23 Things We ARE Telling You About Capitalism

Ha-Joon Chang's '23 Things' refuted

Tim Worstall

The views expressed in this report are those of the author and do not necssarily reflect any views held by the publisher or copyright owner. They are published as a contribution to public debate.

Copyright © Adam Smith Research Trust 2014

im Worstall is a blogger, freelance journalist and Senior Fellow at the Adam Smtih Institute. His day job is the wholesale supply of various exotic metals. He written for *The Times, Daily Telegraph, Express, Independent, City AM, Wall Street Journal, Philadelphia Inquirer, The Guardian and The Register*.

All rights reserved.

Published in the UK by ASI (Research) Ltd.
Printed in England

Contents

Introduction 5

Chang's 23 'Things' Refuted

1) "There is no such thing as a free market" 9

2) "Companies should not be run in the interests of shareholders" 13

3) "People are not paid more through individual productivity" 17

4) "The washing machine has changed the world more than the internet has" 21

5) "Market economists claim that everyone is greedy" 25

6) "Inflation is not so bad" 29

7) "There should be protectionism in places seeking economic growth" 33

8) "We should direct inward foreign investment to where it is needed" 37

9) "We should boost manufacturing" 41

10) "It is a myth that capitalist Americans are richer than others" 45

11) "Planning, not markets, produced growth in Africa" 49

12) "Governments can pick winners" 53

13) "Helping the rich to become richer does not help the poor to become richer" 57

14) "American executives are paid far too much, and this is wrong" 61

15) "People in poor countries are not entrepreneurial" 65

16) "We need government because people are not always rational" 69

17) "Extending access to higher education is misguided" 73

18) "Regulation can benefit business so we should not oppose it" 77

19) "Central planning is useful to achieve economic growth" 81

20) "We should pursue equality of outcome, not just of opportunity" 85

21) "Larger governments increase economic flexibility" 89

22) 'Finance should be slowed down" 93

23) "We do not need economists to be able to run a decent economy" 97

Introduction

The financial crisis usually dated from 2008, but whose roots lie earlier, generated doubts about the way in which the world's economies are organized. Some commentators thought, with apparent relish, that it marked the end of capitalism and of free markets, and that the world would now move to alternative economic systems based on central planning and direction. Others saw it as presenting an opportunity to impose heavier regulation and controls, and to bring capitalist and market economies under the political control of democratically-elected governments.

After decades of the Twentieth Century in which state planning had seemed part of an inevitable future, its final two decades saw a massive resurgence of free market economics, with an emphasis on incentives, competition and opportunity. Although some resisted its advance, the combination of capitalism, markets and free trade advanced steadily, creating in its wake more wealth than the world had ever generated, and lifting more people across the globe out of subsistence and starvation than ever before in human history.

Those who opposed the spontaneity of free markets still hankered for economic policies designed to achieve outcomes that fitted more comfortably alongside their own ideology, but were unable to resist the success and the new self-confidence of free-market capitalism. When the crisis of 2008 occurred, it seemed to them

like a gift from heaven. They trumpeted capitalism's demise and engaged in discussions about what might replace it. Keynesians came in from the cold to urge controlled demand management as the way to recover from the shock, and to avoid future crises. Even Marx was briefly disinterred and was declared by some to have been "proved right" about his analysis of the contradictions within capitalism which he thought must lead to its eventual collapse.

Young people set up makeshift street camps to "occupy" Wall Street in New York and St Paul's in London, in protest against the "1%" who they alleged owned or controlled most of the world's wealth. It seemed that the combination of the private ownership of capital and relatively free markets was about to be set aside and replaced by something more controlled, less spontaneous. The unpredictable outcome of a market economy seemed likely to be replaced by something that could produce a more preconceived outcome.

Some who sought political control of business urged more and tighter regulation, arguing that a lack of it had precipitated the crisis in the first place. This view did not sit easily alongside the fact that the finance industry was one of the most, if not the most, tightly regulated industry in the world, and that some of its more baleful actions (such as sub-prime mortgages) had been required of it by governments.

Against this background a series of books appeared arguing that capitalism was doomed, that toxic elements lay at its heart, and which usually added agenda to analysis with proposals to bring it under the control of politicians, to be directed by them to achieve nobler and more worthwhile goals that it might otherwise achieve.

The authors of these books found a ready market among people who shared their disdain and distaste for business and commercial activity, and who wanted a world that would conform more to their vision of what they thought it ought to be. Many of these books sold hundreds of thousands of copies, and made their authors rich in the process.

One book which attracted attention was by Ha-Joon Chang, Reader in Economics at Cambridge. Entitled "23 Things They Don't Tell You About Capitalism," it purported to be an exposé of capitalism with all its defects. In fact it could be argued, and is argued within the pages of this book, that Chang is wrong on most of the claims he makes, and that even on the few points where he is right, he draws

utterly wrong conclusions from them.

This book is an antidote to Chang. It refutes his case systematically, point by point, carefully examining his claims and setting them alongside the true facts. Capitalism is not what he thinks it is, and does not behave as he claims it does. Nor do markets, which he sometimes erroneously equates with capitalism, perform as he asserts they do.

As time distances us from the crisis, it becomes more apparent that at the end of it will be capitalism, chastened somewhat and modified somewhat to curb some of the excesses which were indulged in. It will not be a revived version of the planned economies that caused so much misery and blighted so much of the Twentieth Century that takes its place. After each crisis, the capitalist, market economy, picks itself up, modifies and improves itself, and gradually recovers its confidence. It is renewed capitalism that takes over, rather than anti-capitalism.

Within the pages of this book gradually emerges the reason why this happens, why market capitalism has an enduring value that has never been matched. Reading why Chang is wrong gives one a powerful sense of why capitalism is right.

Dr. Madsen Pirie

President, Adam Smith Institute

1. There is no such thing as a free market

The first 'shocking' thing that Chang tells us is that there is no such thing as a free market. He seems to suppose that it follows from this that we must succumb to whatever limitations on our actions that sensible people in authority might wish to impose upon them, and without complaint at all of course, since they are justified by the absence of a free market.

This is not a satire of Chang's views; it is the distilled essence of it.

It is of course true that there is no such thing as a truly free market. Even in anarcho-capitalism (in fact especially there, as there would be no other limits) there are restrictions on what happens in a market. At the most simple, there is societal expectation: if we agree to swap apples for pears than I am indeed expecting you to hand over the apples as I deliver the pears. That in this sense no market is ever truly free does not therefore mean that we should accept any and every restriction upon them. One example of how Chang leaps from the first to the second positions is that he tells it is "obvious" that such things as trade in narcotics or transplant organs should be banned: two things that many libertarian free marketers, including myself and others in the Adam Smith Institute, have long argued should have legal trade in them.

A certain nuance in his argument becomes apparent when he claims that determining the proper limit to market activity is inevitably a political question, for what should or should not be traded is an ambiguous thing. Thus there can be no hard and fast rules and it will depend upon opinion at any one time: hence it is politics. If you believe that there are no hard and fast rules, this would indeed be true. Whether people can choose their own pint or working hours or narcotic of choice does become just an opinion to be settled by political means. This is only true if you do already believe that politics, not logic, or rights, or civil liberty, should settle such matters.

Those who advocate free markets do, though, have a set of hard and fast rules. They are at the heart of what classical liberalism is all about, and are best summed up in Mill's freedom to swing the fist ending where the nose of another begins. This does give us hard rules. Subject to one exception, markets are the default: except where the exercise of a market right interferes with the rights of another. I cannot claim a free market in someone else's boots but I most certainly can in my own. I cannot insist that someone else must work a certain set of hours: but I can indeed insist that he be free to determine his own.

This gives us our framework to decide upon the regulations that Chang sees as just being political. That "obvious" ban on trade in narcotics not only causes deaths through the violence of the illegal trade, deaths through the impurity of the drugs themselves, and gross corruption through the illegal money: it is actually a restriction of people's right to do what they want with their own bodies. This may or may not include ingesting things that Chang assumes should be banned.

The exception of course is externalities but these are a form of indirect harm and so come under our general rubric. There should be markets in everything except where the civil liberties of another are being harmed.

Chang further makes the mistake that any regulation of markets needs to be done by the authorities. Laws must be passed to govern behaviour, he thinks, whereas we all see around us, all the time, markets that are governed by convention, accepted behaviour and just general expectations of how people are going to behave. There is no law that says that one should stand their round: yet social pressure is pretty good at ensuring that people who do not know about the displeasure at their actions. To

the point of vehement corrections of said behaviour.

So it is with much of the regulation of markets. To show that norms are required, behaviours expected, is insufficient to make the leap to the insistence that the law must define all of these.

And finally, for this chapter, Chang makes laughable use of working hours and child labour laws to show that markets, and thus capitalism, need to be regulated. For of course it is capitalism and markets, that strange duo, that have made restrictions on child labour and working hours even possible.

When nearly everyone lived in the abject penury of peasant agriculture there were no possible limits on such working hours. All hands on deck all the time was the minimum needed to keep the family fed. This included children of course: indeed, the way in which small children rapidly become earners in peasant agriculture is used as a reason to explain the high fertility of such families. It is only with increasing urbanization (capitalism there, with its factories) that fertility rates drop as young children are no longer economic assets but costs. It is only after this combination of markets and capitalism produces the first rising in living standards that people can indeed labour only 10 or 12 hours a day, and can leave children to have a childhood rather than have them grubbing for the pennies needed to keep their families alive.

One might think that a Korean would know this. For of course, the time when Britain was rich enough to be able to do this was some century, even a century and a half, before Korea was. We do not need to be rich as Croesus to be able to limit child labour, for example. But we do need to have at least started the climb out of abject destitution: and this is the climb that only markets and capitalism has ever managed to achieve for anyone..

2. Companies should not be run in the interests of shareholders

Defining the "Zombie Firm"

In his second chapter Chang tells us that companies really should not be run in the interests of their shareholders. All this nonsense about shareholder value is just that, nonsense. Precisely because shareholders can just cut and run by selling their stock, they are in fact the most short-term thinkers in the entire system.

This is an argument for which a case can be made, and Chang tries to make it. Unfortunately, however, this does not actually accord with the real world out there. In that real world we can ask who actually does, in practice, not in theory, have a longer term view than the shareholders. Who does? Certainly not politicians, as they rarely look beyond the task of winning the next election. And it would be difficult to accuse British trade unions of thinking much beyond the next pay negotiation. It might even be true that shareholders do not think enough about the longer term: but there does not seem to be anyone else out there with a longer time horizon than the shareholders have.

