

TWENTIETH-CENTURY POLITICAL ECONOMY: A BRIEF HISTORY OF GLOBAL CAPITALISM

JEFFREY D. SACHS
Harvard University

Modern capitalism emerged in the early nineteenth century in western Europe and the European offshoots of the Americas and Oceania. Recognizing the unparalleled dynamism of the new socio-economic system, Marx and Engels predicted in 1848 that capitalism would spread to the entire world. By the end of the twentieth century, that prediction was confirmed: capitalism had indeed become global, but only after a tortuous and violent course of institutional change in many parts of the world. This paper provides a brief account of the emergence of global capitalism, and discusses some of the reasons why the diffusion of capitalism has been so conflictual and violently contested.

I. INTRODUCTION

When communism collapsed in Eastern Europe in 1989, the running quip was that socialism was simply the longest road from capitalism to capitalism. The socialist detour, which carried along roughly one-third of humanity as of the mid-1980s, has nearly vanished by the end of the twentieth century, the result of de-communization in Eastern Europe, the collapse of the Soviet Union in 1991, and China's adoption of market reforms after 1978 (even if under one-party rule). Though the post-communist societies face enormous economic, social, and political challenges, not one has the announced goal of

restoring central planning or comprehensive state ownership. The governments of the world have embraced Adam Smith as never before, at least on the rhetorical level.

It is not just the post-communist economies that are going through deep institutional change at the century's end. Virtually the entire developing world has been abandoning key assumptions of state-led development adopted in the wake of national independence by state-builders such as Nasser, Sukarno, Ataturk, and Nehru. Even the long-independent states of Latin America came to view themselves as semi-colonial or 'dependent' economies in the wake

of the Great Depression, and they too adopted statist models of development similar to those of the post-colonial nations. Those statist models are now being abandoned, though heated debates continue about the appropriate role of the state in the economy.

By the end of the twentieth century, almost all of the world nations—even the very poorest countries—have adopted the basic framework of modern capitalism, though few societies have done so without deep and continuing controversy. The twenty-first century opens with a recognizable international system that can be fairly characterized as global capitalism, though it is a system fraught with social conflict and political contestation at the national and international levels. As has been true for much of the past two centuries, capitalism continues to be viewed in much of the world, especially the poorer countries, as a system of exploitation rather than as a reliable path to economic prosperity. Many governments are turning to capitalist institutions out of the exhaustion of alternative models, or in order to curry favour with powerful nations, rather than out of any particular conviction that market reforms will solve long-standing problems of economic backwardness.

Though 1989 was hailed everywhere as the collapse of Marxism, in one sense it represented the fulfilment of one of Marx's most famous predictions. Writing in *The Communist Manifesto* in 1848, Marx and Engels portrayed the newly emergent capitalist system of western Europe as historically unprecedented in its dynamism and productivity, so dynamic and productive in fact, that the whole world would become capitalist, forced to change in response to the awesome capacity of Western economies.

They wrote:

The bourgeoisie, by the rapid improvement of all instruments of production, by the immensely facilitated means of communication, draws all, even the most barbarian, nations into civilization. The cheap prices of its commodities are the heavy artillery with which it batters down all Chinese walls, with which it forces the barbarians' intensely obstinate hatred of foreigners to capitulate. It compels all nations, on pain of extinction, to adopt the bourgeois mode of production; it compels them to introduce what it calls civilization into their midst, i.e., to

become bourgeois themselves. In one word, it creates a world after its own image.

In this light, 1989 can be seen as a watershed predicted by Marx, though one that arrived perhaps a century later than Marx might have expected.

Let's be clear, however. The rest of Marx's predictions, about the demise of capitalism following the immiserization of the masses, turned out to be wildly off base. These errors in forecast can be traced to Marx's reliance on a very crude labour theory of value, according to which Marx claimed that the income of capitalists resulted from the exploitation of labour. Marx fundamentally misunderstood that economic value is created not only by labour, but also by entrepreneurship, saving, and technological progress. Marx's most deadly legacy, indeed, was the interpretation that gaps in income between rich and poor are caused by exploitation rather than differences in productivity. This Marxist attack on wealth as ill-gotten exploitation fuelled most anti-capitalist ideologies of the twentieth century.

Standing at the end of the twentieth century, we can survey the traumas that accompanied the transformation to global capitalism. Capitalism did batter down the Chinese walls, and often with guns rather than cheap commodities. The first conflict of the modern capitalist era, the Opium Wars between Britain and China (1839–42), was fought to make the world safe for free trade in narcotics. Other wars of colonial conquest followed, especially in Africa and Asia. But even when countries (or at least their ruling élites) had their own choices to make, they rarely adopted capitalist institutions as a first resort. Despite the clear association of modern capitalism with the richest countries in the world, most of the poorer countries rejected capitalist models until they had tried a number of alternatives. Many of those detours—especially socialism and national socialism—imposed horrific costs on these societies and on others that got in their way.

