23 Things They Don’t Tell You about Capitalism

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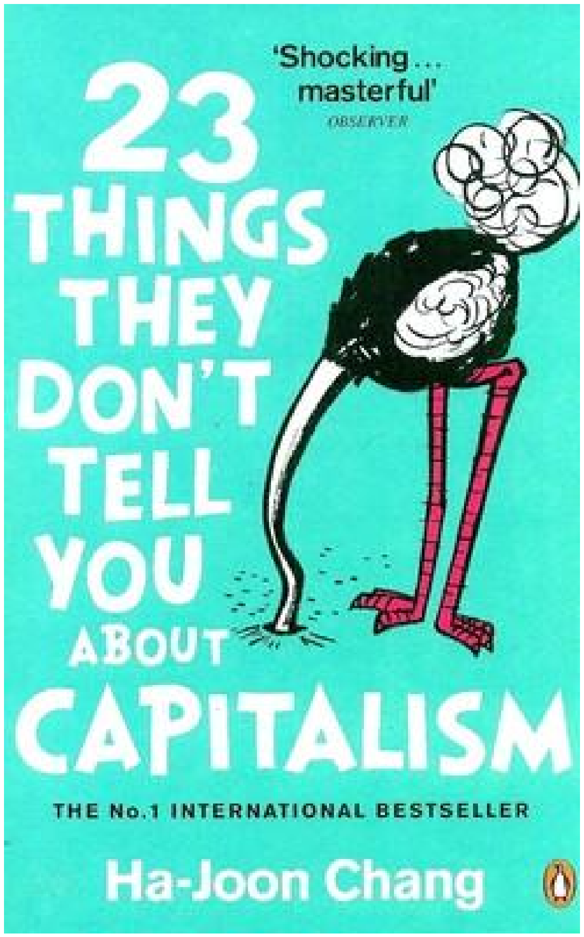

Free-Market

- The 2008 global crash still remains the second-largest economic crisis in history, after the Great Depression
- The huge budget deficits created by the crisis will force governments to reduce public investments and welfare entitlements significantly, negatively affecting economic growth, poverty and social stability – possibly for decades
- This catastrophe has ultimately been created by the free-market ideology that has ruled the world since the 1980s.

Free-Market

- We have been told that, if left alone, markets will produce the most efficient and just outcome
- Efficient, because
  - Individuals know best how to utilize the resources they command
  - Firms, being closest to the market, know what is best for their businesses and should be given maximum freedom
- Just, because the competitive market process ensures that individuals are rewarded according to their productivity

Free-Market

- Governments cannot improve on market outcomes, as they have neither the necessary information nor the incentives to make good business decisions
- Following this advice, most countries have introduced free-market policies over the last three decades –
  - Privatization of state-owned industrial and financial firms,
  - Deregulation of finance and industry
  - Liberalization of international trade and investment
  - Reduction in income taxes and welfare payments.

Free-Market

- These policies, their advocates admitted, may temporarily create some problems, such as rising inequality, but ultimately they will make everyone better off by creating a more dynamic and wealthier society
- The rising tide lifts all boats together!

But why??

- Slower growth, rising inequality and heightened instability in most countries
- Thus, what we were told by the free-marketeers – or, as they are often called, neo-liberal economists – was at best only partially true and at worst plain wrong!

Thing 1
There is no such thing as a free market

- ***What they tell you:***
  - Markets need to be free.
  - People must be left 'free to choose'
- ***What they don't tell you***
  - Every market has some rules and boundaries that restrict freedom of choice.
  - Government is always involved

Thing 1
There is no such thing as a free market

- The ‘freedom’ of a market is, like beauty, in the eyes of the beholder.
- There is really no objective way to define how free that market is.
- If some markets *look* free, it is only because we so totally accept the regulations that are propping them up that they become invisible.
- A Kungfu Master & Piano Wire

Thing 1
There is no such thing as a free market

- Child labor?
- Ban trading in firearms or alcohol?
- Many countries allow only companies with more than a certain amount of capital to set up banks or enter stock markets.
- Restrictions on street-vending or zoning laws
- Interest rates are also determined by politics
- Fair trade?