After all, the current value of the shares is the net discounted value of all future

income from them. Any company that really is not thinking about the long term is therefore going to have a low share price.

But there is a much larger underlying confusion in Chang's thinking here. He talks about other ways of organizing matters so that extant companies do indeed exist long into the future: deliberately having strategic stockholders for example, the way that the Japanese keiretsu do perhaps. The problem with this is that there is no particular reason why a specific company should exist for the long term. Indeed, it is often entirely desirable that they do not, that they should go broke, and that their assets should be re-distributed in bankruptcy to those who can make better use of them.

Most growth in the economy, and almost all employment growth, comes from new entrants into the market. It is small firms starting and growing, old firms failing and leaving, which changes the marketplace. Yes, of course, we can all think of examples of the opposite: Nokia started out making gumboots and later switched to mobile phones. But this is very much the exception. It is the start-ups that revolutionize the economy to all of our great benefit.

Once we accept this, then the very idea of trying to insist upon the long-term viability of a specific company becomes a nonsense. We want to be able to increase and grow the economy into the future, most certainly. But there is no particular reason why the corporate entity called Rover, or Rolls Royce, or Glencore, should survive in the long term. Indeed, there are good reasons why the economy would be better if firms were to die out at some point. That point is reached when their particular skills and advantages are no longer appropriate to the demands of the rest of us in the economy.

Schumpeter made this point: that capitalism is all about creative destruction. Those small companies do provide the creativity, and it is the large companies, at the end of their business or technological tether, that are destroyed. So-called 'stakeholder' interests make that destruction a great deal more difficult.

There are two recent examples. Uber is a method of hailing a yellow cab over a smart-phone rather than waving one's arms on a street corner. This is not rocket science, but it has taken a year so far to fight through the bureaucracy to get this

simple system licensed. And once that had been achieved the 'stakeholders,' the limo drivers of New York City, sued to overturn that. Their alleged grounds were, incredibly, that it would be age discrimination because older people are less likely to have a smart-phone. In other words, the incumbent stakeholders were resisting their creative destruction.

The blast furnaces at Florange in France are another example. The unions, and then the government, acting on the behalf of such stakeholders, are insisting that these blast furnaces must remain open. The problem is that no-one at all wants the iron made in these furnaces. Technology has moved on, and we now recycle much of our iron and steel here in Europe, to the point that we just do not require as many blast furnaces as we did: they have been replaced by electric arc furnaces. So which is better for the economy as a whole here? The stakeholders fighting to save the past, or the shareholders liquidating that past and making spaced for new technologies? Many people would argue that it is the shareholders here who have the longer-term interests right.

This highlights what is problematic about a stakeholder, as opposed to shareholder, economy. It becomes static. If the stakeholders, as they will, demand that their interests be protected, then the interests of stakeholders will indeed be protected. Which means that there will be insufficient of that capitalist destruction to make room for the new capitalist creation. The stakeholder argument might have more merit if we did in fact desire a stagnant economy. As we do not, the argument falls.

Another way of putting this is that by running companies for the benefit of the wider community, rather than purely for the profit of the shareholders, we entrench in that wider community of stakeholders the power over what that company does. That power decides whether the company survives, and whether it gains entry to government subsidy schemes perhaps.

What Adam Smith did not quite say (but might have done) is that they will then conspire against the wider public to ensure the continuation of their benefits through their stakeholding interest. This is not what we want at all. We want companies to continue as long as they continue to make a profit: for profit is that signal that the output is worth more than the inputs, and that value is being added. Once that is no longer true we want the companies to fold and make way for new market entrants. Given that profit is the marker of this success or lack of it, then we want these decisions to be made by those who benefit from the profits: the shareholders.

We do not want the decisions made by those who benefit from the jobs, or patronage, or political power. This means we do not want them made by the workers, by the unions or by the politicians. If stakeholders are allowed to run the system, then there will still be blast furnaces 50 years after they became technologically obsolete, and people will still have to stand in the rain to get a taxi. For stakeholder interests oppose and thwart the creative destruction that is the very essence of capitalism.

3. People are not paid more through individual productivity, but because they live in better organized economies

In the third chapter of the report from the Cambridge Economics Department Chang tells us that people are not in fact paid according to their individual productivity. He uses the examples of Sven and Ram, Swedish and Indian bus drivers respectively, the first getting some 50 times the annual wage of the second.

Of course Chang is correct, in that the individual does not get paid the value of their own productivity. No, even if we consider the time value of the people on the bus, which will indeed be much higher for Sven than Ram, that is not the reason for the higher income. Nor, even, is it the barriers to immigration which explain it all: although this is what Chang blames it all upon.

The average wages in any economy will be determined by the average productivity in that economy. Another way of putting very much the same point is that wages are determined by not the job that is actually being done by the worker, but by the

next one that could possibly be done by that worker. Ram may indeed drive just as well as Sven. But if Ram's alternative employment is peasant destitution then he will be paid like a destitute peasant for driving. If Sven can cross to Finland and Nokia and make phones (or gumboots) then he will be paid to drive a bus very much like a phone maker.

It is this very point that Chang gets so horrendously wrong. He does in fact say this:

> It is not simply, or even mainly, because they are cleverer and better educated that some people in rich countries are hundreds of times more productive than their counterparties in poor countries. They achieve this because they live in economies that have better technologies, better organized firms, better institutions and better physical infrastructure - all things that are in large part products of collective action taken over generations.

Many people, including both supporters and opponents of free markets, would have no problem in finding agreement with this. But Chang is writing a book about how capitalism and the free market just are not all they are cracked up to be. In view of this it is quite reasonable to ask, then, how did the advanced countries end up with the better technologies, better institutions, better firms and infrastructure? Could it, possibly, have anything to do with the fact that they have been largely capitalist and free market for a couple of centuries?

The judgement could be even harsher than that. Everywhere, anywhere, that has been roughly free market, roughly capitalist, for the past century is so rich that the bus driver is indeed paid 50 times as much as a better one in India is paid. That is actually the point of the entire socio-economic structure: it makes even bus drivers rich by any global or historical standard.

This is not confined to any one group or set of countries either. Just since the Second World War, Hong Kong, Japan, Taiwan, and South Korea have all joined the nations which enjoy that distinction. China is catching up fast. Those countries that have not been roughly free market, roughly capitalist, have not made similar progress. For many decades they included, for example, the bureaucratic and planned economy in India which has left Ram so far behind his Nordic counterpart.

This is why the lucky people at the Adam Smith Institute, born into a rich country and gloriously appreciative that this happened to us, argue so strongly that

everywhere else should embrace the joys of free market capitalism. Precisely and exactly because this is the only way that anyone has yet found to make bus drivers gloriously rich.

Perhaps Cambridge just does not do irony? Perhaps they push all those capable of it off into Footlights or something. For here is what Chang's actual argument in this chapter is: The average person in rich countries is rich because of the institutions, infrastructure and better organized firms in rich countries. This shows that capitalism and free markets do not work, even though those institutions have been formed by capitalism and free markets. He should next try proving that black equals white, and trying not to be killed on a zebra crossing.

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

In our fourth chapter we get told that the washing machine has changed the world more than the internet. Something which we can all actually agree upon as long as we accept the conceit that the washing machine is standing in for domestic labour saving technology in general. We might quibble with the example of email not being much of an advance upon the telegraph: email allows you to broadcast to 5,000 or more which the telegraph certainly did not.

I personally have been able to run a software business that simply could not have happened without being able to send files and graphics. But Chang is correct that the development of domestic labour-saving technology has, so far at least, had more effect.

It has, for example, liberated half the rich world human race and allowed them to join the paid, market, economy. It really was not all that long ago that women simply could not do this, given the pressures of domestic labour: and it remains true that many women in many poorer countries cannot do so yet.

However, yes, again, we find Chang being extremely partial in his discussion of

how all this happened. As someone who once owned a Soviet washing machine (no, really) I am sure that this capitalism and free markets thing had a hand in it all. Firstly, in the invention, production and distribution of those devices: the route from carpet beaters through Spangler to Hoover was indeed the usual market-style chaos of no-one at all understanding what they were doing (certain early models blew dust around rather than sucked for example).

Similarly the route from washing stone through washtub to mangle and finally washing machine was not a planned excursion. It was driven by incremental steps the users of which could see the advantages on offer. It was capitalism meeting the market and then further innovation taking place.

What annoys to some extent is that Chang actually mentions a point about servants:

> The main reason why there are so much fewer (of course, in proportional terms) domestic servants in the rich countries- (...) - is the higher price of labour. With economic development, people (or rather the labour services they offer) become more expensive in relative terms than "things".

This is entirely true and is known as Baumol's Cost Disease. The annoyance is that the other half of William Baumol's work is about how invention and innovation happens. What socio-economic system leads to all these wondrous things like a machine that washes clothes without effort or much time expenditure? The answer to that is that innovation works vastly better in a free market socio-economic system. As Baumol points out, the planned Soviet system invented some pretty cool stuff: but I, as the past owner (user would not be the correct word) of a Soviet washing machine would point out, the planned economy most certainly did not come up with successful labour-saving domestic devices.

Which leaves the final line of his "what they tell you part" looking a little strange:

> We - as individuals, firms or nations - will have to become ever more flexible, which requires greater liberalization of the markets.

This is true, even though Chang uses the rest of the chapter to argue against the idea. The reason why we do want this greater liberalization of markets is precisely because it is this, the very thing as Baumol tells us, that produces those innovations like domestic labour-saving technology. This is the very point: we want to encourage

and to continue, the replacement of grunt human labour with machines. And this does indeed require those free markets - or at the very least benefits hugely from them.

I do agree that so far the washing machine has changed the world more than the internet. This is precisely why we want to be promoting that socio-economic system that came up with that very washing machine.

5. Market economists claim that everyone is greedy

Chang's fifth chapter insists that free market economists claim that everyone is greedy, therefore untrustworthy. But a market economy would not actually work if this were true. Chang then goes on to point out that there are many more motivations to human action than simple greed: in which statement he is obviously correct. Risking your life to save that of a stranger is clearly not motivated by economic greed.

However, he rather misrepresents the free marketeer's insistence upon greed being a motivating force. We do indeed insist that most people are greedy and most people are also lazy. They would like to have as much as they can (or wish) of whatever it is with the least effort required in getting it. This does not rule out there being other motivating forces of course. But more than that, we insist that this is "enlightened self interest". That is, most of us look at rather more than the immediate future, thinking about reputation in general and so on. All of this is pretty much the standard argument. We would also try to limit pure self interest to being an economic motivation, perhaps not a general one for the entirety of life.