This article tries to shed some light on the patterns of diffusion of capitalist institutions during the twentieth century. Modern capitalism was born in the Industrial Revolution in Great Britain at the end of the eighteenth century, and was spread throughout western Europe and European offshoots in the

Americas and Oceania in the first half of the nineteenth century. What determined the diffusion or rejection of these institutions in other parts of the world during the twentieth century? Did capitalism depend on social and cultural institutions unique to Europe; or was the fate of capitalism outside of western Europe determined more by political and economic factors rather than social factors?

II. THE CHALLENGE OF EUROPEAN CAPITALISM

Modern capitalism emerged as a social system in western Europe in the first half of the nineteenth century. The western European capitalist societies were distinguished by four features. On economic grounds they were the first societies in history in which economic activities were predominantly organized via market exchange, based on private property relations in labour, capital, land, and ideas. On political grounds these societies were based on notions of citizenship and the rule of law, at least in comparison with most other societies where an individual's legal standing depended on birthright, and where sovereign power was exercised without juridical constraint. On social grounds, these societies had substantially abandoned formal structures of hierarchy based on birthright, such as the distinctions of nobility and serfdom of pre-nineteenth century continental Europe, or analogs of caste and orders found in most other societies. Finally, in the sphere of ideas and belief systems, western European societies were increasingly secularized and grounded in a modern scientific outlook.

Societies outside of western Europe, other than in European colonies in the Americas and Oceania, shared few of these characteristics. Economic institutions were rarely organized around market exchange and private property. In many societies, a substantial proportion of rural labour was bound to the land through institutions of serfdom or slavery. The rights of capital ownership were heavily circumscribed by suspicious state authorities. Freedom to engage in international trade was often severely hamstrung, for example in China and Japan. Intellectual property was almost everywhere seen as a natural prerogative of the sovereign rather than private inventors. New ideas (such as the printing press in Islamic societies) were viewed as

more a threat to political power or the social order than an opportunity for economic development. Similarly, political institutions were typically based on traditional authority structures rather than rational law. Property was often seen as the natural claim of a patrimonial state, with private ownership merely a provisional claim to be made at the sufferance of the monarch. Cultural and religious institutions reinforced political and economic hierarchies, by linking one's place in the division of labour to birthright, or to membership in a particular religious or ethnic group. Finally, concepts of Western science had not yet penetrated deeply in non-Western societies.

As economic historians since Simon Kuznets have stressed, modern economic growth took off in western Europe and its offshoots at the end of the eighteenth century, while not taking off elsewhere for a century or more, thereby creating within a couple of generations an historically unprecedented gap between western Europe and the rest of the world in material well being, industrial power, and military force. Much as Marx and Engels predicted, a considerable amount of nineteenth and twentieth century history can be read as the playing out of this profound imbalance in economic and military power, a confrontation between a dynamic capitalist western Europe (and its American and Oceanic offshoots) and a much less dynamic non-European world. Everywhere in the old world—Africa, the Middle East, Russia, South Asia, Central Asia, East Asia—western Europe's power led to confrontation with much weaker societies. In vast parts of the world, the result was direct imperial rule by European powers. In other parts of the world, the result was an attempt, successful or unsuccessful, to recast traditional empires (Russia, China, Ottoman, Japan) increasingly in a Western institutional image—with market reforms, financial systems, commercial law, modern infrastructure (telegraphy, railroads, internal canals, and oceanic ports), and even parliaments.

As is well known, only Japan among the old-world empires was able to manage a comprehensive and dramatic capitalist makeover. The Meiji Restoration of 1868, carried out under the shadow of Western military threat and a series of unequal treaties imposed by Western powers, constituted the most successful and comprehensive capitalist

revolution in world history, a veritable ‘shock therapy’ of capitalist reform in which market institutions and private property replaced long-standing feudal relations. Elsewhere, as in Russian in the era of Great Reforms (1858–65), or the Ottoman Empire (from the 1840s onward), or the Ch’ing Dynasty (especially in the 1890s–1900s), the reforms were partial, typically introducing market reforms but often at the cost of state instability. All three empires ended up collapsing—China in 1911, and the Russian and Ottoman empires in the wake of the First World War, after teetering precariously in the preceding decades. Much of the rest of the world did not even get this far, succumbing in the nineteenth century to direct imperial rule. This was true, of course, of all of the African continent with a couple of exceptions (Ethiopia, Liberia), most of South-east Asia (with the notable exception of the buffer state of Siam, wedged between British Burma and French Indochina), the Indian subcontinent, and Central Asia (largely falling prey to the Russian Empire, itself a victim of collapse).