Thing 2
Companies should *not* be run in the interest of their owners

What they tell you

- Shareholders own companies

What they don't tell you

- Capitalism was transformed into a system of huge corporations hiring hundreds or even thousands of employees, including the top managers themselves, with complex organizational structures
- Shareholders, especially the smaller ones, prefer corporate strategies that maximize short-term profits, usually at the cost of long-term investments, and maximize the dividends from those profits, which even further weakens the long-term prospects of the company by reducing the amount of retained profit that can be used for re-investment
- Running the company for the shareholders often reduces its long-term growth potential
- ≠ Karl Marx' idea of 'joint-stock company': He thought the joint-stock company was a 'point of transition' to socialism in that it separated ownership from management, thereby making it possible to eliminate capitalists
- A new class of professional managers emerged

Thing 3
Most people in rich countries are paid more than they should be

What they tell you

- In a market economy, people are rewarded according to their productivity

What they don’t tell you

- the Swedish bus driver gets paid nearly fifty times that of his Indian equivalent
- Wages are largely politically determined
- Poor countries are poor not because of their poor people
- If there were free migration, most workers in rich countries could be, and would be, replaced by workers from poor countries
- Swedish workers are protected from competition from the workers of India and other poor countries through immigration control

Thing 4
The washing machine has changed the world more than the internet has

What they tell you

- The internet, has fundamentally changed the way in which the world wo
- Unless countries (or companies or, for that matter, individuals) change at corresponding speeds, they will be wiped out. We – as individuals, firms or nations – will have to become ever more flexible, which requires greater liberalization of markets

What they don't tell you

- Washing machine is relatively more important!
- A far higher proportion of people in poor countries have maids than in rich countries

Thing 5
Assume the worst about people
and you get the worst

What they tell you

- The market beautifully harnesses the energy of selfish individuals thinking only of themselves (and, at most, their families) to produce social harmony
- Communism failed because it denied this human instinct and ran the economy assuming everyone to be selfless, or at least largely altruistic

What they don't tell you

- If the world were full of the self-seeking individuals found in economics textbooks, it would grind to a halt because we would be spending most of our time cheating, trying to catch the cheaters, and punishing the caught?
- Self-interest is not the only human motivation that matters even in our economic life
- We have many other motives – honesty, selfrespect, altruism, love, sympathy, faith, sense of duty, solidarity, loyalty, public-spiritedness, patriotism, and so on

Thing 6
Greater macroeconomic stability has *not* made the world economy more stable

What they tell you

- Given that economic stability is necessary for long-term investment and thus growth, the taming of the beast called inflation has laid the basis for greater long-term prosperity

What they don't tell you

- There have been a huge number of financial crises, including the 2008 global financial crisis, destroying the lives of many through personal indebtedness, bankruptcy and unemployment.
- An excessive focus on inflation has distracted our attention away from issues of full employment and economic growth
- The proportion of countries with banking crises shot up to around 20 per cent in the mid 1990s and went up to 35 per cent following the 2008 global financial crisis
- the increase in non-price forms of economic instability, such as more frequent banking crises and greater job insecurity
- Why?

Thing 7
Free-market policies rarely make poor countries rich

What they tell you

- Developing countries tried to develop their economies through state intervention, sometimes even explicitly adopting socialism.
- They tried to develop industries such as steel and automobiles, which were beyond their capabilities by using measures such as trade protectionism, a ban on foreign direct investment, industrial subsidies, and even state ownership of banks and industrial enterprises
- All of today’s rich countries, with the exception of Japan (and possibly Korea, although there is debate on that), have become rich through free-market policies, especially through free trade with the rest of the world.
- Developing countries that have more fully embraced such policies have done better in the recent period.

Thing 7
Free-market policies rarely make poor countries rich

What they don't tell you

- It is *not* true that almost all rich countries have become rich through free-market policies
- Most of these countries grew much faster, with more equitable income distribution and far fewer financial crises, during the 'bad old days' than they have done in the period of market-oriented reforms.

Thing 7
Free-market policies rarely make poor countries rich

- ***Country A***: Until a decade ago, the country was highly protectionist, with an average industrial tariff rate well above 30 per cent. Despite the recent tariff reduction, important visible and invisible trade restrictions remain.
- The country has heavy restrictions on cross-border flows of capital, a state-owned and highly regulated banking sector, and numerous restrictions on foreign ownership of financial assets.
- Foreign firms producing in the country complain that they are discriminated against through differential taxes and regulations by local governments.
- The country has no elections and is riddled with corruption.
- It has opaque and complicated property rights. In particular, its protection of intellectual property rights is weak, making it the pirate capital of the world.
- The country has a large number of state-owned enterprises, many of which make large losses but are propped up by subsidies and government-granted monopoly rights.

Thing 7
Free-market policies rarely make poor countries rich

- ***Country B*****:** The country's trade policy has literally been the most protectionist in the world for the last few decades, with an average industrial tariff rate at 40–55 per cent.
- Corruption is rampant, with political parties selling government jobs to their financial backers. The country has never recruited a single civil servant through an open, competitive process.
- Its public finances are precarious, with records of government loan defaults that worry foreign investors. Despite this, it discriminates heavily against foreign investors. Especially in the banking sector, foreigners are prohibited from becoming directors while foreign shareholders cannot even exercise their voting rights unless they are resident in the country.
- It does not have a competition law, permitting cartels and other forms of monopoly to grow unchecked.
- Its protection of intellectual property rights is patchy, particularly marred by its refusal to protect foreigners' copyrights.