However, there is something that Chang has entirely missed here and that is the implications of the ultimatum game. He says:

> Going back to our examples above, if you, as a taxi driver, want to chase and beat up a runaway customer, you may have to risk getting fined for illegal parking or even having your taxi broken into. But what is the chance of you benefiting from an improved standard of behaviour by that passenger, who you may not meet ever again? It would cost you time and energy to spread the good word about that Turkish garage, but why would you do that if you will probably never visit that part of the world again? So, as a self-seeking individual, you wait for someone foolish enough to spend his time and energy in adminstering private justice to wayward taxi-passengers or honest out-of-the-way garages, rather than paying the costs yourself. However, if everyone were a self-interested individual like you, everyone would do as you do. As a result, no one would reward and punish others for their good and bad behaviour. In other words, those invisible reward/sanction mechanisms that free-market economists say create the optical illusion of morality can exist only because we are not the selfish, amoral agents that these economists say we are.

Which brings us to the ultimatum game. In this, player one is given $100. Told to split it between themself and player two, he or she can choose any split they like. $99 for her, $1 for the poor second. Or it could be $50/$50, or any other split. Player two is allowed to decide whether the split stands. If it does then the money is divided as was decided upon by player one. If the second player rejects the split then the money is confiscated and no-one gets anything.

The results of this rather astonished the people who first performed it. Once the split starts to look "unfair" (roughly, when it passes through $60/$40 or so) then player two starts to reject it more often. Being entirely rational one should accept any split at all: better to have $1 from an unfair split than no dollars from confiscated money. But that is just not what people do. People will harm their own immediate economic interests in order to punish those they see as acting unfairly.

And it is this very ultimatum game that gives us the answer to whether we are all greedy or not. The answer being, yes, we are: for almost no one at all ever offers a $40/$60 split or better than that. The player one offers always start at 50/50 and get worse. That is, we are greedy in our own motivations and actions if we can get away with it. However, in observing (or having influence over) the actions of others

we seem to turn on that fairness switch.

That is, human interaction seems to have within it, as the very basis of how we interact, a mechanism to curb and revise the inherent greediness of others.

Interestingly, recent research has shown that this might only apply to relatively well-educated, comparatively affluent economic players. Those from less developed cultures behave differently. People from forest tribes might accept a 99/1 split, preferring the $1 that comes free, rather than trying to punish someone lucky enough to have been chosen as the first player. Someone from a Middle Eastern culture might reject a 20/80 offering, because to receive a gift is to incur an obligation they might not wish to accept. But for developed, affluent players, their sense of fairness leads them to act against those they regard as too selfish.

This willingness apparently leads us to punish our own economic interest in order to punish those we think are taking a liberty. Now why would have such a mechanism have arisen if we did not suppose that people are indeed greedy in their own actions? We do not protect the virginity of our daughters because we think it is unnecessary to do so: we protect the virginity of our daughters precisely because we know there is great interest in relieving them of it. The existence of a powerful social force to punish greed insists that greed is prevalent.

You could indeed say that player two's reaction is altruism. But even if you do want to say that, it is still altruism from the second actor, not the first. The reaction clearly exists in the first place in order to curb that greed we all expect from player one, and that is what brings us back to enlightened self-interest.

Such social interactions are not one-time games. Indeed, the way to play the closely related prisoners' dilemma game is tit for tat, if the game is to be played through many sequences, as most social life actually is. We have in our most basic reactions something that curbs that innate greed. Which is a good indication that that greed really does exist in the first place.

It is not that we are all greedy all of the time. It is just that in some societies there is a countervailing force, one that must be there for markets to work. It must, at the very least, be one that we consistently find is absent where markets do not work very well.

The bottom line is that we cannot go around claiming that humans are not, in their own motivations and actions, inherently greedy when we can observe such a powerful social force to curb the greed in the motivations and actions of others. Game theory results show that this force exists, and therefore that people must be inherently greedy.

6. Inflation is not so bad, and attempts to reduce it bring economic instability

The sixth thing about capitalism we are told is that inflation just is not so bad. Furthermore, we are told that attempts to reduce inflation have led to greater economic instability elsewhere. We should thus chill out about inflation and concentrate on other things.

Chang is indeed correct about low rates of inflation. The 1-3% sort of levels that central banks currently aim for are not so bad: indeed they often aid other changes in the economy. Take, for example, Keynes' point about the rigidity of nominal wages. If inflation is 3% and wage rises 1% then real wages will be falling (as, sadly, they sometimes need to do, as was seen in Germany early this century) and this will cause a great deal less fuss and social unrest than if inflation is zero and nominal wages fall 2%.

It is also true that the aim is for low inflation because, in a debt-financed society, we really do not want to get into a deflationary period. If nominal incomes and production values fall while nominal debt levels stay static it is entirely possible to enter a sort of death spiral. So erring on the side of caution, a couple of percent, is sensible enough.

Chang goes on to make the leap to the idea that moderate (which, apparently, means 20-40% a year) is also not so bad. He agrees that hyperinflation is bad because:

> Hyperinflation undermines the very basis of capitalism, by turning market prices into meaningless noise.

This is an example of how Chang continually conflates capitalism and markets. They are really just not the same thing. They might work well together but capitalism is a description of who owns the productive asserts: the capitalists. Markets describe a method of exchange. These simply are not the same thing at all. Indeed, we can have capitalism without markets (the Soviet system was state capitalism without markets) and we can have various forms of socialism with markets (Tito's Yugoslavia was an attempt at this and we can certainly have socialist entities within markets: Mondragon, the Co-op and John Lewis come to mind), but it is vital to keep in mind that the two are descriptions of different things, not just interchangeable names for the same socio-economic system.

But Chang's real complaint is not about inflation: it is about the economic instability of the other parts of the "neo-liberal" package. By concentrating on curbing inflation we have raised such things as job instability and other forms of non-price instability. Chang thinks this is a bad idea: but it could be thought to be a good thing, and not because neo-liberals want to grind the faces of the workers into the dust in fear of losing their jobs.

No, the entire point and aim of this economic system is that we want to move productive assets from lower value uses to higher value ones. That is what we are trying to do, because this movement is the very definition of wealth creation. And, given that we still have nearly a billion people living on $1 a day and the like, more wealth creation is still an urgent task.

If we need to be continually moving productive assets to higher valued uses then yes, labour will be more insecure in its current employment, as will capital and land of course; and most especially so will human capital. Very few indeed expect to leave university these days and not have to learn new skills by the time they retire. Price insecurity caused by modest inflation, does aid us in these reallocations: but not once we have passed that 1-3% level. By the time we reach 20% and above, the price insecurity is raising that signal-to-noise ratio in the informa-

tion that prices are giving us. Thus we find that the allocations of assets that we are making is becoming less efficient as a result of the rise in that noise.

Even what Chang calls “moderate” inflation will, in an economy anywhere near the technological boundary, lead to us simply not having accurate enough information to know what we should be doing next: and that hampers wealth creation. It is worth noting that the economies he uses to show that inflation is not so bad are those which were, at the time, decidedly not at that technological boundary.

As an analogy let us compare inflation to oil or grease. We can agree with Chang that drowning in a vat of hyperinflation is a bad idea, most unpleasant. We can also both agree that a small amount of oil greases the operation of the economy. The difference is that he sees the lake of oil on a skidpan as being an exciting experience, one that does not limit our speed, whereas others might see it as one where the feedback from the system leaves us all entirely out of control and with no idea where we are going or how to change where we are.

It is not that we are increasing economic instability in this neo-liberal age, but that we have the instability we need and require: the flexibility to deploy productive assets from lower to higher value uses. This is what helps to make the poor rich.

7. There should be protectionism in places seeking economic growth

What Chang wants us to understand is that because we used to have protectionism and we still had economic growth and development, then therefore there should be protectionism in those places where we want to have economic growth. In other words the poor countries should throw up trade barriers so that all the rich world mega-corporations cannot supply the people of those countries. Thus will industry develop and in the long term, wealth will be created.

There are a few problems with this argument. One of the most glaring is that he takes historical levels of tariffs as evidence of levels of historical protectionism. This is an absurdity: until well into the 20th century transport costs were more important than whatever tariff levels were as a barrier to trade. Just as an example, it is true that US tariffs near doubled post Civil War. But actual trade barriers fell as transport prices (essentially, the ocean going steam ship) fell by more than that doubling of the tariffs. His historical evidence of tariff barriers is thus highly suspect. The reason that most countries developed their own industries is precisely because non-tariff barriers, those high transport costs, were more important.

Another problem is that, as he actually points out but does not make the connec-

tion with, all of his examples which developed behind such tariff barriers and with infant industry protection, etc, simply were not democracies in any modern sense. Even the countries that developed behind them in the 20th century like Taiwan (or his native Korea) were not. Semi-fascist military dictatorships would actually be a more useful description of some of the political systems. And do not forget what the sort of planning that he is advocating means: not just that government should encourage certain industries but also that local people must be actively prevented from wasting their energies in things which are not part of the plan. It is extraordinarily difficult to think of a way in which a free and liberal democracy could do such things. Force some companies to enter ship-building, yes, and perhaps that could be done with carrots and not with sticks. But how would one, in any semblance of a liberal society, prevent someone from setting up to build ships if that is how they desired to waste their money? This is the sort of thing that did actually happen in those planned economies too.

Even if we grant him his thesis, that such planned and directed industry, protected by trade barriers, did lead to industrial development, it is difficult to see how anything like it could be done in anything close to a free society. Indeed, we might even consider the idea that the reason this “worked” in certain societies (like parts of East Asia) and did not work at all in others (parts of Latin American and Africa) was precisely that those two latter sets of societies were not authoritarian enough to allow it to work. People had enough freedom to be able to ignore the plan.

One further very important point emerges from Chang’s own argument. He does insist that only those countries that have reached the technological leading edge benefit from free trade. His argument is absolutely not that the rich countries of today, those on that leading edge, would benefit from restrictions on trade: quite the contrary. His argument, such as it is, applies only to developing, not developed, nations. So no-one should start using his arguments, faulty even as they are, to propose that the UK or the US or EU, should retreat behind tariff barriers. That is not what even he is saying.

We might also mention that historical evidence of restricted trade areas is interesting in an historical sense: but it is not really of any relevance today. This is because of the sheer scale of modern industry. Perhaps, maybe, it made sense for the US to build a steel industry behind barriers. There were a number of companies in it and between them they created a market, however protected it was. These days, even the EU is not a large enough market, all 500 million of them, to

produce, say, a viable computer industry. The idea that Tanzania (just as an example) should have tariff barriers in order to encourage an indigenous computer industry is therefore ridiculous. Or a car industry: it costs $1 billion just to plan out a major new car platform these days, let alone tool up to manufacture it.

