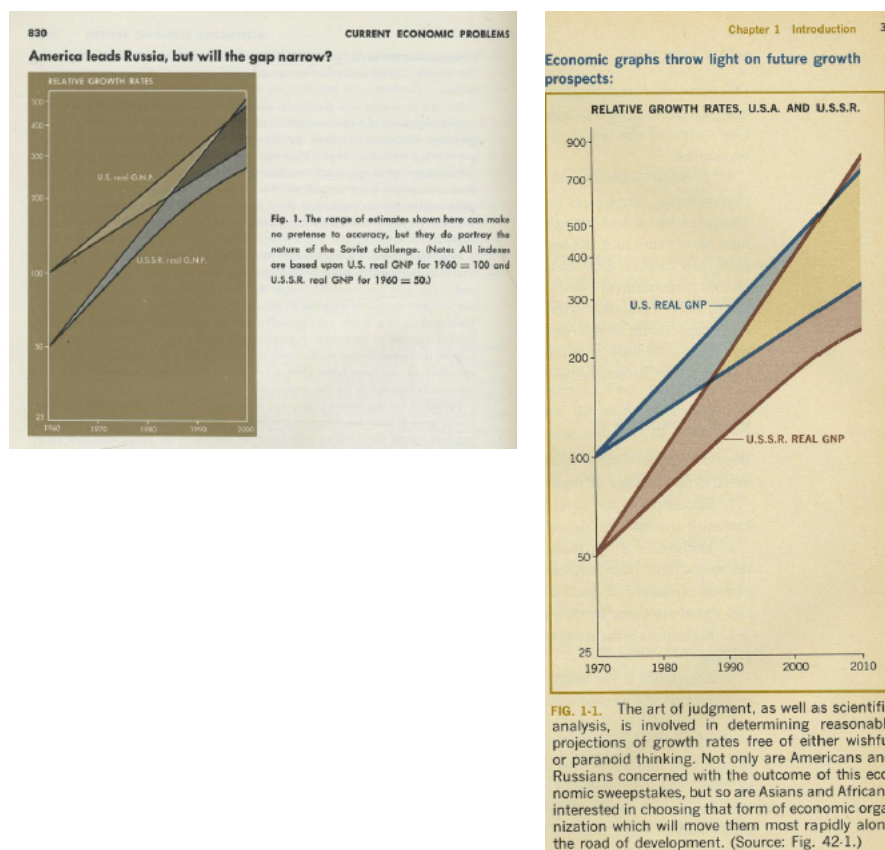
First, he suggested, capitalism’s greatest strength—its propensity for ‘creative destruction’—is also a source of weakness. Disruption may be the process that clears out the obsolescent and fosters the advent of the new, but precisely for that reason it can never be universally loved. Second, capitalism itself tends towards oligopoly, not perfect competition. The more concentrated economic power becomes, the harder it is to legitimize the system, especially in America, where ‘big business’ tends to get confused with ‘monopoly.’ Third, capitalism ‘creates, educates and subsidizes a vested interest in social unrest’—namely, intellectuals. (Here was the influence of Harvard; Schumpeter knew whereof he spoke.) Finally, Schumpeter noted, socialism is politically irresistible to bureaucrats and democratic politicians.³

The idea that socialism would ultimately prevail over capitalism was quite a widespread view—especially in Cambridge, Massachusetts. It persisted throughout the Cold War. ‘The Soviet economy is proof that, contrary to what many skeptics had earlier believed, a socialist command economy can function and even thrive,’ wrote Paul Samuelson, Schumpeter’s pupil, in the 1961 edition of his economics textbook—a sentence that still appeared in the 1989 edition. In successive editions, Samuelson’s hugely influential book carried a chart projecting that the gross national product of the Soviet Union would exceed that of the United States at some point between 1984 and 1997 (see figure 1). The 1967 edition suggested that the great overtaking could happen as early as 1977. By the 1980 edition, the timeframe for this great overtaking had been moved forward to 2002-2012. The graph was quietly dropped after the 1980 edition.⁴

Samuelson was by no means the only American scholar to make this mistake. Other economists in the 1960s and 1970s—notably Campbell McConnell and George Bach—were ‘so over-confident about Soviet economic growth that evidence of model failure was repeatedly blamed on events outside the model’s control,’ such as ‘bad weather.’ Curiously, McConnell’s textbook more or less consistently estimated U.S. GNP to be double that of the USSR between its 1960 and its 1990 editions, despite also insisting in the same period that the Soviet economy had a growth rate roughly double the American.⁵ Yet it was Lorie Tarshis whose textbook drew the most damaging fire (from William F. Buckley amongst others) for its sympathetic treatment of economic planning, despite the fact that Tarshis was more realistic in his assessment of Soviet growth.⁶ The uncritical use of the simplistic ‘production possibility frontier’ framework—in which all economies essentially make a choice between guns and butter—was a key reason for the tendency to overrate Soviet performance.⁷ For example, as late as 1984 John Kenneth Galbraith could still insist that ‘the Russian system succeeds because, in contrast with the

Western industrial economies, it makes full use of its manpower.’ Economists who discerned the miserable realities of the planned economy, such as G. Warren Nutter of the University of Virginia, were few and far between—almost as rare as historians, such as Robert Conquest, who grasped the enormity of the Soviet system’s crimes against its own citizens.⁸

Figure 1. Paul Samuelson’s projections of U.S. and USSR GNP, 1967 and 1970



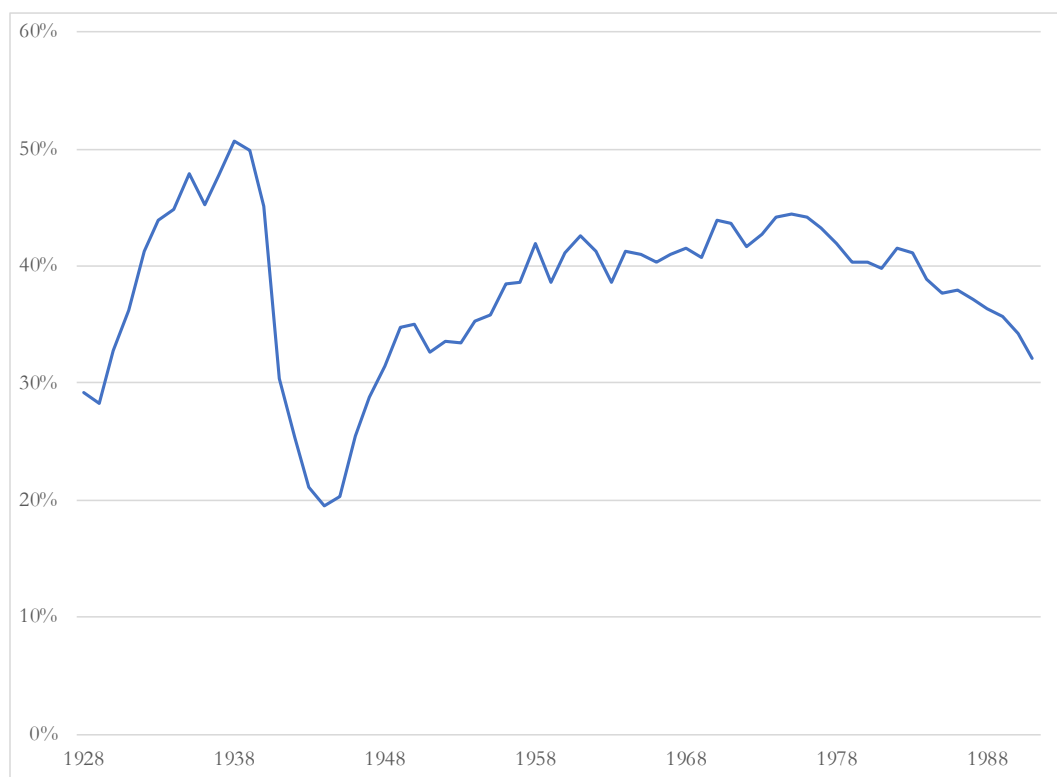
Source: Levy and Peart, 'Soviet Growth & American Textbooks.'