By the opening year of the twentieth century, the European imperial powers (now joined by an imperial United States, owner of Puerto Rico and the Philippines following the Spanish–American War) had indeed created a world in their image. Five-sixths of the world’s inhabited land area was effectively under political control of Europeans (counting Russia, the Americas, and Oceania). This world was linked together by global trade, financed heavily by British banks and capital markets, and with gold and silver monetary standards that were nearly universal, and that provided the monetary framework for the rapidly growing international commerce. This global system, centred on western Europe, was elegantly described by John Maynard Keynes in the opening pages of *The Economic Consequences of the Peace*.

What an extraordinary episode in the economic progress of man that age was which came to an end in August 1914! . . . The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; or he could decide to couple the security of

his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could despatch his servant to the neighbouring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language, or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference. But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable.

III. THE LONGEST ROAD FROM CAPITALISM TO CAPITALISM

Perhaps the greatest surprise of twentieth century political economic history is *what did not happen*. Looking out on the world described by Keynes, one would have confidently predicted as of 1910 that the world would continue on a path of uninterrupted progress and global integration, presumably under European political leadership and tutelage. Indeed such predictions were widespread, for example in the best-selling volume *The Great Illusion* by Sir Norman Angell, published in 1910. Angell rightly argued that in a world of advanced technology and unprecedented economic integration, war among the leading countries of Europe would be suicidal and completely irrational—surely incapable of delivering any benefits that could offset the horrendous human and economic costs. These conclusions proved to be true, but Angell erroneously concluded that such suicidal costs would be enough to deter European states from entering into armed conflict. Enter they did in 1914, with costs that greatly exceeded even the dire forecasts given by Angell. The First World War shattered the global capitalist system based on European imperialism. It took another three-quarters of a century until a comparable global system would arise to take its place.

The unprecedented butchery of the First World War had several major consequences. First, the European powers were gravely weakened by the war, financially and politically. As Keynes predicted in 1919, the trade and financial imbalances left by the

war and the harsh peace that followed created instabilities throughout the 1920s that contributed to the Great Depression of the 1930s, and to the resurgence of German militarism under the Nazi banner. Second, the Ottoman and Russian empires, long weakened by their inability to keep up with western Europe, succumbed to the war itself. Both collapsed in the wake of battlefield losses and financial disarray that resulted directly from the strains of wartime finance. Even the less tottering Habsburg Empire of Central Europe similarly collapsed, partly as the result of military defeat, but mainly out of the design of the victors to support national self-determination among the ethnic groups that comprised much of the empire. Third, Bolshevism established its beachhead as Lenin rushed to seize power in the vacuum of Tsarist Russia's collapse. Interestingly, the overseas colonies of Europe, in Africa, the Middle East, and Asia remained intact, despite the profound weakening of the metropole powers. The European powers were able to hold on to their overseas possessions until after the Second World War. Some new lands even fell into European hands through the dismemberment of the Ottoman Empire's Middle Eastern possessions. Other colonies—such as Germany's holdings in Africa—changed hands as victors took the spoils of war.

The Bolshevik success in Russia must be judged as one of the great 'contingent' events of history, that is a decisive turning point not firmly rooted in underlying social and political conditions, but rather reflecting the accidents of history. Up until the First World War, the Tsarist regime was fitfully reforming and Russia was fitfully industrializing. Without the war itself, peaceful transformation seemed to be likely. The war bled the state, and exhausted the society. But even so, after 4 years of military hardship, revolutionaries like Lenin lacked broad support. The Bolsheviks were a fringe party without the ability to mobilize mass political backing. But they had the advantage of ruthlessness, daring, and brutality. In the anarchy of Tsarist bankruptcy, food riots, and the flood of ill-fed and ill-clothed troops returning from the front, political order collapsed, and Lenin seized his moment. As he himself wrote later, his success was a matter of hours. Any delay or missed timing, and all would be lost. This is, of course, the very opposite of Marx's original concep-

tion of the collapse of capitalism as an historically determined process.

In the rest of Europe, the 1920s were occupied with rebuilding the foundations of the capitalist economy. The states of Central and Eastern Europe—Germany and the successor states of the Habsburg empire—had to overcome military defeat, heavy debts, and the burdens of reparations payments. The turmoil contributed to a series of hyperinflations, the first true hyperinflations in world history (using the accepted definition of inflation of at least 50 per cent per month). These were fitfully extinguished in the course of the decade. France, too, needed stabilization, though from inflation rates considerably below hyperinflationary proportions. Great Britain famously botched its return to peacetime economics by adopting an overvalued currency as it hurriedly re-established the pre-war gold parity of the pound sterling in 1925.