The scale of modern industry is simply such that anyone trying to recreate any substantial part of it behind tariff barriers is just going to be making shoddy goods, very expensively, for no very good reason. You might, just about, get away with a little degree of restriction with the billion and more in China and or India. But the idea that Somalia will, with the appropriate planning and protection, ever have a viable steel, car, chemicals or computer industry is simply nonsense. It might well end up producing firms in an interesting niche or other: but the creation of an entire industry for such a small number of people is just never going to happen.

And there is one final overarching reason why this autarkic route to development is undesirable: it is immoral. Building up infant industries behind tariff barriers is very much a case of jam tomorrow, not jam today. The idea is to deliberately remove from the inhabitants of the country concerned the ability to consume the delights of the current world, so as to enrich those who own the industry within those tariff barriers. That populace is subjected to decades of worse consumption goods than they could have had. Even if this does, in the end, lead to development, we have still impoverished the people in favour of the capitalists of that society. Not that I think it does lead to such development: but even if it did, that is what is being urged.

Which rather brings us back to why this is unlikely to work in a democracy, or in anything even vaguely approaching a free and liberal society. Yes, certainly, economic growth is important but not at the cost of deliberately impoverishing this generation, and that is what infant industry protection does. Not only do the voters appear to be unwilling to sit still for that (and thus it succeeds, if at all, under authoritarian regimes). It is, at the very least, morally dubious for us to go around insisting that they should.

8. We should control inward foreign investment to direct it where it is needed

TIn his eighth chapter Chang tells us that as capital is, despite Marxist insistences, national in some manner, therefore we should be nationalist about capital. Whether or not we allow Johnny Foreigner to come and invest in our pristine and national economy thus becomes a political question: the politicians should stroke their beards and ponder upon whether this specific capital is going to do the right thing in our specific economy.

One major problem with this is that, unlike Chang, we do not think that politicians, however long and grey their beards, have the ability to determine whether a particular investment is good for the economy or not. The average political researcher turned Cabinet Minister could not invest their way out of a wet paper bag. But let us not talk about British politics specifically.

In one part of his analysis Chang is obviously and clearly correct: that capital and companies do still have a national character however multi- or trans-national they may seem.

This is not, of course, a new idea:

> By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.

Yes indeed, that is Adam Smith. Wealth of Nations Book IV Chapter 2 para 9. And it is also the only mention of "invisible hand" in the entire tome. No, invisible hand is not a shorthand for the market and all its wondrousness: it is a comment upon the way in which even if capital were entirely free, and foreign profits were higher than domestic, there is still something about security and familiarity that leads to capital being invested in that domestic trade. Very much the same reasons Chang gives for why corporate people do indeed still have something of a home nation bias.

So Chang is right here but only because he is unoriginal. And it is really most odd to insist that no one tells us this about capitalism when the very point is made in the foundation document of capitalist economics.

However, there is a very large mistake that is being made in the rest of the argumentation here. In short, it is in this sentence:

> This means that the home country appropriates the bulk of the benefits from a transnational corporation.

If the high-end R&D is done at home, if the profits flow home, then the home country gets the major gains because these are the major benefits of a transnational corporation. This is absurd poppycock, and is an entirely ludicrous thing for an economist to try and claim.

The major benefit of any productive organization is what is produced: the benefit that people get from what the company (or co-op or individual) pumps out. This is known as the consumer surplus and this really ought to be known even at Cambridge. The benefit of Google is not cushy jobs for engineers, nor the lack of tax revenue in the UK; the benefit of Google's existence is that we all get to use Google. Whether VW's R&D is in Wolfsburg or not matters very much less than that we all have the chance to drive VWs.

Indeed, we can make an attempt at showing how vast is the difference between these two concepts of the value that a corporation provides. It is not quite exact, because this paper talks about Schumpeterian profits (ie, what the entrepreneurs get, not finance capital) but the stunning fact is that the entrepreneurs only get 3% of the value created.

> The present study examines the importance of Schumpeterian profits in the United States economy. Schumpeterian profits are defined as those profits that arise when firms are able to appropriate the returns from innovative activity. We first show the underlying equations for Schumpeterian profits. We then estimate the value of these profits for the non-farm business economy. We conclude that only a minuscule fraction of the social returns from technological advances over the 1948-2001 period was captured by producers, indicating that most of the benefits of technological change are passed on to consumers rather than captured by producers.

It is not quite exactly the same but it is indeed indicative. The vast majority of the value that is created by any productive enterprise is not in who gets the jobs nor the profits nor the tax from that enterprise. It flows to the consumers who get to use the produce of that enterprise. That is, after all, why the consumers buy it: they value it at more than it costs them to purchase it.

At heart this chapter shows one of Chang's basic problems. He views the economy as being about the benefits to producers and the benefits of production. He has entirely lost sight of the fact that the whole game, the economy and economics as well, is about consumption and opportunities for consumption. Whether or not foreign owners of companies do their R&D locally, pay their taxes or employ locals in the higher echelons of management is such a tiny part of the whole that it is an irrelevance. That foreign capital is still pumping out things that the locals can use and that is where all the value is, in that consumer surplus.

After all, Smith also said:

> Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it. But in the mercantile system the interest of the consumer is almost constantly sacrificed to that of the

> producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.

That was back in 1776: is not it about time that it sunk in?

9. We should improve the proportion devoted to manufacturing in our economy

The ninth thing we are told is that even though manufacturing is becoming a smaller part of our economy, of all economies, it is still very important, oh yes indeed it is! There is a certain sadness in watching the argument develop in this chapter in fact.

Chang is quite right on his facts: it is not that manufacturing output has shrunk at all. In the UK that was rising until 2007 (and we do not know how much of the subsequent fall is recession related or structural) and it is still rising in the US. It is just been rising less than the growth of the rest of the economy: thus falling as a proportion but not absolutely. Manufacturing employment has been falling substantially: a small part of this is simple reclassification. The graphic designers who used to work at the factory were counted as manufacturing workers: now they take their cocaine in Soho lofts they are service workers. The majority of that work-force fall is because of rising productivity: we simply need fewer people to make ever more stuff as we become more efficient at using labour to make things.

Chang gets all of this right: then he makes something of an intellectual leap and it is sad to see the tumble into the chasm of illogicality.

Given all of the above he says that manufacturing is still important and we should work to increase the portion of the economy that is such. The argument being that as productivity is easier to increase in manufacturing than it is in services, as manufacturing becomes an ever smaller part of the economy then total productivity growth will fall. Well, yes, it will, undoubtedly (and there is rather a clue as to why productivity growth has been falling in rich societies in recent decades: because that manufacturing where productivity growth is faster has been becoming an ever smaller part of the economy).

But to then insist that we must have more manufacturing in order to improve productivity growth is most odd. For we do not desire productivity growth per se. It is nice to have, for sure, because it means we can make more stuff with fewer inputs.

But even with that we only actually want to make more stuff, become more efficient at making stuff, that we actually want. There is no point in becoming more efficient at making Simon Cowell for example, as we all have a surfeit already. And so it is with things that are manufactured. We do not want to simply become more productive: we want to have more of the things that we want with the resources we have available, not more things that are manufactured just because it improves average productivity.

It is also true that manufacturing (yes, output is rising, but as a portion) of the global economy is falling. So the advice that every country should focus more on manufacturing is ridiculous. Manufacturing what for whom? If manufacturing is carriages and services are cars (metaphorically), Chang's insistence here is like saying we should all be making more buggy whips. Sure, no one particularly wants them but we are getting ever so much better at making them that average productivity would rise as a result of doing so.

The point here being that "productivity" is not some thing that we should reify. It is indeed the secret to rising living standards: as Paul Krugman has said productivity is not everything but in the long run it is almost everything. What Chang has missed, though, is that the output is measured at market prices: if we overproduce manufactures simply because this will raise the productivity number, then their market price will fall: and productivity will not in fact increase at that point.

So even though his basic facts are right here his prescription still fails. For while we would like rising productivity and it is easier to raise productivity in manufacturing than services this does not then mean that we want to throw resources at manufacturing.

Another way of clarifying this point is that, as we said in the last chapter, the purpose of all production is consumption. Sure, it would be nice to be more efficient at production: but only of things that people want to consume. And as it happens, it appears that further units of services produce greater consumer surplus than further units of manufactures.

Chang also goes on to point out that developing countries must concentrate on manufactures as this is the only way to raise their general productivity, that productivity increase that by definition leads to becoming a developed country. And it is, indeed, highly likely that the developing countries will go through their own industrial revolutions. But not for this particular reason:

> If you base your development largely upon services from early on, your long term productivity rate is going to be much slower than when you base it on manufacturing.

The confusion here is that yes, when you are at the technological frontier then improving manufacturing productivity is easier than service productivity. For when you are at that frontier there is much head scratching and pondering about what to do next. When you are well behind that frontier then there is no particular reason to think that this is so: indeed, we might think that services are easier. Take, just as an example, retailing in India and the computer hardware industry in India. In which do we think it would be easier to improve productivity?

It could be argued that it is retailing, the service, rather than computing, the manufacture. To improve the productivity of retailing all we have to allow (or the Government of India has to allow) is WalMart and Tesco in to start building the standard retailing logistics chain. That is going to be far easier (and cheaper) than trying to build silicon super-plants (and all the rest) in a country without reliable electricity supplies. Or we might argue that we could improve the various state bureaucracies by computerizing them away from the current quill pen and parchment systems.

That it is more difficult for us rich world people to improve services productivity than manufacturing such is entirely true. That the same is true of those places mired in seventeenth century services productivity is not. And what is really interesting about this argument is that if services are 70% of the economy (as they are, UK and US alike) and current poor world services became as productive and efficient as ours, then we would see those poor countries become vastly richer whatever they do about their manufacturing. This is simply because they will be getting more services for the same as the current input: that is what increasing productivity means.

10. It is a myth that capitalist Americans are richer than others

The tenth thing Chang wants us to understand is that actually Americans are not as rich as all that. This is very important because if that sort of free market capitalist society did lead to the richest society on Earth then of course all the other strictures about how awful free market capitalism is would be rather wasted. We would start to believe our own eyes rather than the Reader in Economics at Cambridge, and that would just never do.

The rest of the chapter is just hemming and hawing about how we should change the figures to show that actually Americans are not the richest society on the planet. It is true that there are certain microstates that beat the US: Luxembourg for example. But comparing a few hundred thousand people to 300 million seems rather like cheating. It would be like comparing Manhattan to Texas for example, which is just not quite fair. Or, again about the same distortion of scale, comparing the residents of Eaton Square to the entirety of Luxembourg.