The majority view exemplified by Samuelson and Galbraith was of course wrong. Despite Schumpeter’s pessimism, capitalism survived precisely because socialism did not work. After 1945, according to Angus Maddison’s estimates, the Soviet economy was never more than 44 percent the size of that of the United States. By 1991, Soviet GDP was less than a third of

U.S. GDP. The tendency of American intelligence experts was to exaggerate the extent of Soviet success. But those who visited the Soviet Union could hardly miss its inferiority. Henry Kissinger noted the almost naïve desire of the Soviet leader Leonid Brezhnev to impress his American guests when he played host to an American diplomatic delegation at Zavidovo, the Politburo hunting preserve northeast of Moscow, in May 1973. Brezhnev invited Kissinger and his colleagues to dinner at his villa,

which he first showed off with all the pride of a self-made entrepreneur. He asked me how much such an establishment would cost in the United States. I guessed tactlessly and mistakenly at four hundred thousand dollars. Brezhnev's face fell. My associate Helmut Sonnenfeldt was psychologically more adept: Two million, he corrected—probably much closer to the truth. Brezhnev, vastly reassured, beamed.⁹

Figure 2. USSR gross domestic product as a percentage of U.S. total (purchasing power parity basis, 1990 international dollars), 1928-1991



Source: http://www.ggdcc.net/maddison/Historical_Statistics/vertical-file_02-2010.xls

Moreover, beginning in around 1979, the very term ‘socialism’ went into a decline, at least in the English-speaking world. Use of ‘capitalism’ also declined—as the two terms were in some senses interdependent, often appearing on the same page—but not as much. This was a humiliating reversal of fortune; socialism had led from the second half of the nineteenth century until the mid 1920s, and again in the 1960s and 1970s.

Figure 3. Capitalism and socialism in English-language publications, 1840-2008



Source: <https://books.google.com/ngrams>

II

The terms ‘capitalism’ and ‘socialism’ had their origins in the British Industrial Revolution. As the Chicago economist Thorstein Veblen argued, nineteenth-century capitalism was an authentically Darwinian system, characterized by seemingly random mutation, occasional speciation and differential survival.¹⁰ Yet precisely the volatility of the more or less unregulated markets created by the Industrial Revolution caused consternation amongst many contemporaries. Until there were significant breakthroughs in public health, mortality rates in industrial cities were markedly worse than in the countryside. Moreover, the advent of a new and far from regular ‘business cycle,’ marked by periodic crises of industrial over-investment and financial panic, generally made a stronger impression on people than the gradual increase in the economy’s average growth rate. Though the Industrial Revolution manifestly improved life over the long run, in the short run it seemed to make things worse.

Intellectuals, as Schumpeter observed, were not slow to draw attention to this shadow side. One of William Blake's illustrations for his preface to *Milton* featured, amongst other somber images, a dark-skinned figure holding up a blood-soaked length of cotton yarn. For the composer Richard Wagner, London was 'Alberich's dream come true—Nibelheim, world dominion, activity, work, everywhere the oppressive feeling of steam and fog.' Hellish images of the British factory inspired his depiction of the dwarf's underground realm in *Das Rheingold*, as well as one of the great leitmotifs of the entire *Ring* cycle, the insistent, staccato rhythm of multiple hammers.

Steeped in German literature and philosophy, the Scottish philosopher Thomas Carlyle was the first to identify what seemed the fatal flaw of the industrial economy: that it reduced all social relations to what he called, in his great essay *Past and Present*, 'the cash nexus':

the world has been rushing on with such fiery animation to get work and ever more work done, it has had no time to think of dividing the wages; and has merely left them to be scrambled for by the Law of the Stronger, law of Supply-and-demand, law of Laissez-faire, and other idle Laws and Un-laws. We call it a Society; and go about professing openly the total separation, isolation. Our life is not a mutual helpfulness; but rather, cloaked under due laws-of-war, named 'fair competition' and so forth, it is a mutual hostility. We have profoundly forgotten everywhere that *Cash-payment* is not the sole relation of human beings ... [It] is not the sole nexus of man with man,—how far from it! Deep, far deeper than Supply-and-demand, are Laws, Obligations sacred as Man's Life itself.¹¹

That phrase—the ‘cash nexus’—so much pleased the son of an apostate Jewish lawyer from the Rhineland that he and his co-author, the heir of a Wuppertal cotton mill-owner, purloined it for the outrageous ‘manifesto’ they published on the eve of the 1848 Revolutions.

The founders of communism, Karl Marx and Friedrich Engels, were just two of many radical critics of the industrial society, but it was their achievement to devise the first internally consistent blueprint for an alternative social order. A mixture of Georg Wilhelm Friedrich Hegel’s philosophy, which represented the historical process as dialectical, and the political economy of David Ricardo, which posited diminishing returns for capital and an ‘iron’ law of wages, Marxism took Carlyle’s revulsion against the industrial economy and substituted a utopia for nostalgia.

Marx himself was an odious individual. An unkempt scrounger and a savage polemicist, he liked to boast that his wife was ‘*née* Baroness von Westphalen’ but was not above siring an illegitimate son by their maidservant. On the sole occasion when he applied for a job (as a railway clerk) he was rejected because his handwriting was so atrocious. He sought to play the stock market but was hopeless at it. For most of his life he therefore depended on handouts from Engels, for whom socialism was an evening hobby, along with fox-hunting and womanizing; his day job was running one of his father’s cotton factories in Manchester (the patent product of which was known as ‘Diamond Thread’). No man in history has bitten the hand that fed him with greater gusto than Marx bit the hand of King Cotton.

The essence of Marxism was the belief that the industrial economy was doomed to produce an intolerably unequal society divided between the bourgeoisie, the owners of capital, and a property-less proletariat. Capitalism inexorably demanded the concentration of capital in ever fewer hands and the reduction of everyone else to wage slavery, which meant being paid

only ‘that quantum of the means of subsistence which is absolutely requisite to keep the laborer in bare existence as a laborer.’ In chapter 32 of the first tome of *Capital* (1867), Marx prophesied the inevitable denouement:

Along with the constant decrease of the number of capitalist magnates, who usurp and monopolize all the advantages of this process of transformation, the mass of misery, oppression, slavery, degradation and exploitation grows; but with this there also grows the revolt of the working class ...

The centralization of the means of production and the socialization of labor reach a point at which they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated.

It is no coincidence that this passage has a Wagnerian quality, part *Götterdämmerung*, part *Parsifal*. But by the time the book was published the great composer had left the spirit of 1848 far behind. Instead it was Eugene Pottier’s song ‘The Internationale’ that became the anthem of Marxism. Set to music by Pierre De Geyter, it urged the ‘servile masses’ to put aside their religious ‘superstitions’ and national allegiances, and to make war on the ‘thieves’ and their accomplices, the tyrants, the generals, princes and peers.