By the start of 1929 one might have had some justifiable confidence that pre-First-World-War normalcy was indeed being re-established, except with the anomaly of Bolshevik Russia. Even Germany seemed to be making some recovery after two emergency loans and partial restructuring of reparations obligations. But then the Great Depression erupted, ushering in the most fateful collapse of capitalist economies during the 200 years from the start of the Industrial Revolution till today. The causes of the Great Depression continue to be debated. Some see the decade of depression as a confirmation of Keynes's 1919 warnings about the instability that would follow a Carthaginian peace in Central Europe. Others see it as the result of clinging too long to *laissez-faire* doctrines in a world of large-scale industry. Still others see a concatenation of errors by the major central banks of the day.

All of these explanations have some merit, but none puts adequate stress on another crucial feature of the era. The world's major currencies were all linked to gold, and it was the gold standard that prompted all of the major countries of the world economy to adopt simultaneous contractionary monetary policies, even in the face of sharply rising unemployment. As a backdrop to the Great Depression, the world's monetary gold supplies had not been increasing rapidly enough to support the growth

of world income. There were no major gold discoveries in the world after those of the 1890s. The shortfall of monetary gold was especially acute at the end of the 1920s as the countries of Europe established gold parities at exchange rates that overvalued their national currencies, i.e. at rates that assigned too high a gold backing to each unit of currency. When financial troubles brought down several banks in Europe and the United States in the early 1930s, wealth holders scrambled to protect their wealth by converting some money balances into gold, and all of the major central banks suddenly faced extreme pressures on their scarce gold reserves. Even though unemployment was already rising throughout Europe and the United States, the central banks simultaneously pursued very contractionary monetary policies (even rejecting the lender-of-last-resort function as domestic banks failed), thereby leading the industrial nations into a simultaneous steep downturn. These can be termed monetary errors, but in fact the central banks were playing their assigned roles of the era. On top of this monetary collapse came a spiral of trade protectionism, as each country attempted to hoard scarce foreign exchange and gold supplies.

The economic crisis in Europe was of course the opening for the rise of Nazism in Germany. And yet, even in the shadow of the Great Depression, Hitler's rise to power was in many ways as contingent and accidental as Lenin's. Both seized fleeting opportunities to gain a foothold of power, and then ruthlessly used violence to consolidate power in the midst of a power vacuum brought on by general crisis. Just as the Bolshevik success depended on seizing the precise moment in the October Revolution, so careful historians have shown that Hitler's rise to power in January 1933 was another tragic accident of history. By the start of that year, the Great Depression was actually easing in Germany. The reparations burden too had been relaxed, though of course not sufficiently to insure against disaster. The leading German newspapers on 1 January 1933 opened the new year with confident assertions that the Nazi rise to power had been decisively thwarted, that the tide of popular support had peaked and was on the wane. And yet, just 30 days later, Hitler was proclaimed Chancellor, the result of Hitler's stunning ability to out-intrigue a number of intriguers to power that were competing for positions in the German government. It must be remembered that

Hitler gained the position of Chancellor not through the ballot box, but in a cabinet reshuffle. The later electoral strength of the Nazis, manipulated through great street violence and propaganda, only followed Hitler's rise to power.

The Second World War finished the European conflagration started in the First World War, again with several profound consequences for the global economy. This time the destruction in Europe was so profound that the European imperial powers were too exhausted and discredited to maintain their hold on their empires. From the 1940s to the 1980s, the European empires were unwound. The French, in particular, fought bitterly to hold on to many of their possessions. Other powers essentially abandoned their claims, as did Britain in India in 1947. Still others fought for a while, only to realize the futility of attempting to hold on to power, as in the case of the Dutch in Indonesia. The second major consequence involved the upheavals of Asian power. Japan had launched its own wars of conquest in Asia in the 1930s, to construct a 'co-prosperity sphere' under Japanese domination. Japan's attack on China destabilized the fragile and corrupt Nationalist regime, and thereby opened the way to communist power after a three-year civil war (1946–9). Japan's military defeat also led to the end of Japanese colonial rule in Korea and Taiwan, the latter becoming the refuge of the defeated Chinese Nationalist government.