Chang has two basic methods in use here to show that the American Dream is just that, a wraith. After we go through all the various ways that we can measure income he agrees that Purchasing Power Parity is the right one. Which is good, for

it is. We do not measure just incomes, but incomes as compared to prices in the places the people are living. This gives us a much better idea of living standards. And by PPP measurements, absent those microstates, the US is indeed the winner. To which Chang says we should consider other factors.

Firstly, we know that the US is a more unequal society than many others. Thus the average does not give us a true view of how people really live. In an unequal society there will be more people below that (mean) average and thus the real average (ie median) living standard is lower than in a more equal society. This could even be true but it is not all that large an influence. After we account for all of the taxes and benefits, then everyone from Sweden to the US is in a gini (the way we measure inequalty) range of 0.25 to 0.38 or so. And the scale does run from 0.01 to 1.00. More importantly perhaps we do have some evidence of what actual living standards are at the bottom of the pile in a number of different societies. This chart:

[CHART GOES HERE]

These are the incomes at PPP (so adjusting for price differences) after taxes and benefits. And the comparison is to US median income: so, the bottom 10% in Sweden get 38% of US median income. The bottom 10% in Finland get 38% of US median income. And the bottom 10% in the US get 39% of median income.

This means that the contention that the US higher average income is not really valid because the poor get less than the average....with the greater inequality making the lives of the poor in the US worse off than the poor in other countries.... does not really stand up. The US is definitely a more unequal country. But the poor seem to be about as well (or badly) off as the poor elsewhere.

The other trump that Chang plays is to point out that Americans have longer working hours than people in most other countries. Given that slaving away over a hot desk is not what life is all about then perhaps we might not want to attempt to emulate this US lifestyle? And while it is true that money is not everything and that very few of us go into that long dark night bemoaning the paucity of hours we spent working for the firm, Chang has committed a terrible error here. He has assumed that the only form of work we do is paid working hours.

The actual division made is between personal time (we cannot get someone else to sleep for us, take our shower for us), paid working time, household production time and the balance left over is leisure time. The important point to note here is that there is that unpaid working time: that time spent in household production. We might think of digging the allotment to feed the family, childcare time, cooking time, washing and cleaning, repairing the car. It is this time plus paid working time for the firm, which produces total working time. And when we look at this total working hours it is not obviously true that Americans do work more hours than, say, Europeans. It is also possible to substitute household production for paid working time and vice versa. Once can slave over the hot desk to buy a takeaway, or slave over a hot stove to make up for the lack of income from the time not spent at the desk.

In fact, when people actually study exactly this question (ie, here) they find that the opposite is true. Americans do not work longer hours. For example, the average German woman is working an hour and a half a week more than her US equivalent. And for the men the working hours are almost exactly the same.

The German woman might be making sauerkraut at home (a somewhat culturalist thought) while her American sister goes out to work, earns the money and they buys it: in the process the American sister gaining more leisure time than the German.

It is indeed true, as Chang states, that Americans do more paid working hours per year than Europeans. It is also true that the US is a more unequal society than most of Europe (Italy is actually more so than the US). However, the American poor have incomes around and about the same as the European poor. Americans work fewer unpaid, household production, hours leading to equal or greater leisure time. And as Chang has already admitted, the Americans do indeed, on average, have both higher incomes and greater command over consumption opportunities as a result of those higher incomes.

The poor receive about the same: the regular guy is both richer and has equal or greater leisure time. Perhaps there is something to say for this free market capitalism stuff they have in the US then?

Footnote. For those who think we should not be talking about household production, please read the Stiglitz Report. The entire issue is well explained there.

11. Free markets have failed to produce growth in Africa where planning had earlier succeeded

The eleventh thing we have not been told about capitalism is so bizarre as to make one wonder whether Chang was proofread before publication. He says the layout of the free market position is that Africa is irredeemably doomed to low or no economic growth because of structural factors: ethnic diversity, disease, geography and so on. And the reason that we free marketeers say this is because we are embarrassed about the fact that Africa instituted free market reforms in the 80s and has not grown since then. Thus we have invented reasons as to why it has not, rather than rethinking our commitment to free market development.

Chang also tells us that post colonial Africa grew rather well (and note that even he admits not well but better than nothing) in the 60s and 70s. So therefore we free marketeers are doubly wrong. We not only killed off what was working we also prescribed what does not and are now lying about it.

There is one tiny little problem with this. Chang has shifted his decades a bit. There was indeed a change in the 80s but this was not the widespread adoption

of free market policies. That was the debt fuelled autarkic development that was abandoned. Actual free market policies did not take root until the 1990s in sub-Saharan Africa (the place Chang and we are talking about) and since the mid-1990s there has indeed been a take off in growth in those countries.

In fact, if we look at the work of people like Xavier Sala-i-Martin (worth looking up because although his web page is a hoot, he is also one of the most cited economists around) we find that Africa is growing so well that they actually have rising Sen Welfare. That is, not only are incomes going up but inequality is falling at the same time.

What drove the much slower growth of the 60s and 70s was exactly the set of policies that Chang usually proposes. Infant industry protection, government direction of the economy, planning. And most crucially, borrowing to fund that economic development. And, as is usually the problem when people play socialism at some point you run out of other peoples' money. Among the actual investments that were made, just about every country decided they needed an integrated steel mill for example. Almost none of these ever worked at anything like capacity because the continent could really support perhaps two, not the dozens planned. These investments simply never did pay back the borrowings made to construct them. So the policy of state-directed development not only did not work, it came crashing down in a ghastly and impoverishing heap.

What happened to African development is an argument against Chang's policies, not one in favour of them. And as mentioned earlier, one cannot be sure that you can do Chang's form of directed development in a democracy. Even if it could be done in an authoritarian or repressive society (which it cannot), the political dynamic is such that it cannot be done wherever the people are allowed to vote.

Take, as an example, Ghana. Nkrumah very definitely believed in the socialist and state directed development model. Vast sums were borrowed in order to construct the industry it was thought the place needed (and there was many a western socialist writing these plans in Accra at the time). But while Nkrumah did become increasingly repressive himself he did still face democratic pressures. So the economic policies favoured the urban population, those who tended to vote (or even riot where they could be seen) rather than the larger rural one. The exchange rate

was fixed high, for example, to the great detriment of the cocoa farmers trying to export, and to the great benefit of the urbanites who wished to import goods. There was indeed an attempt to have that planned economy, to build and protect those infant industries. It is just that they were all bad plans: and at least part of the reason the bad ones were followed was precisely because it was a democracy.

No, this does not mean that we should have authoritarian government in order to attain economic development through planning. Quite the opposite: that given that we have a democracy, we cannot have that planning because the democratic pressures will lead to bad planning.

Ghana, and everyone else who tried to follow the same development path (pretty much everyone), ended up going bust. This is what brought about the slump of the 80s. Finally the recommendations of the Washington Consensus managed to trickle through the intellectual barriers (and remember that the Consensus is really just a list of stupid things you should not do) and to be applied in the 90s.

Since then we have had good and decent growth in sub-Saharan Africa. This is a cause for celebration, but that is a very different story indeed than the one Chang is telling. This is what rather makes people wonder whether the book was proofread before publication.

There is one little aside as well. Chang does correctly point out that many to most African countries have bad external transport links. For reasons both historic and geographic. There is something puzzling, though. Chang says that a country should not leap into the global marketplace, but should develop at least to begin with behind its own borders. Yet, given that Africa had no choice in this, why is not it developed? If few imports lead to economic development as this encourages domestic production then why have African countries not developed, since they have had few imports?

That is just an aside though. The real problem with our eleventh thing is that Chang is certainly not describing things as they really did happen. Sub-Saharan Africa did go down the planned and tariff-bound infant industry protection route in the 60s and 70s. And growth was there but feeble: then the entire system went bust. Once the mess was cleared up and free market policies were adopted in the 90s, there has been good and decent growth across the region. And no, it is not the free marketeers who have been ascribing Africa's problems to anything other

than economic policy. Quite the contrary: we have been using the benighted continent as absolute proof of our contentions. Managed development was tried and failed: free market development is working.

12. Free marketers are wrong to claim that governments cannot pick winners

Chang's twelfth thing about capitalism that we are not told is a masterpiece of straw manning. We are told that the free marketeers insist that government can never pick winners and are then presented with a couple of examples of supposed winners that have been picked by government. We are told that, QED, the free marketeers are wrong.

But that is not actually our argument: we do not insist that government, or planning, can never produce a winner, only that it is less likely to do so than a free market approach to such decisions. At which point the proof falls apart.

Chang does tell us of the foolishness that accompanied the 60s and 70s approach to the planning of economies. The famous line from Eugene Black, the World Bank President, that developing countries were fixated on the three totems - the highway, the integrated steel mill and the monument to the head of state. The monuments were overturned along with the head of state, the roads were unused and the steel mills, as already mentioned, were built with reckless abandon and then left to rot.

Chang's response to this is that South Korea managed it! POSCO was set up as a state planned, run, and financed, company and it has ended up as a thriving steel company. Even though South Korea did not have either the iron ore or the coking coal that would normally be domestically produced to feed such a series of plants. Thus planning can indeed work, we are told.

To which there are three responses: the first being that an example of not-A is not a refutation of generally-A. For example, we cannot refute the statement that ugly men generally do not end up with good looking women by observing the beauty of Simon Cowell's latest partner. We could refute that ugly men never do this by such an observation, but not generally. So it is with our observation that governments are generally bad at picking winners, and generally make bad investment decisions This is not refuted by the observation that one government, once, managed to invest in a decent enough steel company.

This is where Chang's straw man argument comes in: he has claimed that the free market argument is that governments can never do this, whereas the actual argument is simply that this succeeds less often than alternative methods.

The second is that the power to direct the economy as South Korea did in the time Chang talks about is not something that is available in a free society. This has been covered earlier, but it is worth using some of the examples that Chang himself gives us:

> However, even when all those carrots were not enough to convince the businessmen concerned, sticks – big sticks – were pulled out, such as threats to cut off loans from the then wholly state – owned banks or even a "quiet chat" with the secret police......(...)....In the 1960s, the LG Group, the electronics giant, was banned by the government from entering its desired textile industry and was forced to enter the electric cable industry.....(...)... In the 1970s, the Korean government put enormous pressure on Mr. Chung Ju-Yung, the legendary founder of the Hyundai Group, famous for his risk appetite, to start a shipbuilding company. Even Chung is said to have initially baulked at the idea but relented when General Park Chung-Hee, the country's then dictator and the architect of Korea's economic miracle, personally threatened the business group with bankruptcy.