Before identifying why they were wrong, we need to acknowledge what Marx and his disciples were right about. Inequality did increase as a result of the Industrial Revolution. Between 1780 and 1830 output per laborer in the UK grew over 25 percent but wages rose barely 5 percent. The proportion of national income going to the top percentile of the population rose from 25 percent in 1801 to 35 percent in 1848. In Paris in 1820, around 9 percent of the population were classified as ‘proprietors and *rentiers*’ (living from their investments) and

owned 41 percent of recorded wealth. By 1911 their share had risen to 52 percent. In Prussia, the share of income going to the top 5 percent rose from 21 percent in 1854 to 27 percent in 1896 and to 43 percent in 1913.¹² Industrial societies, it seems clear, grew more unequal over the course of the nineteenth century. This had predictable consequences. In the Hamburg cholera epidemic of 1892, for example, the mortality rate for individuals with an income of less than 800 marks a year was thirteen times higher than that for individuals earning over 50,000 marks.¹³

It was not necessary to be an intellectual to be dismayed by the inequality of industrial society. The Welsh-born factory-owner Robert Owen envisaged an alternative economic model based on co-operative production and utopian villages like the ones he founded at Orbiston in Scotland and New Harmony, Indiana.¹⁴ It was in a letter to Owen, written by Edward Cowper in 1822, that the word ‘socialism’ in its modern sense first appears. An unidentified woman was, Cowper thought, ‘well adapted to become what my friend Jo. Applegath calls a Socialist.’ Five years later, Owen himself argued that ‘the chief question ... between the modern ... Political Economists, and the Communionists or Socialists, is whether it is more beneficial that this capital should be individual or in common.’¹⁵ The term ‘capitalism’ made its debut in an English periodical in April 1833—in the London newspaper the *Standard*—in the phrase ‘tyranny of capitalism,’ part of an article on ‘the ill consequences of that greatest curse that can exist amongst men, too much money-power in too few hands.’¹⁶ Fifteen years later, the *Caledonian Mercury* referred with similar aversion to ‘that sweeping tide of capitalism and money-loving which threatens our country with the horrors of a plutocracy.’¹⁷

Yet the revolution eagerly anticipated by Marx never materialized—at least, not where it was supposed to, in the advanced industrial countries. The great *bouleversements* of 1830 and 1848 were the results of short-run spikes in food prices and financial crises more than of social

polarization.¹⁸ As agricultural productivity improved in Europe, as industrial employment increased and as the amplitude of the business cycle diminished, the risk of revolution declined. Instead of coalescing into an impoverished mass, the proletariat subdivided into ‘labor aristocracies’ with skills and a *Lumpenproletariat* with vices. The former favored strikes and collective bargaining over revolution and thereby secured higher real wages. The latter favored gin. The respectable working class had their trade unions and working men’s clubs.¹⁹ The ruffians had the music hall and street fights.

The prescriptions of the *Communist Manifesto* were in any case singularly unappealing to the industrial workers they were aimed at. Marx and Engels called for the abolition of private property; the abolition of inheritance; the centralization of credit and communications; the state ownership of all factories and instruments of production; the creation of ‘industrial armies for agriculture’; the abolition of the distinction between town and country; the abolition of the family; ‘community of women’ (wife-swapping) and the abolition of all nationalities. By contrast, mid-nineteenth-century liberals wanted constitutional government, the freedoms of speech, press and assembly, wider political representation through electoral reform, free trade and, where it was lacking, national self-determination (‘Home Rule’). In the half-century after the upheaval of 1848 they got a great many of these things—enough, at any rate, to make the desperate remedies of Marx and Engels seem *de trop*. In 1850 only France, Greece and Switzerland had franchises in which more than a fifth of the population got to vote. By 1900 ten European countries did, and Britain and Sweden were not far below that threshold. Broader representation led to legislation that benefited lower-income groups; free trade in Britain meant cheap bread, and cheap bread plus rising nominal wages thanks to union pressure meant a significant gain in real terms for workers. Building laborers’ day wages in London doubled in

real terms between 1848 and 1913. Broader representation also led to more progressive taxation. Britain led the way in 1842 when Sir Robert Peel introduced a peacetime income tax; by 1913 the standard rate was 14 pence in the pound. Prior to 1842 nearly all British tax revenue had come from the indirect taxation of consumption, via customs and excise duties, regressive taxes that take a proportionately smaller amount of your income the richer you are. By 1913 a third of revenue was coming from direct taxes on the relatively rich. In 1842 the central government had spent virtually nothing on education and the arts and sciences. In 1913 those items accounted for 10 percent of expenditure. By that time, Britain had followed Germany in introducing a state pension for the elderly.

Marx and Engels were wrong on two scores, then. First, their iron law of wages did not exist. Wealth did indeed become highly concentrated under capitalism, and it stayed that way into the second quarter of the twentieth century, but income differentials began to narrow as real wages rose and taxation became less regressive. Capitalists understood what Marx missed: that workers were also consumers. It therefore made no sense to try to grind their wages down to subsistence levels. On the contrary, as the case of the United States was making increasingly clear, there was no bigger potential market for capitalist enterprises than their own employees. Far from condemning the masses to ‘immiseration,’ the mechanization of textile production created growing employment opportunities for Western workers—albeit at the expense of Indian spinners and weavers—and the decline in the prices of cotton and other goods meant that Western workers could buy more with their weekly wages. The impact is best captured by the exploding differential between Western and non-Western wages and living standards in this period. Even within the West the gap between the industrialized vanguard and the rural laggards widened dramatically. In early seventeenth-century London, an unskilled worker’s real wages

were not so different from what his counterpart earned in Milan. From the 1750s until the 1850s, however, Londoners pulled far ahead. At the peak of the great divergence within Europe, London real wages were six times those in Milan. With the industrialization of northern Italy in the second half of the nineteenth century, the gap began to close, so that by the eve of the First World War it was closer to a ratio of 3:1. German and Dutch workers also benefited from industrialization, though even in 1913 they still lagged behind their English counterparts.²⁰

Chinese workers, by contrast, did not do so much catching up. Where wages were highest, in the big cities of Beijing and Canton, building workers received the equivalent of around 3 grams of silver per day, with no upward movement in the eighteenth century and only a slight improvement in the nineteenth and early twentieth (to around 5-6 grams). There was some improvement for workers in Canton after 1900 but it was minimal; workers in Sichuan stayed dirt poor. London workers meanwhile saw their silver-equivalent wages rise from around 18 grams between 1800 and 1870 to 70 grams between 1900 and 1913. Allowing for the cost of maintaining a family, the standard of living of the average Chinese worker fell throughout the nineteenth century. True, subsistence was cheaper in China than in North-western Europe. It should also be remembered that Londoners and Berliners by that time enjoyed a far more variegated diet of bread, dairy products and meat, washed down with copious amounts of alcohol, whereas most East Asians were subsisting on milled rice and small grains. Nevertheless, it seems clear that by the second decade of the twentieth century the gap in living standards between London and Beijing was around six to one, compared with two to one in the eighteenth century.²¹

The second mistake Marx and Engels made was to underestimate the adaptive quality of the nineteenth-century state—particularly when it could legitimize itself as a *nation*-state. In his

Contribution to a Critique of Hegel's Philosophy of Right, Marx had famously called religion the 'opium of the masses.' If so, then nationalism was the cocaine of the middle classes.