IV. THE POST-WAR TRIPARTITE WORLD

The victorious United States hoped for the emergence of a new world political and economic system after the Second World War, based on the newly established international institutions of the United Nations (including the World Bank and the International Monetary Fund), national sovereignty after the dismantling of European empires, and open international trade. This vision never came to fruition. Rather quickly the wartime alliance of the United States, United Kingdom, and the Soviet Union dissolved into a bitter rivalry and competition between the capitalist democracies and the Soviet communist state. Indeed, the Soviet Union soon imposed one-party communist rule throughout Eastern Europe. The divisions deepened further with the

communist victory in China in 1949, and the outbreak of war on the Korean peninsula the next year.

The USA strongly supported a return to democratic capitalism in western Europe and Japan, through extensive aid programmes and military backing. Aid was predicated on the adoption of market institutions, especially those that supported European integration and Japan's return to an open trading system. By 1958, Europe had re-established convertible currencies as the monetary underpinning of open, market-based international trade. Japan's currency became internationally convertible by 1964. The USA, Europe, and Japan also pursued step-by-step trade liberalization through a series of negotiations on tariff reductions.

The struggle between the first (capitalist) world and the second (socialist) world was made considerably more complex by the actions of the developing countries, especially the dozens of newly independent states that had gained independence from European colonial rule. While the USA hoped that these countries would join the first world, as capitalist societies, in the struggle against communism, most of the newly independent countries opted for political non-alignment and an economic third way between capitalism and communism. Thus, the term 'third world' refers not only to poor countries in general, but also in most cases to a political choice of 'third way' between capitalism and socialism. It is ironic that the term 'third way' has been later appropriated by left-of-centre parties in the USA and Europe to signify capitalism with institutions of social support (such as income transfers, health insurance, pension support). The original 'third way' was considerably less capitalistic in orientation than the programmes flying this banner in recent years.

The third-world leaders had many considerations in mind. Most of them viewed the capitalist countries not as trading partners, but as political and economic predators, former colonial masters who would look for new opportunities of exploitation. It is good to remember that national movements often fought their colonial overlords through political and economic campaigns of self sufficiency. The idea of turning around after independence and trading freely with former colonial overlords struck many of the new leaders as suicidal. And considering that countries such as India and much of Africa had actually

been colonized, indeed governed, first by multinational companies (the British East India Company in the case of India) rather than by European governments, the affection for multinational firms was also wanting, to say the least. It was hard to judge in 1950 that the colonial era was decisively over, and that multinational firms no longer represented the risk to sovereignty that they once did.

The new state-builders had other considerations as well. They looked back at the Great Depression as a harbinger of continued capitalist instability. Indeed, the new doctrines of Keynes argued that such instability was inbuilt in the capitalist system. Who could know that the Great Depression was a once-in-two-hundred-year phenomenon, more the accident of a dying gold standard than an intrinsic feature of industrial capitalism. By contrast, it seemed that the Soviet Union had found a way to avoid business cycles. Had it not continued to industrialize throughout the 1930s? The Soviet Union had triumphed over German fascism, and the scientific merits of state planning seemed evident. Of course, few knew at that point about the millions of lives slaughtered in Soviet collectivization campaigns, purges, and forced industrialization.

The final element of anti-market sentiment involved the perception that free markets would condemn laggard economies to servitude in the world trading system, selling primary commodities while depending on the advanced countries for manufactured goods. The leaders of the post-colonial states, and of the Latin American societies, equated state power, naturally enough, with industrialization. They feared, however, that they were too far behind economically to accomplish industrialization on the basis of free-market competition. They needed to protect infant industries behind tariff walls, and to foster them with state support, such as public ownership, subsidies, and protection against ruinous competition. Thus, many developing countries adopted systems of state-led industrialization, based on import-substitution of industrial goods. This semi-market path, somewhere between capitalism and socialism, was seen as the surest way to the end result of industrialization.

A handful of post-colonial countries went in a different direction. After experiments with state-led import substitution in the 1950s, both Korea and

Taiwan adopted market-based export-oriented industrialization strategies in the 1960s. Other East Asian economies followed suit, including Hong Kong and Singapore in the 1960s, most of South-east Asia (Indonesia, Malaysia, and Thailand) in the 1970s and 1980s, and the Philippines in the 1990s. These development strategies were surely not *laissez-faire*, but they were market-based in the following senses: industrial enterprises were privately owned; the currency was convertible for purposes of international trade; tariff rates were kept low on intermediate and capital goods, thereby allowing domestic enterprises to purchase needed inputs on world markets; and foreign firms were courted for the purpose of spurring technology transfer. Foreign firms participated in the domestic economy via foreign direct investment, joint ventures, and outsourcing arrangements (in which domestic firms assembled final products using inputs and technical specifications supplied by the foreign companies).