One can hear, all the way from Cambridge, the lascivious licking of the lips at this display of firm authoritarian government in true Confucian style. Few of the rest of us would disagree, being as liberal as we are, that whatever the economic results of such plans we would rather not have a General as dictator with the power to insist upon such things. As indeed we do not, and as was pointed out earlier, the result would be to have planning driven by democratic concerns, something very different.

The third argument is that Chang is that he entirely ignores opportunity costs here. This is astounding in a self-professed economist. For opportunity cost is the first and most important thing that one has to grasp about the subject (the only other is that incentives matter). The actual argument is not whether government can decree that a steel mill, or a shipyard, should be built. Nor is it even whether such projects will make a return on their investment and survive into the future. It is rather whether that money and investment would have produced better returns if employed in another manner. What could South Korea have built instead of a steel mill or shipyard? Perhaps the profits would have been larger in building a world-beating textiles industry?

By resolutely ignoring this point Chang is here showing that whatever it is that he is talking about, it is not really economics. For opportunity cost lies at the heart of the subject.

The final argument against government picking investments is best described as momentum. The most important part of an economic system is not actually the decision about what to do. It is about what to stop doing. More specifically, how do we decide that a project, an investment idea, as gone wrong and needs to be killed off? It is in this that governments are appallingly bad, horribly, hugely, worse than the private or free market sector.

To take once recent example: the London Olympics. Before the selection of which city would hold it we were told that it would cost some £2.5 billion or so to stage. Once the decision had been made the budget started to balloon. One of the things that drove it through the £10 billion barrier was the realization that the government plans had not included the VAT that the government would be charging itself. A reasonable estimate of the final cost is £20 billion and change.

A private sector adventure that was going ten times over budget would have led to

a phone call to Paris asking if, despite having lost the selection competition, they would still like to have the Games. Or even to stick them in Athens, which already had all the stadiums from a previous one.

The impetus in politics, the incentive, is never to admit to having made a mistake. Thus government designed projects, even if they turn out to be disasters, tend not to get cancelled. Doubling down, good money after bad, this is how it works. The free market sector, by contrast, does indeed look at error, agree that it is an error, and closes it down.

This is a clinching argument against state planning of investment and industry. It is not that governments can never pick a winner: even the blind monkey finds a banana occasionally. It is not just that governments are less likely to pick a winner either. Nor that private industry has not decided upon some stinkers along the way. Even if government and the market were equally capable of picking winners, government is a lot worse at closing down, bankrupting, the losers. This means that resources are wasted by government in a manner that the private sector does not.

13. Helping the rich to become richer does not help the poor to become richer

Chang's thing number 13 is simply that trickle down economics does not work. Making the rich richer does not make everyone richer therefore we should not be planning to make the rich richer. The whole thing is based upon the marginal propensity to invest: investment is good for the future of the economy, the rich invest more of their incomes than the poor do thus if the rich get more of the money then there will be more investment and that is good for the future. Chang insists that this idea is wrong, based as it is upon the classical economists. The rich do not necessarily invest more therefore allowing them to have more of the pie will not increase investment and so no glorious future.

There is a very serious problem with this argument of Chang's. For the flip side of this marginal propensity to invest is the marginal propensity to consume. And it is an absolutely standard part of Keynesian economics (most definitely not classical economics then!) that the poor have a greater marginal propensity to consume than the rich do. Indeed, we do get people telling us that in economic hard times we should be taking money from the rich to give to the poor. Precisely because the rich will just save and invest it while the poor will spend it thus boosting aggregate demand.

Here is such an argument in fact:

> For example, in an economic downturn like today's, the best way to boost the economy is to redistribute wealth downward, as poorer people tend to spend a higher proportion of their incomes.

The greater marginal propensity to consume is exactly the same thing as the lower marginal propensity to save and invest: if the poor are more likely to spend then this is the same statement as the rich are more likely to save. The really unfortunate thing for Chang's rejection of the idea that the rich invest more is that this sentence comes from Chang. It is in this very same chapter where he urges us to reject the greater marginal propensity to invest of the rich. Oh dear.

It is also probably true that Chang should be deprived of his economists' secret decoder ring for confusing wealth and income as he does in that sentence. Wealth is a stock, income a flow, and never should the two be confused.

There is a common rhetorical flourish throughout the chapter that should have been avoided as well. He veers between talking about a redistribution of income upwards in recent decades and the way in which the growth in incomes has gone disproportionately to the already rich. The two are very much not the same statement: the first is that extant incomes have been snatched, like a humble crust from a Dickensian waif's lips, to be awarded to the rich. The second is that of the new incomes that are being created the upper part of the income distribution is acquiring most of that new income: the crusts are still safe in the waif's hands. The truth is that there has not been a redistribution of incomes upwards: the last few decades have seen average (both mean and median) incomes rise, therefore nothing has been taken away from anyone. It is true that a large portion of the new income created has gone preferentially to those already gaining high incomes. You may be happy about this or not, but that is what has been happening, not the first but the second.

Now we should look at the proof Chang uses to show that allowing the rich those higher incomes does not improve the growth of the economy. It is, fairly simply, that in more equal times like the 50s and 60s, economic growth was higher than it has been since the 80s, when inequality started to rise. What more proof could we require that the rich getting more of the pie does not grow the said pie?

At which point we would probably recommend that Chang should read his own chapter 9. In which he tells us, entirely correctly, that as economies mature growth will become more difficult and thus, presumably, slower. Chang's argument (and, interestingly, the correct argument, which is an amusing coincidence) is that in the long term economic growth comes from improvements in total factor productivity (tfp). This tfp is easier to increase in manufacturing than it is in services. Chang uses this to argue that therefore economies should have lots of manufacturing so that tfp can be improved: an argument we rejected as there is only so much manufacturing that we actually want.

But look at what that does to Chang's subsequent argument about economic growth. We know very well that manufacturing has fallen as a portion of western world economies in recent decades. Indeed Chang tells us that manufacturing as a percentage of total production fell, in Britain, from 37% in 1950 to 13% today. That is the manufacturing where tfp growth is easier than in the services which have grown faster (for yes, manufacturing output has still grown, just not as fast as services) which has shrunk as a portion of the economy. And it is Chang himself who tells us that this makes future economic growth more difficult as a result of that difficulty in increasing tfp in services.

Yet when it comes to comparing growth rates in manufacturing-heavy and services-heavy economies, the lack of growth is all about how the rich have all the money. Go figure. Consistency is not just the hobgoblin of little minds.

One final point about why we do not want to be taxing those high incomes too much. It is not, as Chang purports, because only the rich can make everyone else rich by investing. Rather, it is because the process of people getting rich is what makes us all richer. Assuming no rent seeking (which we free marketeers do indeed abhor) and the lucky sperm club then the only way you can become rich is by satisfying the desires of others. You need to be producing something that others are willing to purchase. That they are willing to purchase it shows that they value it more than it costs them: by definition this makes them richer. As the influx of cash makes you richer.

It is not the static state of being rich that makes everyone better off: it is the activity of producing what others value that makes both the producer and consumer richer. And that is why we do not want to take huge bites out of the incomes of people who are doing this: because we would like them to be seen to be well

rewarded so that others are willing to take the risks of similarly producing value that all can enjoy. After all, we know that taxing something produces less of it: thus taxing the creation of wealth will produce less wealth.

14. American executives are paid far too much, and this is wrong

Our fourteenth thing is simply that American executives get paid far too much money and that this is wrong. In itself this is proof that a market manner of doing things is ineffective: just the simple fact that the average US CEO gets 300 times the wage of one of his workers proves this.

And we should admit that Chang has some useful points to make here. It is entirely possible that there is rent seeking in the way that CEO pay is determined. Interlocking boards, where "you scratch my back with a pay rise and I will approve yours next month" could be partly to blame. The agent/principal problem may well be in play as well. While the shareholders are the legal owners of the company we can all find examples of organisations being run for the benefit of the managers, not the owners. So there is some truth to the processes which Chang points to as raising US CEO incomes.

However, there is not enough truth in this to support his contention that these pay rates are in some manner wrong or unjustified. Take, as an example, the comparison between the 30 or 40 times average wages that CEOs used to be paid and the 300 they are now. This occurred back when the average US CEO was running a

US domestic market company. This simply is not the case now: the large corporations there (as with the large corporations everywhere in fact) are now global companies. They are massively larger than they used to be so it is not entirely surprising that pay for those running them has gone up.

The two major mistakes made though are not quite so simple. The first is that Chang wants to claim that people are paid according to their marginal productivity: only if a CEO is worth 300 times the average worker should he be paid that. That is really not quite how labour markets work. Yes, average wages in a country are going to be determined by average productivity, this is true, but the wages of individuals are going to be determined by supply and demand of those particular skills. Given the mess certain CEOs make of running large corporations we can also see that the supply of the necessary skills is fairly small. We would thus expect a high price to be paid for them.

But even this is still understating the point. The job of a CEO is not just to make profits for the shareholders: it is to avoid making losses for them. The value therefore of a CEO is not just the profit booked at the end of the year: it is also the losses avoided. And those losses can, of course, amount to the entire value of the firm itself as Chrysler and GM shareholders found out.

The second is that Chang has not recognised that CEO compensation is like that of traders or footballers. We are in a tournament here. There is no static benchmark by which we measure the performance: that performance is only ever relative to everybody else in the same field. You can be a very fine footballer indeed and never make it to the Premiership simply because there are a couple of hundred players who are better than you are. You could make a perfectly adequate CEO: but you will not get there if there are a few hundred to a few thousand who are better at it than you are. The fact is that CEO pay is not being based upon some critical appraisal of some abstract standard: it is all about whether you are actually better than the other candidates or not.

And we do very much know one thing about what happens to pay in such tournament markets. It soars: because being 5% better than the other guy means that the employer wants to have you, not the other guy.

That is really what is behind high executive pay. There is undoubtedly rent seeking, there is certainly some aspect of larger companies paying larger amounts and

so on. The real point, however, is that it is indeed a tournament and the one thing we know very well about tournament markets is that they pay massively to those who win the tournaments

15. Free marketers are wrong to say that people in poor countries are not entrepreneurial

In our fifteenth thing that we did not know about capitalism (because the capitalists have been so misinforming us) we are rather flipped over into the absurd. Chang's claim is that we are all browbeaten into believing that poor countries are poor because the people there are not entrepreneurial. He goes on to point out, quite rightly, that this is an absurd thing to believe. The poor everywhere are vastly more entrepreneurial than the bourgeois middle class types: they have to be in order to survive. This is as true of poor people in rich countries as it is in poor ones, too. The ducking and diving that goes on to make a life on benefits more pleasant is entrepreneurialism in a raw form. All of which is why no one at all does go around claiming that the poverty of some countries is based upon a lack of that raw entrepreneurialism, which makes that claim something of a straw man.

