

We Won!

(Note to reader: This is the unedited version of my review of The Commanding Heights by Daniel Yergin and Joseph Stanislaw. An edited version, "How the Markets Beat Marx, Hands Down," was published in Fortune, August 3, 1998.)

Fortune Magazine, August 3, 1998

Are you looking for a book that reads almost like a novel but that also helps you understand the recent decades' sea changes in the world's political and economic systems? Then *The Commanding Heights*, by Daniel Yergin and Joseph Stanislaw, is the book for you. Too much of history is a boring recitation of who crossed what bridge when. But the history of political and economic change, when told well, is inherently exciting because it is full of stories about colorful players thinking things through, planning and carrying out their moves over decades, and, sometimes, being threatened with death. Yergin and Stanislaw, president and managing director, respectively, of Cambridge Energy Research Associates, tell it well. Think of *The Commanding Heights* as a true soap opera with over 50 characters.

The book's title is from a famous 1922 speech in which Soviet leader Vladimir Lenin said that the state must control the "commanding heights," the most important sectors, of the economy. Socialists around the world, particularly the British Labour Party and India's Congress Party, adopted the idea. Belief in government's competence at economic planning reached its peak in the postwar years. While communists in the Soviet Union, China, and other socialist countries were running those countries' whole economies--into the ground, it turns out--governments in Western Europe, Africa, Latin America, and the United States were also taking on more and more power. Yet a modern Rap van Winkle who fell asleep in, say, 1976 and woke up in 1996 would be stunned by the rollback in government. Governments around the world have cut top marginal tax rates, privatized dozens of government-run industries worth over \$100 billion, reduced tariffs, and ended price controls.

The change was greatest in countries where government had the most power. In Russia, where government ownership was virtually total just 10 years ago, the authors point out that 70% of GDP is generated in the private sector. In China in

1978, peasants facing a severe drought and unwilling to break through the hard land for the sake of a collective owner, pleaded with communist leader Deng Xiaoping to allow each family to keep all production, in excess of a low quota, on the land they tilled. Deng allowed it, creating a de facto system of property rights and an implicit marginal tax rate of zero. The result: between 1978 and 1990, the share of agricultural output sold in open markets rose from 8% to 80% and in the six years after 1978, real income in farm households rose by 60%. Deng also allowed more freedom to companies located in Special Economic Zones along China's coast, which have since grown much faster than the rest of China. "I have two choices," said Deng. "I can distribute poverty or I can distribute wealth." The authors comment: "he had seen enough of the former under Mao."

Yergin and Stanislaw also document the shift away from government and toward economic freedom in India, in the rest of Asia, in Latin America, and in Britain. But how did all this happen? They cite two main causes. First, people, including government planners, noticed how badly government ran things. The authors quote a senior economic planner in regulation-laden India: "Everything I had believed about economic systems and tried to implement was wrong." The head of the Chinese Communist Party's propaganda department was shocked when he visited Japan and noticed that cars, TVs, refrigerators, and washing machines were widely owned. He also wrote, "One Sunday we went out to a busy street. Of all the women we saw, no two wore the same style of clothes." He added, "The female workers accompanying us also changed clothes every day."

The second cause of the rollback of government was ideas. Even when political thinkers saw the ruthless destruction wreaked by governments, they needed something to take socialism's place. Free-market economists, and their popularizers in various think tanks, were ready. Stanislaw and Yergin heap credit on libertarian economists Friedrich Hayek and Milton Friedman. In the 1940s, Hayek had shown that socialist economies must fail because they lack a price system, which complex economies absolutely must have to direct resources. (See David R. Henderson, "Why Socialism Isn't Dead," *Fortune*, May 8, 1989.) Yergin and Stanislaw write, "it is Keynes who has been toppled and Hayek, the fierce advocate of free markets, who is preeminent." In the 1960s, Milton Friedman, now at Hoover Institution and formerly at the University of Chicago,

along with economist Anna Schwartz, had produced evidence that the federal government's monetary policy, not the free market, had caused the Great Depression. The authors write, "it is the University of Chicago that is globally influential in the 1990s." One politician who carefully read Hayek went on to become prime minister of Britain in 1979. Her name: Margaret Thatcher. And Yegor Gaidar, Boris Yeltsin's chief economist, when asked which Western writers most influenced him, replied, "Of course, Hayek."

Lead author Daniel Yergin seems to have undergone his own intellectual odyssey. In *Energy Future*, a 1979 book he co-edited, Yergin expressed deep skepticism about the free market's ability to allocate energy efficiently and advocated mandatory conservation of oil and large subsidies to solar energy. Yergin now seems to appreciate the power of markets in allocating resources.

Yet Yergin is still skeptical. The authors write that capital markets create financial risk, whereas financial economists have shown that capital markets allow people to contract out of risk and sometimes allow an overall reduction of risk. Also, the authors question whether economic freedom can satisfy the yearning for "some higher meaning beyond materialism." Leftists during the Spanish civil war, they write, "are said to have died with the word Stalin on their lips." Few people, they claim, "would die with the words free markets on their lips." "Free markets" is admittedly a clunky term; I prefer "freedom." But if I had to choose which words to utter with my dying breath, the choice between the name of a mass murderer and a system that has liberated mankind would not be a close call.