Nationalism had its manifestos, too. Giuseppe Mazzini was perhaps the nearest thing to a theoretician that nationalism produced. As he shrewdly observed in 1852, the Revolution 'has assumed two forms; the question which all have agreed to call social, and the question of nationalities.' The Italian nationalists of the Risorgimento:

struggled ... as do Poland, Germany, and Hungary, for country and liberty; for a word inscribed upon a banner, proclaiming to the world that they also live, think, love, and labor for the benefit of all. They speak the same language, they bear about them the impress of consanguinity, they kneel beside the same tombs, they glory in the same tradition; and they demand to associate freely, without obstacles, without foreign domination ...²²

For Mazzini it was simple: 'The map of Europe has to be remade.' In the future, he argued, it would be neatly reordered as eleven nation-states. This was much easier said than done, however, which was why the preferred modes of nationalism were artistic or gymnastic rather than programmatic. Nationalism worked best in the demotic poetry of writers like the Greek Rigas Feraios ('It's better to have an hour as a free man than forty years as a slave'), or in the stirring songs of the German student fraternities ('The sentry on the Rhine stands firm and true'), or even on the sports field, where Scotland played England on St Andrew's Day, 1872, in the world's first international soccer match (result: 0–0). It was more problematic when political borders, linguistic borders and religious borders failed to coincide, as they did most obviously in the fatal triangle of territory between the Baltic, the Balkans and the Black Sea. Between 1830 and 1905 eight nation-states achieved either independence or unity: Greece (1830), Belgium

(1830–39), Romania (1856), Italy (1859–71), Germany (1864–71), Bulgaria (1878), Serbia (1867–78) and Norway (1905). But the American Southerners failed in their bids for statehood, as did the Armenians, the Croats, the Czechs, the Irish, the Poles, the Slovaks, the Slovenes and the Ukrainians. The Hungarians, like the Scots, made do with the role of junior partners in dual monarchies with empires they helped to run. As for such ethno-linguistically distinct peoples as the Roma, Sinti, Kashubes, Sorbs, Wends, Vlachs, Székelys, Carpatho-Rusyns and Ladins, no one seriously thought them capable of political autonomy.

Success or failure in the nation-building game was ultimately about *Realpolitik*. It suited Camillo Benso, conte de Cavour, to turn the rest of Italy into a colonial appendage of Piedmont-Sardinia, just as it suited Otto Eduard Leopold von Bismarck, Count of Bismarck-Schönhausen, to preserve the prerogatives of the Prussian monarchy by making it the most powerful institution in a federal German *Reich*. ‘If we want everything to stay as it is, everything will have to change.’ The most famous line in Giuseppe Tomasi di Lampedusa’s historical novel *The Leopard* (1958) is frequently cited to sum up the covertly conservative character of Italian unification. But the new nation-states were about more than just preserving the cherished privileges of Europe’s beleaguered landowning elites. Entities like Italy or Germany, composites of multiple statelets, offered all their citizens a host of benefits: economies of scale, network externalities, reduced transaction costs and the more efficient provision of key public goods like law and order, infrastructure and health. The new states could make Europe’s big industrial cities, the breeding grounds of both cholera and revolution, finally safe. Slum clearance, boulevards too wide to barricade, bigger churches, leafy parks, sports stadiums and above all more policemen—all these things transformed the great capitals of Europe, not least Paris, which Baron Georges Haussmann completely recast for Napoleon III. All the new states had imposing

façades; even defeated Austria lost little time in reinventing itself as ‘imperial-royal’ Austria-Hungary, its architectural identity set in stone around Vienna’s Ringstrasse.²³ But behind the façades there was real substance. Schools were built, the better to drum standardized national languages into young heads. Barracks were erected, the better to train the high-school graduates to defend their fatherland. And railways were constructed in places where their profitability looked doubtful, the better to transport the troops to the border, should the need arise. Peasants became Frenchmen—or Germans, or Italians, or Serbs, depending where they happened to be born.

So effective was the system of nation-building that when the European governments resolved to go to war over two arcane issues—the sovereignty of Bosnia-Herzegovina and the neutrality of Belgium—they were able, over more than four years, to mobilize in excess of 70 million men as soldiers or sailors. In France and Germany around a fifth of the pre-war population—close to 80 percent of adult males—ended up in uniform. When the leaders of European socialism met in Brussels at the end of July 1914, they could do little more than admit their own impotence. A general strike could not halt a world war.

III

What gave socialism a shot was that the hypertrophic nationalism of the first half of the twentieth century plunged the world into not just one but two world wars. Without these catastrophes, it is inconceivable that so many devotees of Marx would have come to power in the seventy years after 1917. The world wars made the case for socialism in multiple ways. First, they seemed to confirm the destructive tendencies of ‘imperialism, the highest form of capitalism.’ Second, they greatly expanded the role of the state, which became the principal purchaser of goods and

services in most combatant countries, creating precisely the kind of state-controlled economy that socialist theory claimed would perform better than free markets. Third, the wars acted as a great leveler, imposing very high marginal rates of taxation, wage controls and price controls in ways that tended to reduce wealth and income disparities. Fourth, in 1917 the German government financed the Bolshevik coup in Russia that brought Lenin to power.

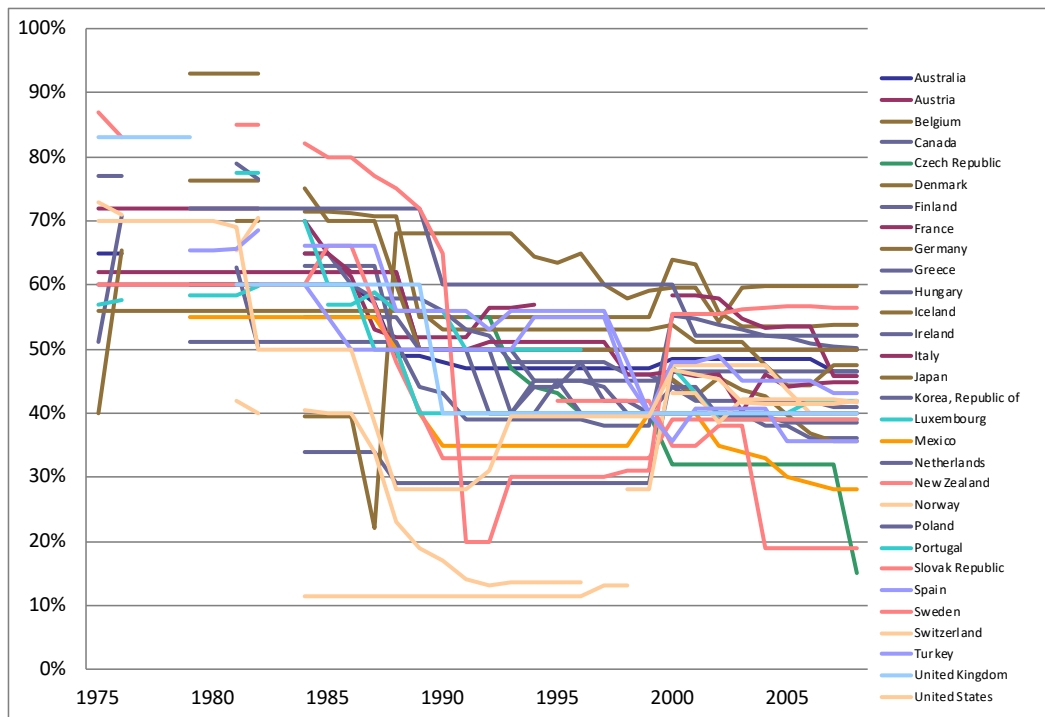
The tragedy was that those who promised utopia generally delivered hell on earth. According to the estimates in the *Black Book of Communism*, the ‘grand total of victims of Communism was between 85 and 100 million’ for the twentieth century as a whole.²⁴ The lowest estimate for the total number of Soviet citizens who lost their lives as a direct result of Stalin’s policies was more than 20 million, a quarter of them in the years after World War II.²⁵ Mao alone, as Frank Dikötter has shown, accounted for tens of millions: two million between 1949 and 1951, another three million by the end of the 1950s, a staggering 45 million in the man-made famine known as the ‘Great Leap Forward,’ yet more in the mayhem of the Cultural Revolution.²⁶ Even the less bloodthirsty regimes of Eastern Europe killed and imprisoned their citizens on a shocking scale.²⁷ In the Soviet Union, 2.75 million people were in the Gulag at Stalin’s death. The numbers were greatly reduced thereafter, but until the very end of the Soviet system its inhabitants lived in the knowledge that there was nothing but their own guile to protect them from an arbitrary and corrupt state. Other communist regimes around the world, including the very durable dictatorships in North Korea and Cuba, were strikingly similar in the miseries they inflicted on their own citizens.