Chang is also quite right in pointing out that the reason why this greater extent of entrepreneurialism amongst the poverty-stricken does not then go on to create great wealth is not because of some deficiency in the people themselves. Nor is it a lack in their ability to do that ducking and diving. The lack is in the institutions

in their society that allow the microbusiness to flower into the larger one. This is indeed quite true.

We also know quite a lot about what it is that is lacking in those institutions. Chang mentions things like crooked bureaucrats: the shorthand for not having them and their ever-changing interpretations of the regulations (and the subsequent opportunities for personal enrichment to turn a blind eye) is the absence of the rule of law. There are other things too: Hernando de Soto has pointed out that many of the poor in these poor nations do indeed own property. But they do not own it legally: they hold it informally, by common recognition that they do rather than government recognition of their ownership. This means they cannot borrow against it, mortgage it, leverage their wealth. This can also be known as the absence of property rights. Or at least the absence of the formal recognition, de jure, of de facto property rights. De Soto has gone on to show that when such rights are formally acknowledged, then matters improve.

In the absence of such property rights it is extraordinarily difficult to have a smoothly functioning financial system. The reason microcredit ever worked at all (and Chang is again perfectly correct in pointing out that it is not been quite the success sometimes advertised) was because it replaced that security of the lender being able to call on property for repayment with the security of the social pressure of the guarantors of the loan. Borrowers were in groups: the others in the group could not borrow until the first loan had been paid off. It was the finding of a different form of security, in a society without those formal property rights, that allowed any success at all. But clearly, if we want a financial system that can be used for the financing of the acquisition of property (whether it be a bullock for ploughing, a building to trade from or live in, or a factory) then there has to be a system of recognizing and transferring the ownership of that property. It also needs to be backed up by a functioning court system, and so on.

So far it looks like I am agreeing with Chang in this chapter. And I do not dispute his facts, this is true. But let us recall what the book is about as a whole. It is about the way in which we have been misled into believing that capitalism and free markets have created the wealth that we enjoy. The application of capitalism and markets to the currently poor being what would make them rich: this is the thesis that Chang wishes to refute. But his facts in this chapter simply show us

quite how important and true that thesis is.

For what Chang is actually complaining about, what he is stating is keeping the poor poor, despite their admirable entrepreneurialism, is the absence of capitalism and free markets. For that is what capitalism is: a method of describing who owns productive assets. Markets are a method of exchanging things one with another, under the rule of law. It is the very absence of these things that Chang is identifying as keeping them poor: which is exactly the same as the capitalist and market case for why people are poor. They do not have the institutions that allow entrepreneurialism to flourish. They have, in short, too little of that law, capitalism and market freedom which are necessary to become rich.

That is why this chapter leads into such absurdity. Chang tells us that the poor do not have this, that and the other, which is what keeps them poor. This is true: but this, that and the other are what capitalism and free markets are. At its most basic too: the rights to own, transfer and trade legally.

In a sense I am agreeing with Chang. I agree entirely that what blunts the success of that admirable effort and nous shown by the poor is the absence of the institutions that allow it to flourish. But Chang seems to think that this shows that capitalism and markets are not the way forward: when the very definition of the institutions that allows such effort to flourish is capitalism and markets. So how the analysis, that the poor are kept poor by the absence of capitalist institutions, can be used as an example of why capitalist institutions are undesirable for the poor is by no means clear. But that is the absurdity that Chang is putting forward.

16. We need governments to guide us because people are not always as rational as free marketeers claim

Our sixteenth thing is that we are all far too stupid to be allowed out without the government nanny holding our hands. Chang does not put it in quite these words but it is his general meaning. He runs through the usual arguments: we free marketeers think that people are rational, so we allow them to get on with it.

Chang says (rightly) that people are not always rational so they need guidance. When that runs into the problem that the people doing the governing are going to be just as irrational as everyone else, Chang tells us that government should simply ban things until we understand them. For example, and it is his example, new financial products should be banned until we understand them.

One major problem with this approach is that the argument for market activity does not depend upon rationality. One is, over and above that, that we know our desires better than others can know them. However much each of us might want to be Prime Minister we do not know the desires of others better than they do. There is thus an extremely strong assumption that we should not be (even if we

were to become Prime Minister) trying to restrict the actions of others unless there is some overriding reason to do so. What we think is best for people is not good enough. That overriding reason can be found in Mill for example: the proximity of an about-to-be-broken nose to your swinging fist. Chang's argument in favour of regulation does not overcome this reason for non-regulation at all.

It is also rather irritating to be told, again, "that as Adam Smith said about the invisible hand." No, he did not: he used the phrase once in The Wealth of Nations, about the propensity for domestic investment even in the face of the free movement of capital. It was absolutely nothing at all about the glories of market coordination.

The real heart of Chang's argument is Herbert Simon's point that we humans have bounded rationality. We cannot consider everything so we do not: we are not bright enough to consider the ins and outs of every possible action so we have rules of thumb which we act by. This is undoubtedly true: it is rather the flip side of the idea that we do not particularly maximize utility but we do it to a satisfactory level (although a purist would argue that by not bothering to think too much, because thinking is hard, we are maximizing utility). And there is indeed a great deal of truth in this. Company routines, our own sleep patterns and breakfasts (to use Chang's examples) are based not on rigorous contemplation of all the available options. Rather they are based on the very limited number of choices that we allow ourselves through our routines or company structures.

Thus, says Chang, the government should impose such regulation on all: and that is the leap that is too far. This applies even in the face of the uncertainty (no, not risk, uncertainty) about the impact of that new financial instrument.

Think a moment about evolution. We all generally think of it as leading to a certain harmony. This is not, as deeper down we know, how it actually is. We have this random mixture going on through mutation, we have a further mixture of genes through mating (in sexual animals at least) and it is the ever-changing environment which does the selecting about who and which will survive. That is the only way that life can in fact deal with the inherent uncertainty about future conditions.

You can see where this is leading: market processes are an endless repetition of experimentation, much like those gene mutations and mixtures. Which of these experiments will survive depends upon the environment they are tried in. Writing

great smartphone apps in 1955 would not have been a path to success: in 2015 it is highly likely to be. And this is exactly why we do not want government building regulation to stop the experimentation. Precisely and exactly because we do not know what the future environment will be and thus do not know what will succeed in it. Because it is uncertainty, not risk, we cannot know: therefore we must not stop the experimentation.

Another way of putting this is that we do not want to regulate market experimentation out of existence because such market actions are precisely the way we find out what is either good or bad. Further, if we do not allow the ideas out into the markets we can never get enough information to know whether they are good or bad: so, in Chang's universe nothing would ever happen because we have lost the very mechanism by which government can decide whether to regulate or allow something.

The final killer for Chang's extreme interpretation of the precautionary principle (for that is what it is) can be explained by anyone who has ever tried to explain something to a politician. These are the people Chang wants to make all these decisions for the rest of us. They are no brighter than you or me and almost inevitably less well informed. They also have rather different motivations: one becomes a politician with power by spending inordinate amounts of time working out how to gain and hold on to power. Bad incentives, less information and no greater (at best) mental faculty than the rest of us: their rationality is more bounded than our own. This is not a good argument in favour of their being responsible for protecting us from our own bounded rationality.

17. The current preoccupation with extending access to higher education is wrong

In Thing 17 Chang tells us that the current preoccupation with extending access to higher education is grossly wrong. It might well be true that more people should enjoy three years at the gleaming spires (and in the modern world, the booze, babes or boys to choice) and we are indeed in a richer world so why not?

We do expect to take some portion of our ever-increasing wealth in more leisure and there is no reason at all why this should not be three years at the start of working life rather than more days off during it or more years of senescence after it. But if we think that more of this higher education is going to make us all richer then we are simply wrong. In this argument Chang is absolutely and completely correct.

As Chang points out, Tony Blair might have caught the zeitgeist with his mantra of "education, education, education," but there is absolutely no evidence at all to show that he was right. Countries with higher further education rates do not have richer economies, or ones growing more strongly, or ones with higher technologies.

There just is not, in the actual data, any correlation at all with wealth and university education. Indeed, there is the suggestion that going above the 10-15% of young people going off to university is wasteful: we just end up in a signalling game rather than actually teaching anyone anything that is useful in terms of working life. This is the 10-15% that Switzerland had until recently and we had historically.

Given that so very little of what we are ever actually taught at university is ever used in a job (other than teaching the next cohort through university) this should not come as all that much of a surprise. We might also note the fact that Chang's book has been very popular among the Guardianista classes, but with few, if any of them, mentioning this point. Surprise, surprise.

I would take issue with only one of his points.

> 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.

I would replace "national" and "nation" there with "economics" and "economy." For the nation state is not actually the determinant of that ability to organize into such enterprises with high productivity. Indeed, one of the major points we can make about the UK is that absolutely it is not.

London, The City at least, is organized into a global economy that connects Hong Kong, Singapore, New York and a number of other lesser international legal, financial and banking centres. London is also the richest of the EU statistical units (ie, not nation states, but the next level down). Cornwall, parts of the North, the poor parts of Wales and Scotland, are some of the poorest such regions in the EU. It is the ability of an economy to organize high productivity, not the ability of a nation to do so, which is important.

Perhaps the reader might think this a trivial distinction. But if we keep on becoming all national about these things then we will become both nationalist and statist. This is very much the point we should not be taking from this. If such high productivity can be organized across national boundaries, without national governments doing the planning or the regulating, then we know that the creation of those high productivity enterprises is not dependent upon the nation or the State,

do we not? Nor even that “helping hand” of government.

18. Regulation can benefit business so we should not oppose it

Chang's eighteenth is the regulation can sometimes be good for business, even if business does not think so, therefore we should not rail against the regulation of business. This is certainly true to some extent: regulations against trading while insolvent are most certainly helpful to clearing out the deadwood of zombie enterprises from the economy, to the benefit of all other businesses. But that is not of course, quite what Chang means. His meaning rather is that a benevolent government will stop business doing things that might be extremely worthwhile in the short term but will have bad long-term effects. An example of his is that companies in poor countries should be barred from importing old technologies.

As this could lock them into a sub-optimal development path, perhaps they should be forced into importing more expensive, more up to date, technology even at that short-term cost.