Thing 8
Capital has a nationality

What they tell you

- The real hero of globalization has been the transnational corporation
- If a country's government discriminates against them, transnational corporations will not invest in that country. The intention may be to help the national economy by promoting national firms, but such policies actually harm it by preventing the most efficient firms from establishing themselves in the country

What they don't tell you

- Most trans-national companies in fact remain national companies with international operations, rather than genuinely nation-less companies

Thing 9
We do not live in a post-industrial age

What they tell you

- Most rich countries have entered the 'post-industrial' age, where most people work in services and most outputs are services
- With the natural tendency for the (relative) demand for services to rise with prosperity and with the rise of high-productivity knowledge-based services (such as banking and management consulting), manufacturing industries have gone into decline.

What they don't tell you

- Most (although not all) of the shrinkage in the share of manufacturing in total output is not due to the fall in the absolute quantity of manufactured goods produced but due to the fall in their prices relative to those for services
- The idea that developing countries can largely skip industrialization and enter the post-industrial phase directly is a fantasy

Thing 10
The US does not have the highest living standard in the world

What they tell you

- The US still enjoys the highest standard of living in the world , if we consider the fact that the same dollar (or whatever common currency we choose) can buy more goods and services in the US than in other rich countries
- This is why other countries seek to emulate the US, illustrating the superiority of the free-market system, which the US most closely (if not perfectly) represents

What they don't tell you

- Given the country's high inequality, this average is less accurate in representing how people live than the averages for other countries with a more equal income distribution.
- It has cheaper services than in other comparable countries
- Americans work considerably longer than Europeans.

Thing 11
Africa is not destined for underdevelopment

What they tell you

- Africa is destined for underdevelopment
- People do not work hard, they do not save and they cannot cooperate with each other
- There is no other way forward for Africa than being propped up by foreign aid

What they don't tell you

- All the structural handicaps that are supposed to hold back Africa have been present in most of today's rich countries – poor climate (arctic and tropical), landlockedness, abundant natural resources, ethnic divisions, poor institutions and bad culture
- The real cause of African stagnation in the last three decades is free-market policies that the continent has been compelled to implement during the period

Thing 12
Governments can pick winners

What they tell you

- Governments do not have the necessary information and expertise to make informed business decisions and 'pick winners' through industrial policy
- If government tries to go against market logic and promote industries that go beyond a country's given resources and competences, the results are disastrous

What they don't tell you

- Governments can pick winners

Thing 13
Making rich people richer doesn't make the rest of us richer

What they tell you

- We have to create wealth before we can share it out
- It is the rich people who are going to invest and create jobs
- The politics of envy and populist policies of the past have put restrictions on wealth creation by imposing high taxes on the rich. This has to stop.
- But in the long run poor people can become richer only by making the rich even richer
- When you give the rich a bigger slice of the pie, the slices of the others may become smaller in the short run, but the poor will enjoy bigger slices in absolute terms in the long run, because the pie will get bigger

Thing 13
Making rich people richer doesn’t make the rest of us richer

What they don’t tell you

- Despite the usual dichotomy of ‘growth-enhancing pro-rich policy’ and ‘growth-reducing pro-poor policy’, pro-rich policies have failed to accelerate growth in the last three decades
- So the first step in this argument – that is, the view that giving a bigger slice of pie to the rich will make the pie bigger – does not hold.
- The second part of the argument – the view that greater wealth created at the top will eventually trickle down to the poor – does not work either.
- Trickle down does happen, but usually its impact is meagre if we leave it to the market

Thing 14
US managers are over-priced

What they tell you

- Some people are paid a lot more than others.
- However, this is what market forces demand
- You simply have to pay large sums of money if you are to attract the best talents

What they don't tell you

- The managerial class in the US has gained such economic, political and ideological power that it has been able to manipulate
- the forces that determine its pay American managers are not only overpriced but also overly protected in the sense that they do not get punished for poor performance

Thing 15
People in poor countries are more entrepreneurial than people in rich countries

What they tell you

- One of the reasons behind the lack of economic dynamism in a range of developing countries is the lack of entrepreneurship

What they don't tell you

- People who live in poor countries have to be very entrepreneurial even just to survive

Thing 16
We are not smart enough to leave things to the market

What they tell you

- We should leave markets alone, because, essentially, market participants know what they are doing – that is, they are rational