The various socialist regimes could not even justify their murderous behavior by providing those they spared with higher living standards than their counterparts living under capitalism. On the contrary, they were economically disastrous. The collectivization of

agriculture invariably reduced farming productivity. A substantial proportion of the victims of Communism lost their lives because of the famines that resulted from collectivization in the Soviet Union and China. North Korea had a similarly disastrous experience. Central planning was a miserable failure for reasons long ago identified by Ludwig von Mises, Friedrich Hayek and Janos Kornai, amongst others. Indeed, the economic performance of strictly socialist countries got worse over time because of rigidities and perverse incentives institutionalized by planning.²⁸

Moreover, the evidence is clear that, as countries moved away from socialist policies of state ownership and towards a greater reliance on market forces, they did better economically. The most striking example—but one of many—is that of China, which achieved a true great leap forward in economic output after beginning to dismantle the restrictions on private initiative in 1978. After the collapse of ‘real existing socialism’ in Central and Eastern Europe in 1989 and the dissolution of the Soviet Union in 1991, there was widespread recognition (the ‘Washington consensus’) that all countries would benefit from reducing state ownership of the economy through privatization and lowering marginal tax rates. As figure 4 shows, the highest marginal personal income tax rate was reduced in nearly all OECD countries between the mid 1970s and mid 2000s.

Figure 4: Top marginal personal income tax rates, OECD, 1975-2008



Source: OECD.

IV

By 2007, socialism seemed dead almost everywhere. Only the most ardent believers could look at Cuba or Venezuela—much less North Korea—as models offering a better life than capitalism. Even when the era of globalization and deregulation ended in the disarray of the global financial crisis, socialism did not initially show much sign of making a comeback. In most countries, the financial crisis of 2008-9 was more politically beneficial to the populists of the right, illustrating that, as in the 19th century, national identity tended to trump class consciousness whenever the two came into conflict.

Why, then, has socialism come back into vogue in our time—and in America, of all places?

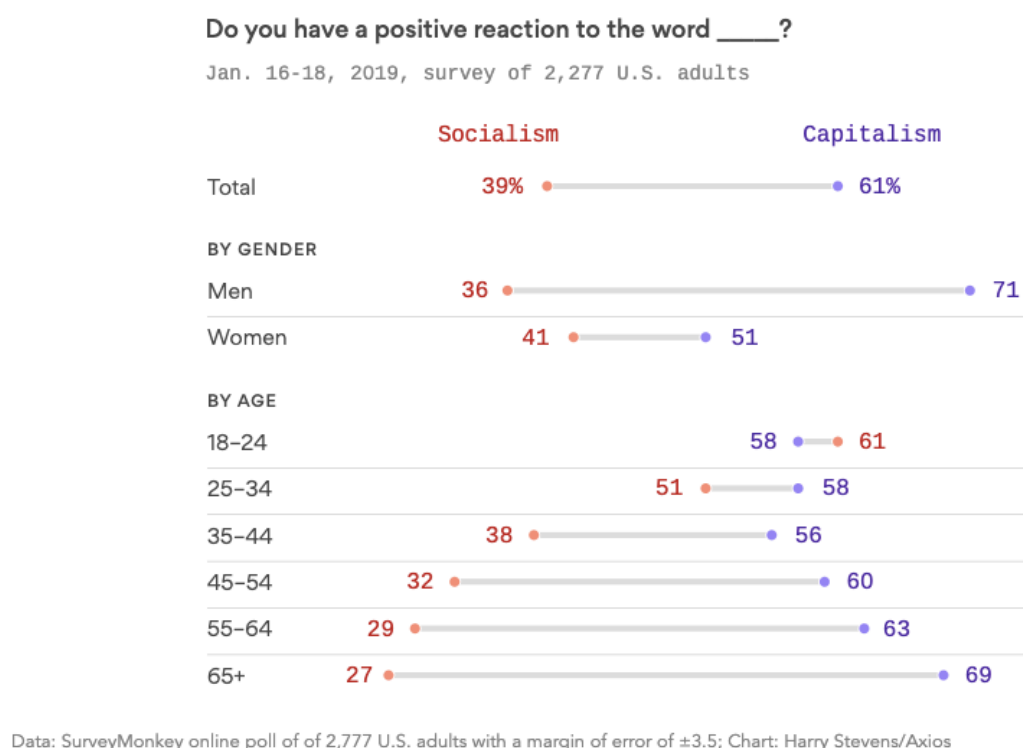
To answer this question, it is helpful to turn back to Schumpeter. It will be remembered that he argued, first, that capitalism's propensity for 'creative destruction' was also a source of weakness; second, that capitalism tends towards oligopoly, not perfect competition; third, that capitalism 'creates, educates and subsidizes a vested interest in social unrest,' namely intellectuals; and, finally, that socialism is politically attractive to bureaucrats and (many) democratic politicians. All four tendencies are visible in the United States today. Although policymakers have been successful in reducing the volatility of output and the rate of unemployment since the financial crisis—and very successful in raising the prices of financial assets above their pre-crisis level—the relative losers of the past decade have been succumbing in alarming numbers to what Case and Deaton have called 'deaths of despair.'²⁹ A number of authors have noted the decline in competition that has afflicted the United States in the recent past, most obviously but by no means only in the information technology sector, which has come to be dominated by a handful of network platforms.³⁰ The American academy is now skewed much further to the left than it was in Schumpeter's time. And, just as Schumpeter might have anticipated, a new generation of 'progressive' politicians has come forward with the familiar promises to soak the rich to fund new and bureaucratic entitlement programs. It is noteworthy that younger Americans—nine out of ten of whom now pass through the country's left-leaning college system—are disproportionately receptive to these promises.