The tripartite world ran its course from the 1950s to the 1980s. The advanced capitalist economies of the USA, Europe, and Japan not only recovered rapidly from the wartime devastation, but then continued rapid economic growth and dynamic change into the 1970s and onward. Trade barriers were repeatedly lowered among these countries. European integration deepened step by step, culminating in the European Union single market in the early 1990s, and monetary union at the end of the 1990s. The growth of trade consistently outpaced the growth of gross domestic product (GDP), so that the ratio of trade to GDP rose consistently in the First World.

The Second World succumbed to chronic economic stagnation by the 1960s. Technological change outside of the military sector was excruciatingly slow. The division of labour was locked in place by planning decisions taken decades earlier. More and more, Eastern Europe and the former Soviet Union came to resemble a vast industrial museum of enterprises and technologies of the 1930s and 1940s. The region missed entirely the shift towards services and information technology that started in the First World in the 1950s and 1960s. Growth was extensive (simply replicating existing structures of division of labour) rather than based on technological and structural change. Some early experiments in reform in the Soviet Union in the 1960s were

crushed by ideological opposition from the Communist Party. Hungary and Poland both tried to ‘jump start’ their flagging economies by heavy foreign borrowing in the 1970s, ostensibly to purchase foreign technologies. This borrowing spree failed to re-invigorate the socialist economies, but did land these countries in international bankruptcy. It was Poland’s slide into state bankruptcy in 1979 that triggered the rise of the Solidarity trade-union movement. That movement was repressed by martial law in 1981, but survived the repression to lead Poland to political freedom in 1989. The Soviet Union ended up following the Polish and Hungarian slide into bankruptcy during the reform period of Mikhail Gorbachev (1985–91). That episode too ended in financial crisis, and the end of communist rule.

The Third World fared little better than the Second World. State-led industrialization turned out to be a morass. Contrary to the hopes of infant-industry protection, the enterprises built up by the strategy of import substitution did not become efficient or internationally competitive. They could be kept alive only through continued trade protection and state subsidies. Moreover, the failure of these countries to achieve dynamic export growth (in contrast to the East Asian experience) was the Achilles heel of the whole project. These countries needed foreign exchange in order to import foreign technology, capital goods, and intermediate inputs used in the production of manufactured goods. But with sluggish export growth from traditional sectors (such as mining and agriculture), the foreign-exchange earnings of the economy were never sufficient to the import needs. Like the Second World countries mentioned earlier, the Third-World countries went into debt to overcome the shortfall of export earnings. The result was the same: state bankruptcy. By the early 1980s, almost all of the post-colonial countries of Africa and Asia, except for the manufacturing exporters of East Asia, had fallen into state insolvency. So, too, had the countries of Latin America, the other region that championed the model of import-substitution.

V. THE AGE OF GLOBAL CAPITALISM

Much of the world arrived at capitalist institutions the hard way, having passed through decades of colonial rule, only to be followed by misguided

adventures of socialism or state-led industrialization. Even countries that had maintained their independence, such as China, Turkey, and Russia, rejected the models of capitalism on offer from the rich countries of western Europe. Capitalism seemed too dangerous, or too tough a path to follow, starting from so far behind in the process of industrialization.

By the 1980s, however, these alternative models had failed, typically leading to profound macroeconomic instability and state insolvency. In Latin America, the turn towards market reforms began in Chile in 1973, in the aftermath of a brutal coup that overturned a left-wing government intent on establishing socialism. Other countries began to follow suit in the 1980s, following the onset of the debt crisis. In Eastern Europe, the debt crisis would also have been the spur to rapid change, but change was crushed in the region until the late 1980s. India began very gradual market reforms in the 1980s, and these picked up speed in 1991, when India too came to the edge of the financial abyss. In the impoverished countries of Sub-Saharan Africa, market reforms came in the context of the IMF–World Bank structural adjustment programmes of the 1980s and 1990s.

The most dramatic reforms came in China, beginning 2 years after Mao's death in 1976. With the end of the Maoist inspired chaos of the cultural revolution, peasants throughout the vast country began demanding their rights to family land plots, thereby overturning the collectivist agricultural system of Maoist socialism. Within a couple of years, hundreds of millions of Chinese households returned to traditional family peasant farming. Deng Xiaoping, the new paramount leader, wisely encouraged the state apparatus to ratify its support for this surge of grass-roots change. Deng then led several other key market-based changes, including the rights of peasant communities to establish non-agricultural enterprises (known as township and village enterprises, or TVEs), and the right of foreign investors to establish export-oriented, labour-intensive manufacturing firms in designated regions on China's coast. The combination of agricultural reform, the TVE sector, and especially labour-intensive export-led growth (in the tradition of the rest of East Asia), fuelled a powerful surge in China's economy, making it one of the fastest growing countries in the world. Even though these reforms were dramatic

and far reaching, they were sometimes characterized as gradualist, because the state-enterprise sector continued to operate without much change. This was possible, in China's circumstances, since state-enterprise employment constituted just 18 per cent of the Chinese work force.