What they don't tell you

- We have 'bounded rationality'
- We need to, and usually do, deliberately restrict our freedom of choice in order to reduce the complexity of problems we have to face

Thing 17
More education in itself is not going to make a country richer

What they tell you

- The best proof of this is the contrast between the economic successes of the East Asian countries, with their famously high educational achievements, and the economic stagnation of Sub-Saharan African countries, which have some of the lowest educational records in the world

What they don't tell you

- Much of the knowledge gained in education is actually not relevant for productivity enhancement, even though it enables people to lead a more fulfilling and independent life
- With increasing de-industrialization and mechanization, the knowledge requirements may even have fallen for most jobs in the rich countries
- What really matters in the determination of national prosperity is not the educational levels of individuals but the nation's ability to organize individuals into enterprises with high productivity

Thing 18
What is good for General Motors is not necessarily good for the United States

What they tell you

- At the heart of the capitalist system is the corporate sector; This is where things are produced, jobs created and new technologies invented
- What is good for business, therefore, is good for the national economy
- Government needs to give the maximum degree of freedom to business

What they don't tell you

- Regulations can also help businesses by making them do things that may be costly to them individually in the short run but raise their collective productivity in the long run – such as the provision of worker training.
- What matters is not the quantity but the quality of business regulation

Thing 19
Despite the fall of communism, we are still living in planned economies

What they tell you

- In complex modern economies, planning is neither possible nor desirable
- Only decentralized decisions through the market mechanism, based on individuals and firms being always on the lookout for a profitable opportunity, are capable of sustaining a complex modern economy.

What they don't tell you

- Governments in capitalist economies practise planning too, albeit on a more limited basis than under communist central planning.
- All of them finance a significant share of investment in R&D and infrastructure. Most of them plan a significant chunk of the economy through the planning of the activities of state-owned enterprises
- Many capitalist governments plan the future shape of individual industrial sectors through sectoral industrial policy or even that of the national economy through indicative planning
- The question is not whether you plan or not. It is about planning the right things at the right levels.

Thing 20
Equality of opportunity may not be fair

What they tell you

- Equality of outcome is a bad idea as proven by the fall of communism
- When you reward people the same way regardless of their efforts and achievements, the more talented and the harder-working lose the incentive to perform
- The equality we seek should be the equality of opportunity

What they don't tell you

- Equality of opportunity is the starting point for a fair society. But it's not enough
- The question is whether they are actually competing under the same conditions as their competitors

Thing 21
Big government makes people more open to change

What they tell you

- Big government is bad for the economy.
- The welfare state has emerged because of the desire by the poor to have an easier life by making the rich pay for the costs of adjustments that are constantly demanded by market forces.
- When the rich are taxed to pay for unemployment insurance, healthcare and other welfare measures for the poor, this not only makes the poor lazy and deprives the rich of an incentive to create wealth, it also makes the economy less dynamic.

Thing 21

Big government makes people more open to change

What they don't tell you

- A well-designed welfare state can actually encourage people to take chances with their jobs and be more, not less, open to changes
- This is one reason why there is less demand for trade protectionism in Europe than in the US.
- This is why the European countries with the biggest welfare states, such as Sweden, Norway and Finland, were able to grow faster than,
- or at least as fast as, the US, even during the post-1990 'American Renaissance

Thing 22
Financial markets need to become less, not more, efficient

What they tell you

- The rapid development of the financial markets has enabled us to allocate and reallocate resources swiftly
- Liberal financial markets give an economy the ability to respond quickly to changing opportunities, thereby allowing it to grow faster

What they don't tell you

- With recent financial 'innovations' that have produced so many new financial instruments, the financial sector has become more efficient in generating profits for itself in the short run
- However, as seen in the 2008 global crisis, these new financial assets have made the overall economy, as well as the financial system itself, much more unstable
- Moreover, given the liquidity of their assets, the holders of financial assets are too quick to respond to change, which makes it difficult for real-sector companies to secure the 'patient capital' that they need for long-term development
- The speed gap between the financial sector and the real sector needs to be reduced, which means that the financial market needs to be deliberately made less efficient

Thing 23
Good economic policy does not require good economists

What they tell you

- In developing countries, government officials are not very well trained in economics, which they need to be if they are to implement good economic policies

What they don't tell you

- The economic bureaucrats that have been most successful are usually not economists.
- During their 'miracle' years, economic policies in Japan and (to a lesser extent) Korea were run by lawyers. In Taiwan and China, economic policies have been run by engineers
- Indeed, during the last three decades, the increasing influence of free-market economics has resulted in poorer economic performances all over the world