A fear that Hayek raised in *The Constitution of Liberty* was that of future generational conflict. 'Most of those who will retire at the end of the century,' he wrote, 'will be dependent on the charity of the younger generation. And ultimately not morals but the fact that the young supply the police and the army will decide the issue: concentration camps for the aged unable to maintain themselves are likely to be the fate of an old generation whose income is entirely

dependent on coercing the young.’³¹ Things have not quite worked out that way. A significant portion of older Americans are well provided for with substantial shares of total household wealth—much larger shares than younger generations seem likely to accumulate in the prime of life. Nor do the police and army look likely to be agents of generational warfare. Nevertheless, the recent inter-generational divergence of attitudes towards economic policy suggests that he may have been right to worry about the young.³²

New York Representative Alexandria Ocasio-Cortez is often portrayed as an extremist for the democratic socialist views that she espouses. However, survey data show that her views are close to the median for her generation. The Millennials and Generation Z—that is, Americans aged 18 to 38—are burdened by student loans and credit card debt. Millennials’ early working lives were blighted by the financial crisis and the sluggish growth that followed. In later life, absent major changes in fiscal policy, they seem unlikely to enjoy the same kind of entitlements enjoyed by current retirees. Under different circumstances, the under-39s might conceivably have been attracted to the entitlement-cutting ideas of the Republican Tea Party (especially if those ideas had been sincere). Instead, we have witnessed a shift to the political left by young voters on nearly every policy issue, economic and cultural alike. As figure 5 shows, it is the youngest voters in American who are most attracted to socialism, to the extent that those aged under 25 profess to prefer it to capitalism. This must be a matter of serious concern for Republicans, as ten years from now, if current population trends hold, Gen Z and Millennials together will make up a majority of the American voting-age population. Twenty years from now, they will represent 62 percent of all eligible voters.

Figure 5: Attitudes to socialism and capitalism by age cohort, United States, 2019



Source: SurveyMonkey.

Of course, it depends what is meant by ‘capitalism.’ According to a 2018 Gallup poll, just 56 percent of all Americans have a positive view of capitalism. However, 92 percent have a positive view of ‘small business,’ 86 percent have positive view of ‘entrepreneurs’ and 79 percent have a positive view of ‘free enterprise.’ It also depends what is meant by ‘socialism.’ Asked by Gallup to define socialism, a quarter of Democrats (and Republicans) said it meant equality; 13 percent of Democrats saw it as government services, such as free health care; around the same proportion thought that socialism implied government ownership. (About 6 percent believed that socialism meant being social, including activity on social media.)

Asked by Anderson Cooper to define socialism, Ocasio-Cortez replied: ‘What we have in mind and what my policies most closely re-resemble are what we see in the UK, in Norway, in

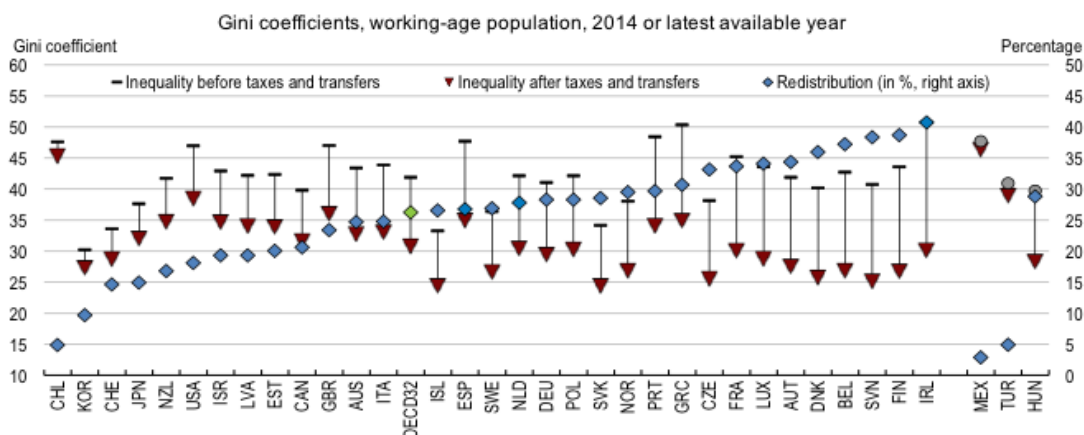
Finland, in Sweden.’ But just how socialist is Sweden today? The country is 9th in the World Economic Forum’s Competitiveness ranking, 12th in the World Bank’s Ease of Doing Business league table, and 19th in Heritage’s Economic Freedom ladder. Many young Americans seem to have in mind the 1970s, rather than the present, when they wax lyrical about Swedish socialism.

So what does American socialism amount to? According to a Harvard poll, 66 percent of Gen Z support single-payer health care. Slightly fewer (63 percent) support making public colleges and universities tuition-free. The same share supports Ocasio-Cortez’s proposal to create a federal jobs guarantee. Many Gen Z voters are not yet in the workforce, but nearly half (47 percent) support a ‘militant and powerful labor movement.’ Millennial support for these policies is lower, but only slightly. Although wary of government in the abstract, young Americans nevertheless embrace it as the solution to the problems they perceive. Among voting-age members of Gen Z, seven in ten believe that the government ‘should do more to solve problems’ and ‘has a responsibility to guarantee health care to all.’

These polling results strongly suggest that what young Americans mean by ‘socialism’ is nothing of the kind. What they have in mind is not the state taking over ownership of the means of production, which is the true meaning of socialism. They merely aspire to policies on healthcare and education that imply a more European system of fiscal redistribution, with higher progressive taxation paying for cheaper or free healthcare and higher education. As figure 6 shows, OECD countries vary widely in the extent to which they reduce inequality by means of taxes and transfers. At one extreme, is Chile, which only minimally reduces its Gini coefficient through its fiscal system; at the other is Ireland, which would be an even less egalitarian than Chile without taxes and transfers, but which reduces inequality by more than any other OECD country through the various levers of fiscal policy. American voters may one day opt for an Irish

level of egalitarianism, but it would be a mistake to regard this is a triumph for socialism. So long as it is a large private sector that is being taxed to pay for the benefits being disbursed to lower income groups, socialism is not *le most juste*.

Figure 6: Gini coefficients and effects of fiscal policy, OECD countries, c. 2014