The reformist regime of Mikhail Gorbachev tried to emulate the Chinese reforms in critical areas. The Gorbachev reforms attempted China's 'trick' of freeing a non-state sector, while preserving the operation of the state-enterprise sector. The Soviets were especially enamoured of China's success in combining market reforms with continued one-party rule. But China's experience did not easily translate to Soviet circumstances. In the Soviet Union, for example, the state-enterprise sector accounted for more than 90 per cent of the labour force. It was not possible to reform the economy while preserving (China-style) the state sector. Gorbachev's reforms ended up unleashing considerable financial instability, while doing little or nothing to spur market-based growth. The Soviet Union itself collapsed in December 1991, and the struggle for market reforms continued in the 15 successor states.

By the 1990s, then, almost the entire world had adopted the fundamental elements of a market economy, including private ownership at the core of the economy, a currency convertible for international trade, shared standards for commercial transactions (for example as codified in the agreements of more than 120 country members of the World Trade Organization), and market-based transactions for the bulk of the productive sectors of the economy.

The narrative has put the stress on political and institutional choices in the emergence of global capitalism, but we must also remember that global technological changes have helped to induce countries to these choices. Most economies in the Second and Third Worlds would have done better to adopt market reforms at an earlier stage, but the benefits of market reforms have probably increased through time, as a result of technological progress in transport, communications, and computing. This revolution in information technology has made possible the globalization of production itself, according to which major multinational enterprises operate

simultaneously in many countries, using their various sites as nodes of a globally integrated production system. Developing countries that successfully attract foreign direct investment and thereby become part of those global production systems have benefited with faster economic development.

VI. LESSONS OF INSTITUTIONAL CHANGE

This very brief précis has touched on many of the great questions of modern history. Why have some countries opted for capitalism, and others for socialism? Is the rise of Lenin, or Hitler, or Mao, to be understood as the workings of great forces of history, or the workings of historical contingency and accident? Are the great institutional changes the result of interests, culture, power, ideas, or accident? Do the rise and fall of institutions in politics and economics reflect a Darwinian process of natural selection, in which the ‘fittest’ institutions survive and spread, and the failures are winnowed out? We of course cannot answer such profound and difficult questions here, but we can reflect on some of the evidence thrown up by the 200 years of modern capitalism and its rivals.

(i) Markets, War, and Peace

Global capitalism has emerged twice, first as a European imperial system at the end of the nineteenth century, and second as a global system of sovereign nations at the end of the twentieth century. Both episodes involved a gradual incorporation of many parts of the world into a common system. In the nineteenth century, that incorporation was partly voluntary (for example, the spread of free trade in Europe; the export-led development of Latin America) and partly coercive, through colonial rule. In the late twentieth century, it has been mostly consensual, though sometimes under the pressures of state bankruptcy.

These two periods share a key distinctive characteristic: they were times of peace among the leading economies (from the Napoleonic wars till 1914 in the last century, and since 1945 in this one). Extended periods of peace cause nations to reduce their fears over foreign encroachments, and to shift towards expanded commercial relations. Authori-

tarian governments tend to lose their hold in peacetime, since the role of the powerful state as protector of society is diminished. This weakening of authoritarian tendencies also creates important opportunities for increased penetration of market forces in domestic politics.

(ii) Ideas versus Interests

Modern political economy tends to see most political and institutional choices in terms of the material interests of the leading actors. Is not ‘public choice theory’ nearly Marxist in its emphasis on the material foundations of political conflict and choice? History suggests, however, that there are crucial times when leading state actors truly have independence of choice, when their actions are not simply a complex vector sum of underlying political-economic forces. Our narrative suggests at least three such episodes. First, the emergence of socialism in Russia was much more accident than Marxist historical necessity (it is often rightly noted that Marx expected socialism to come first to Germany, not to a backwater like Russia). Hitler’s rise to power was similarly accidental. Third, the choice of state-led industrialization in the post-colonial countries of the Third World reflected ideological choices much more than existing economic interests.