Source: OECD

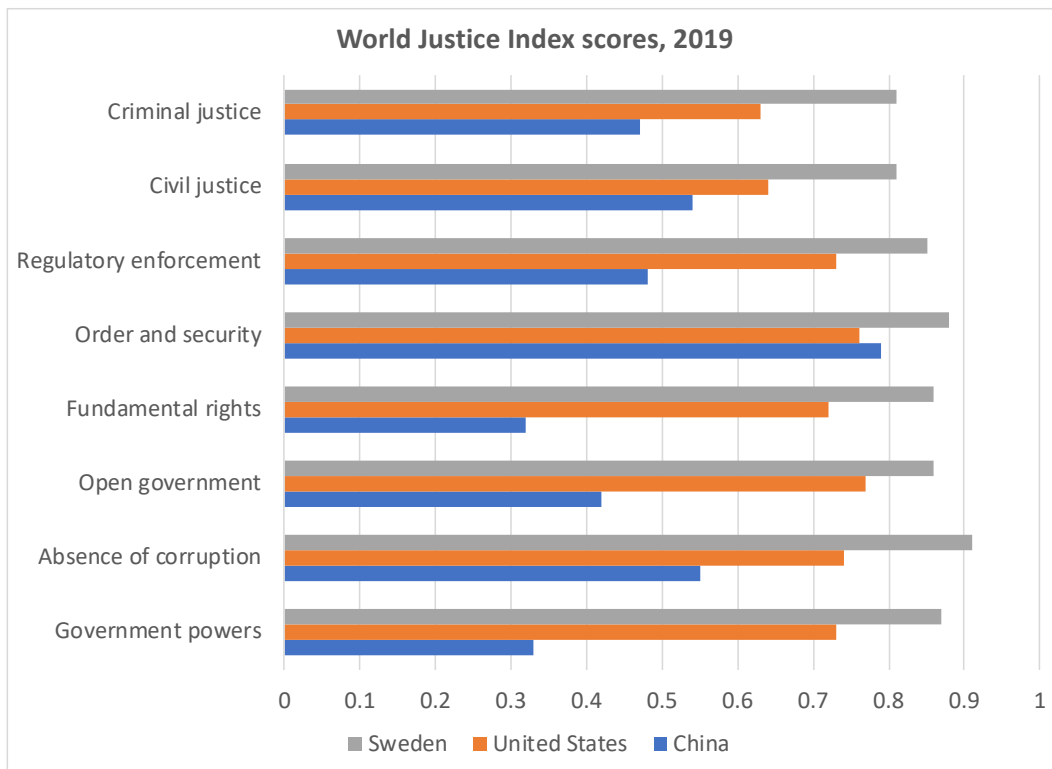
A final cause of confusion that remains to be resolved is what to make of ‘socialism with Chinese characteristics’? According to the *Economist*, ‘The non-state sector contributes close to two-thirds of China’s GDP growth and eight-tenths of all new jobs.’ Clearly, the most dynamic Chinese corporations—Alibaba and Tencent, for example—are not state-owned enterprises. The state sector has shrunk in relative terms significantly since the beginning of economic reform in the late 1970s. A common conclusion drawn by many Western visitors is that China is now socialist in name only; functionally it is a capitalist economy.

One objection to that conclusion is that, since the accession to power of Xi Jinping, there has been a deliberate revival of the state sector. In 2012, for example, private sector companies received 52 percent of new loans issued by the official bank sector, compared with 32 percent to

SOEs. But in 2016 private companies received just 11 percent of new loans, while more than 80 percent flowed to SOEs. The balance has shifted back in the other direction in more recent years, but the central government retains an option to direct credit in this discriminatory way, just as it relies on capital controls to prevent Chinese investors sending more money of their abroad, and on anti-corruption procedures to confiscate the property of officials and businessmen deemed to have transgressed.

Schumpeter largely omitted from his analysis an important variable which helps explain why socialism did not prevail in most countries in the second half of the twentieth century—namely, the rule of law. Because socialism at root means a violation of private property rights—the forced acquisition of assets by the state, with or without compensation—the most effective barrier to its spread is in fact an independent judiciary and a legal tradition that protects property owners from arbitrary confiscation. A common error made in the wake of the 1989 revolutions was to argue that it was capitalism and democracy that were interdependent, whereas in reality it is capitalism and the rule of law. On this basis, it is striking not only that China is so much inferior to the United States by most measures in the World Justice Index, but also that Sweden is some way ahead of the United States.

Figure 7: World Justice Index scores for China, Sweden and the United States, 2019



Source: World Justice Project.

The defining characteristic of socialist states is not their lack of democracy, but their lack of law. So long as China does not introduce a meaningful reform of the law—creating an independent judiciary and a truly free legal profession—all property rights in that country are contingent on the will the Communist Party. It is perhaps worth adding that, precisely because property rights in a socialist state are so constrained, there is almost no limit to the negative externalities that can be foisted on citizens and neighboring countries by polluting state enterprises (see figure 8).

Figure 8: Carbon dioxide emissions, 2007-2018

Million tonnes of carbon dioxide	Share of total emission Percentage change				
	2007	2018	2018	2007-2018	Share of increase 2007-2018
Canada	551	550	1.6%	-0.2%	0.0%
Mexico	429	462	1.4%	7.8%	0.9%
US	5,861	5,145	15.2%	-12.2%	0.0%
Total North America	6,841	6,158	18.2%	-10.0%	0.0%
Brazil	351	442	1.3%	26.0%	2.4%
Total S. & Cent. America	1,103	1,287	3.8%	16.7%	4.8%
Europe	5,008	4,248	12.5%	-15.2%	0.0%
Total CIS	1,963	2,100	6.2%	7.0%	3.6%
Total Middle East	1,511	2,119	6.3%	40.2%	15.8%
Total Africa	958	1,235	3.6%	28.8%	7.2%
China	7,240	9,429	27.8%	30.2%	56.9%
India	1,366	2,479	7.3%	81.5%	29.0%
Indonesia	387	543	1.6%	40.5%	4.1%
Total Asia Pacific	12,663	16,744	49.4%	32.2%	106.2%

Source: BP.

Nearly eighty years ago, Schumpeter was right to identify the inbuilt weaknesses of capitalism and the strengths of socialism, and to perceive that democracy alone would not necessarily uphold the free market system. He correctly identified the enemies within, which would turn against capitalism even in its most propitious habitat, the United States. He did not, however, spend enough time thinking about what institutions might be counted upon to defend capitalism against socialism. In a characteristically sarcastic passage setting out the supposed benefits of socialism, Schumpeter notes that:

A considerable part of the total work done by lawyers goes into the struggle of business with the state and its organs. It is immaterial whether we call this vicious obstruction of the common good or defense of the common good against vicious obstruction. In any case the fact remains that in socialist society there would be neither need nor room for this part of legal activity. The resulting saving is not satisfactorily measured by the fees of the lawyers who are thus engaged. That is inconsiderable. But not inconsiderable is the

social loss from such unproductive employment of many of the best brains. Considering how terribly rare good brains are, their shifting to other employments might be of more than infinitesimal importance.³³

Conspicuously, Schumpeter did not subsequently acknowledge that defending business against the state is in fact an economically beneficial activity, insofar as it upholds the rights of private property and makes it difficult to violate them. Perhaps he did not feel that he needed to state something so obvious. Yet sometimes it is the responsibility of a public intellectual to do just that.

What makes socialism pernicious is not so much the inefficiency that invariably attends state ownership of any asset, as the erosion of property rights that tends inevitably to be associated with the state's acquisition of private assets. Where—as in Sweden in the 1950s and 1960s—socialists acquired a dominant political position without overthrowing property rights in pursuit of direct state ownership, it proved possible to roll it back, once the inefficiencies of state control became apparent.³⁴ But where—as in China or Venezuela—the rule of law has essentially ceased to exist, such self-correction becomes almost impossible. The socialist economy can then go down only one of two possible paths: towards authoritarianism, to rein in the oligarchs and carpetbaggers, or towards anarchy. This is a lesson that young Americans might have been taught at college. It is unfortunate that, as Schumpeter predicted, the modern American university is about the last place one would choose to visit if one wished to learn the truth about the history of socialism.

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Notes

¹ Schumpeter, *Capitalism, Socialism and Democracy*, pp. 61, 167.

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- ² McCraw, *Prophet of Innovation*, pp. 307ff., 317.
- ³ Ibid., pp. 350ff.
- ⁴ Levy and Peart, 'Fragility of a Discipline,' pp. 131-135.
- ⁵ Levy and Peart, 'Soviet Growth & American Textbooks.'
- ⁶ Bockman, *Markets in the Name of Socialism*.
- ⁷ Ibid.
- ⁸ On Nutter, see Magness, 'Soviet Economy.' Nutter had the distinction of being the first of Milton Friedman's doctoral students to embark on an academic career.
- ⁹ Kissinger, *Years of Upheaval*, p. 229.
- ¹⁰ Ferguson, 'Evolutionary Approach.'
- ¹¹ Carlyle, *Past and Present*, Book I, chs. 1-4, Book IV, chs. 4, 8.
- ¹² Kaelble, *Industrialization and Social Inequality*.
- ¹³ Evans, *Death in Hamburg*.
- ¹⁴ Grayling, *Light of Liberty*, pp. 189-93.
- ¹⁵ Sloane, *Women in the Room*, p. 37.
- ¹⁶ *The Standard*, April 23, 1933.
- ¹⁷ *Oxford English Dictionary*.
- ¹⁸ Berger and Spoerer, 'Economic Crises.'
- ¹⁹ See e.g. Fowler, *Lancashire Cotton Operatives*.
- ²⁰ Allen, 'Great Divergence in European Wages.'
- ²¹ Allen et al., 'Wages, Prices, and Living Standards.'
- ²² Mazzini, 'To the Italians.'
- ²³ Schorske, *Fin-de-Siècle Vienna*.
- ²⁴ Courtois et al., *Black Book of Communism*.
- ²⁵ Rummel, *Lethal Politics*.
- ²⁶ Dikötter, *Tragedy of Liberation*; idem, *Mao's Great Famine*.
- ²⁷ Applebaum, *Iron Curtain*.
- ²⁸ White House, *Economic Report of the President*, pp. 381-426.
- ²⁹ Case and Deaton, 'Mortality and Morbidity.'
- ³⁰ Tepper, *Myth of Capitalism*.
- ³¹ Hayek, *Constitution of Liberty*, p. 258.
- ³² Ferguson and Freymann, 'Coming Generation War.'
- ³³ Schumpeter, *Capitalism, Socialism and Democracy*, p. 198.
- ³⁴ Henriksen and Jakobsson, 'Where Schumpeter Was Nearly Right.'



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TABLE OF CONTENTS

PAST AS PROLOGUE TO THE FUTURE

An Opening Conversation

Chapter 1. Why Choose Economic Freedom?.....	6
<i>George P. Shultz and John B. Taylor</i>	

Free to Choose: 1980 to 2020 and the Network

Chapter 2. Introduction to Free to Choose 1980 to 2020 and the Network.....	14
<i>Robert Chatfield</i>	
Chapter 3. Milton, Rose, me and Poetry.....	16
<i>Robert Chitester</i>	

Removing Obstacles on the Road to Economic Freedom: 1947 to 1980

Chapter 4. Removing Obstacles on the Road to Economic Freedom.....	24
<i>Eamonn Butler</i>	
Chapter 5. Milton Friedman: The Early Years.....	26
<i>Jennifer Burns</i>	
Chapter 6. Mont Pelerin 1947.....	32
<i>Bruce Caldwell</i>	
Chapter 7. The Road Not Taken of “Nuovo liberalismo”.....	85
<i>Alberto Mingardi</i>	

Spread of Free-Market Ideas in the 1980s

Chapter 8. The Reception of Free to Choose and the Problem of Tacit Presuppositions of Political Economy.....	102
<i>Peter Boettke</i>	
Chapter 9. The Spread of Free-Market Ideas in the 1980s (With a Nod to the Late 1970s).....	131
<i>David Henderson</i>	
Chapter 10. Ideas of Freedom and Their Role in Active Policymaking.....	142
<i>Condoleezza Rice</i>	

TABLE OF CONTENTS

Lessons Learned from History for the Future of Freedom

Chapter 11. Assaults on Freedom and Citizenship.....	147
<i>Victor Davis Hanson</i>	
Chapter 12. Fed Chair Agonistes.....	152
<i>Amity Shlaes</i>	
Chapter 13. Keynes v Hayek: The Four Buts.....	160
<i>Robert Skidelsky</i>	

IDEAS FOR A FREE SOCIETY

The Role of Law as Protector of Liberty

Chapter 14. Capitalism, Socialism and Nationalism: Lessons from History.....	168
<i>Niall Ferguson</i>	
Chapter 15. Magna Carta, the rule of law, and the limits on government.....	200
<i>Jesús Fernández-Villaverde</i>	
Chapter 16. The Commerce Clause, the Takings Clause, and Due Process.....	208
<i>Douglas Ginsburg</i>	

How to Deal with the Reemergence of Socialism

Chapter 17. The rise and fall of environmental socialism: Smashing the watermelon.....	221
<i>Jeff Bennett</i>	
Chapter 18. Understanding the left.....	226
<i>John Cochrane</i>	
Chapter 19. Economic systems between socialism and liberalism and the new threats of neo-interventionism.....	233
<i>Lars Peder Nordbakken</i>	

Measures of Economic Freedom

Chapter 20. Economic Freedom Matters & Charts.....	248
<i>Anthony Kim</i>	

TABLE OF CONTENTS

Chapter 21. Economic Freedom: Objective, Transparent Measurement.....	279
<i>Fred McMahon</i>	

Chapter 22. The World Bank's Doing Business Indicators.....	310
<i>Valeria Perotti</i>	

Restraining Expansions of Government

Chapter 23. Common Sense Approach to Addressing America's Entitlement Challenge.....	318
<i>John Cogan</i>	

Chapter 24. Key Milestones in Regulation.....	339
<i>Susan Dudley</i>	

Chapter 25. A Quest for Fiscal Rules.....	343
<i>Lars Feld</i>	

ACTIONS FOR A FREE SOCIETY

Taking Ideas to Action around the World

Chapter 26. Turning Freedom into Action: Some Reflections on Reforming Higher Education.....	371
<i>Ayaan Hirsi Ali</i>	

Chapter 27. Culture and the Free Society.....	380
<i>Samuel Gregg</i>	

Chapter 28. Taking Ideas to Action Around the World.....	394
<i>Bridgett Wagner</i>	

What Happened in Chile?

Introduction.....	402
-------------------	-----

Chapter 29. Presentation I.....	403
<i>Axel Kaiser</i>	

Chapter 30. Presentation II.....	406
<i>Ernesto Silva</i>	

Chapter 31. Presentation III.....	409
<i>Arnold Harberger</i>	

TABLE OF CONTENTS

Taking Ideas to Action: Making the Case for Freedom

Chapter 32. Restoring Liberty for American Indians.....	411
<i>Terry Anderson</i>	
Chapter 33. The Effect of Economic Freedom on Labor Market Efficiency and Performance.....	434
<i>Lee Ohanian</i>	
Chapter 34. Making the Case for Liberty.....	466
<i>Russell Roberts</i>	

Taking Ideas to Action in the Private Sector

Chapter 35. Brexit: Taking a Good Idea into Action.....	473
<i>Jamie Borwick</i>	
Chapter 36. Taking Ideas to Action in Central Governments—The US Case.....	476
<i>Tyler Goodspeed</i>	
Chapter 37. Ideas and Actions for a Free Society.....	487
<i>Ruth Richardson</i>	

Taking Ideas to Action in the Private Sector

Chapter 38. Public Policy, Private Actor.....	491
<i>Dominique Lazanski</i>	
Chapter 39. Libertarianism is Dysfunctional but Liberty is Great.....	508
<i>Joe Lonsdale</i>	
Chapter 40. The False Promise of Medicare for All.....	514
<i>Sally Pipes</i>	

A Closing Conversation

Chapter 41. China, Globalization, Capitalism, Silicon Valley, Political Correctness, and Exceptionalism.....	527
<i>Peter Thiel and Peter Robinson</i>	