There is a shared characteristic of these episodes: the normal basis of state power had collapsed or virtually collapsed in each case. Lenin exploited the vacuum of the collapse of Tsarist rule in the wake of the First World War. Hitler exploited the collapse of economic institutions in the midst of the Great Depression (and even then succeeded only by a concatenation of accidents and intrigues). The post-colonial nation builders emerged to power in a vacuum of authority left by the departing colonial masters. I would venture the argument that normal interest-group politics offers the better description of institutional change when governments are stable, but that ideas and individual leadership (for good or ill) play a much more decisive role when political power has collapsed. In those circumstances, society’s fate is up for grabs. Early victors in the struggle for power can then consolidate their grip on power (remember that power is an increasing-returns-to-scale activity: a little bit can go a long way, when it is mustered against yet weaker forces).

(iii) Capitalism and its Discontents

Since the rise of Britain as an industrial power, capitalism has demonstrated its ability to ‘deliver the goods’. Capitalism fuelled the rise of continental western Europe in the first half of the nineteenth century. It similarly fuelled the rise of the United States. It powered Japan to industrialization after the Meiji Restoration of 1868. One would have thought that capitalism would have been an alluring model for the world, and that the adoption of capitalist institutions would have come much more rapidly and readily than it did.

This article has hinted at some of the reasons for the long and twisted course of the diffusion of capitalist institutions. The first obstacle to diffusion was conceptual. Since Marx, if not before, the gains of the capitalist economies (and of the rich within those societies), have been viewed as ill-gotten exploitation. This was an easy interpretation. After all, the rich countries did indeed grossly exploit the rest of the world, via slavery, colonial rule, military pressures, and the like. Yet the causality was mostly the other way around: exploitation was made possible by superior power and wealth, and was not the cause of that superior power and wealth. Still, the exploitation theory of development was convenient: it allowed the laggard states to see themselves as victims needing to sever relations with the rich countries, rather than as societies in need of reform. The image of victimization in anti-capitalist ideologies has remained strong for two centuries.

The second obstacle was the period of colonial rule itself. The capitalist institutions hardly practised what they preached in their imperial possessions. Who but the Europeans introduced statism, coercion of labour, and other pervasive non-market mechanisms into much of Africa? The colonial inheritance in many cases (though not all) was not conducive to a market-based rule of law. Moreover, as already noted, the post-colonial élites in the Third World viewed open trade and investment as a veritable threat to hard-won national independence.

The third obstacle was the revolutionary nature of capitalism itself, in comparison with the stratification of traditional societies. In the late twentieth century, capitalism was often viewed as a con-

servative’s doctrine, the preserve of the rich over the poor. But in actual history, capitalism has challenged traditional authority, of the landed nobility, upper castes, religious authorities, or foreign conquerors who ruled over indigenous populations. The élites of such highly stratified societies often opted for bastardized capitalism, or rejected capitalism altogether, in order to avoid the social and economic mobility that would be unleashed by market forces, and that could therefore endanger their dominant social and economic positions.

The fourth obstacle was that capitalism itself failed to deliver at a crucial historical juncture: the Great Depression. The importance of the Great Depression in international economic history is probably on par with the importance of the First World War in political history. The Great Depression taught many lessons, most of them wrong. Keynes, the greatest political economist of the century, made a grave mistake when he titled his text *The General Theory of Employment, Interest and Money*. He left the impression that the Great Depression was a ‘general’ situation of market economies, not a one-time fluke of grotesque proportions. He failed to make clear that it occurred because of the international gold standard, a monetary arrangement that Keynes had heatedly attacked and abhorred, but strangely under-emphasized in *The General Theory*. In any event, the Great Depression left the world deeply sceptical about self-organizing market systems. It took decades more to revive robust confidence in market economies.

VII. NO END OF HISTORY

We are at the end of the twentieth century, and at the end of this article, but certainly not at the end of history, not even of economic institutional history. If peace underpins the global economy, we must remember that predictions of continued and inevitable peace are, sadly, no more guaranteed than they were at the beginning of this century. The world is filled with hot spots and confrontation, though fortunately rarely among the leading nations in recent years. Much will also depend on whether global capitalism can ‘deliver the goods’, not just in the USA and Europe, but in the rest of the world. There are some positive signs—mainly the dynamism of

India and China in their eras of market reform—but also many danger signs, especially in Africa, but also in much of Latin America and the post-communist nations. It is also good to bear in mind that economic institutions evolve along with technological change. The advances in information technologies and biotechnologies are apt to create demands for new social and economic institutions. Indeed, one can say that as we move more and more to a science and knowledge-based economy, the institutions of learn-

ing (school and universities, public and private research centres, major multinational firms with substantial research and development activities) will take on increasing importance in our societies. Such institutions have never followed the textbook model of private corporate organization. Social learning and scientific advance has always relied on a complex and evolving interplay of public and private institutions. We are indeed primed for further institutional innovation in the future.