This is an argument to which there are a number of answers. The first and most obvious being, what evidence do we have that any random group of bureaucrats or politicians are capable of recognizing a technology, let alone an appropriate one? This is not a skill that is notable in the currently-advanced economies after

all: vide any and all governmental computing projects. We will not dwell too long on the way in which in currently poor countries what constitutes an appropriate technology, or supplier of, tends to be influenced by how fine the new car of the licensing bureaucrat's mistress is either. Nor who paid for it. And a third objection would of course be: what on earth has it to do with the government what technology a private company installs?

But this is Chang's point of course: that it is indeed the government's business whether I use (in my current project) wet or dry gravitational separation and that there is indeed a bureaucrat or politician somewhere who knows the answer. I think not: and no doubt I am near blasphemous given that my basic project is to recreate a process that the Socialist Government of this country I live in closed down in 1952.

What Chang's insistence is missing, though, is that we only actually have one process that reveals to us whether a technology is appropriate or not: that is its interaction with the rest of the world through the free market. As before, we are uncertain about the future. We simply do not know what future conditions are going to be. The only method we have of dealing with that uncertainty is to try many things and see what does survive in the conditions that happen. This really does mean that we cannot centrally plan what we do, detail which technologies who should use from the Ministeriums, simply because that will not allow enough variety.

There is a possibility of redemption in this comment of Chang's:

> The story of GM teaches us some salutary lessons about the potential conflicts between corporate and national interests - what is good for a company, how important it may be, may not be good for the country.

This is most certainly true: but Chang then manages to get it entirely the wrong way around. Leave aside the now ritual complaint that we should not be talking about the country, or the nation, but the economy, which is a very different thing. Chang avers that government planning and co-management of those large firms like GM will help them to survive in the long term. Which is entirely true, large firms can indeed co-manage government to aid in ensuring the survival of them. The way they do this is by manipulating the desire of the politicians and the bureaucrats to regulate. The burden of regulation is much easier for a large firm to

carry than the same burden is for the small and snappy competitor chasing at its heels. Regulation thus becomes a wall keeping out that free market competition which whips up the gale behind capitalism's creative destruction.

This is really what is wrong with the idea of extensive regulation of industry. It is actually bad for the economy in and of itself as it protects the corporate dinosaurs who can manipulate it, at the expense of new competitors and the consumers.

Another way of putting it is this: even if all of those who implemented regulation were the omniscient philosopher kings that Chang assumes inhabit our ministries (rather than the bumblers who do), regulation is still bad for the economy as a whole over time. For regulation protects the incumbents. And the important thing we know about this capitalist and market system is that advances come not from incumbents developing but from their being replaced. It is market entrance and exit that drives the system, not the development of the current market players.

Thus a system of regulation such as Chang proposes, one that protects the incumbents at the expense of the newcomers is going to be bad for the economy in the longer term. Even, dare I say it, for the nation.

19. Central planning is useful to achieve economic growth

Our nineteenth thing of Chang's is that of course planning is lovely: so much so that the collapse of communism is not to be taken all that seriously. Yes, fine, so the central planning of the entire economy is not all that good an idea (although Chang, almost ludicrously, believes that it did work in the early days. Someone should point out to him that the 5-year plans reduced economic growth from the New Economic Policy days, to say nothing about losing 8 million Ukrainian peasants by happenstance along the way.) He thinks there is still a place for the very clever people in government to direct what everyone else thinks about making, buying and selling.

Even if that is not true, firms plan their activities, we have got plenty of firms, so we must have plenty of planning: and indeed we do have plenty of planning. The problem with this is that he is mixing and matching in a way that is not really viable. Firms do indeed plan: but their plans are then subject to examination through competition with the plans of all the other firms. This is what happens in the marketplace. Planning is thus preparatory to the test of whether the planning has worked. With government planning we do not then have that test: for governments do not then subject, or at least limit as much as they can, the exposure of their plans to the said market. You can see this quite clearly in the current argu-

ments about renewables and fracking for shale gas. The DECC has its plan, we will all shiver in the gloom of solar powered (in England!) lights so therefore no one must be allowed to drill for shale which would upset that plan.

I know they have said that it will be allowed to go ahead: but have you looked at the limits they have put on earthquakes? 0.5 on the Richter Scale was the last I saw: that is about the shock of the cat jumping off the bookcase next door*. A deliberate attempt to stifle an innovation that would ruin the government's plans. This is something that private sector companies are not able to do: which is why the results from private sector planning work out so much better. Someone else can indeed derail them, to the consumers' benefit, by having a different and better plan.

If you like, the market is where plans compete to see which is the best one. Government planning does not enter that competition so we never do find out quite how bad those government plans are. We just end up not quite as rich as we thought we were going to be or should be, or could have been.

Chang also talks about how governments plan much of the R&D these days: or at least pay for it and thus presumably have some sort of plan about what they are going to spend it on. He also notes that the Soviets were pretty good at the invention of spiffy things but this did not seem to feed though into making their consumers any better off. He should read his William Baumol to see the connection between these points.

Baumol defines invention as the, well, invention of new and spiffy things. He makes the point that the Soviets did do satellites first. Indeed, either sort of system, planned or market, seems to be about the same at invention as the other. However, innovation is the getting of interesting things stemming from those inventions into the hands of consumers in a shape and form they desire. This can be either to do things with or to develop further to do other things with. And there the planned system is appalling, and only market economies have ever really proven to be any good at all at it. The Soviets could make tanks all right, but hot water tanks were beyond them (quite literally, the Soviet housing system did not have them).

This is really very much the same point as the one above. Markets provide the test to see what an invention might be used for, and who is going to innovate with

it. Further, given that we are talking also about capitalism here, that part of the system provides the incentive to risk the money to find out about one or other innovation. Which is why innovation is indeed driven forward in capitalist and market-based societies and not in planned ones. Even if governments pay for much of the R&D, so what? That is not the important part of the system: innovation is, not invention.

This brings us back to hot water tanks. The Soviet system operated on district hot water heating plants. Hot water piped into the radiators and bathrooms of the whole urban area. From a planning point of view is looked quite efficient: but as it turned out it is not what the consumer actually wanted. As soon as the old system fell, one of the most popular additions to a Russian apartment was an individual hot water system: the type of tank that the Soviets, the planners, did not even know was wanted, rather than the ones they knew how to build but which the market sniffed out almost immediately it was allowed to.

That, in the end, is why planning is inferior to markets. Because planning will provide what the planners think the people want, or should want, or even what the planners think they should have. Markets allow the consumer to do the demanding of what they do want.

*Hyperbole alert. I have since been told that 0.5 on the Richter Scale is actually about equivalent to someone dropping a bowling ball from head height onto the lawn.

20. We should pursue equality of outcome, not just of opportunity

For our twentieth outing we are told by Chang that equality of opportunity is not enough: we must also have a deliberate and planned levelling of outcome in order to produce a truly just society. Chang manages to reach this position by confusing inequality with insufficiency: something not unknown over there on the left. Unfortunately, this is an incorrect conclusion, for the two things really are very different indeed.

It helps that Chang is agreeable to the idea that entirely equal rewards for very different efforts does not actually work. There has to be, unlike Maoist China, some connection between the work put in and the relative rewards taken out. This is true: but that is not quite right even there. For the truth is that we should not really be caring at all about the efforts that are being put in. We are not Puritans; we do not think that work for its own sake is good. Indeed, I myself am very much an Anti-Puritan in this sense. I care not a jot how much work someone puts in to make their money: they are going to receive some of mine according to the value that they produce for me. That is also how it should be on the macro scale, in the entire economy.

If, just as an example, Eddie Izzard finds it takes mere moments to think up a joke which has millions laughing for hours then good luck to him. It is not the effort put in that matters, it is the value he is created that does. This also applies, say, to the miner digging up tantalum to make our mobile phones. None of us gives a hoot whether it takes him 30 seconds or ten hours: the value is in the capacitors in the phones and that is what we are paying for.

That rewards should be commensurate with effort is a corollary of the fallacious labour theory of value. Rather than Adam Smith's much more correct theory of the value in consumption. With this correction we can move on. Now that we accept that it is the value produced for consumption by others which should determine income and reward, not the effort put into that production.

Where Chang does go wrong is in his insistence that true equality of opportunity is not enough. He uses the example of a poor black child in South Africa: if the schools are terrible, the teachers barely literate, in what sense can we say that he has equality of opportunity with his whiter and richer fellow countrymen? He does not, of course. Equality of opportunity would mean at least comparably good schools. Chang then compares this to the UK say, where a poor child will not have perhaps the same self-confidence as his richer contemporaries, nor the same luxuries in his home life. All this might well be true. Then comes the sleight of hand: this inequality of opportunity requires that parental incomes thus be equalized in some manner. Which is, one has to admit, an interesting use of the "it is all for the children" argument.

It is, however, an incorrect argument: equality of opportunity does not require equal incomes: it requires sufficient incomes. Sufficient to be clothed, fed, housed, warm and so on: certainly, it needs all of those. But making sure that everyone has a sufficient income for their children to be provided with these necessary things is very different from insisting that incomes must be more equal. It might be a valid argument for some redistribution even, to ensure those sufficient incomes, but not for more equality of incomes as a specific goal. Imagine, just as a made up number, that it requires £5,000 a year to provide a child with a sufficiency of these things. If all children have that amount available for their care, then we do have equality of opportunity in this education and life success sense: that other children have £40,000 a year lavished upon them does increase

inequality, but does not cause a reduction in opportunity.

That slide from having to reduce inequality to provide equality of opportunity just does not work. Given that we want reward to be tied to the value produced for others to consume, the evident and obvious truth that some do, with varying levels of effort, produce very much more value than others, means that we are just entirely happy with inequality of reward: as long as we do have that equality of opportunity.

21. Larger governments increase economic flexibility

The 21st thing Chang tells us is that a larger government actually makes economies more flexible: thus we should have larger governments in order to increase the necessary flexibility of the economy. If the first part were true then the second part might indeed follow: only it is not, at least not in the sense that Chang means it.

As part of his argument there is one thing that Chang does which is really very naughty indeed. He compares the growth rates of various European countries to that of the US. Furthermore, he divides the growth rates into two periods: early 1950s to late 70s, and late 70s to now (or what was now when he wrote a couple of years ago). He is right that the European economies, with their larger state sectors, grew more quickly than the US did in the earlier period. Hence comes his claim that larger government can mean more economic growth. There is, alas, just one thing missing from this calculation: the Wermacht. As the perceptive will have noticed the German Army did have something of a European tour in the years immediately preceeding the early 50s. The destruction of getting them to go home again was considerable: something which did not happen to the US at the time.

Just as we expect a developing country to have a higher growth rate than a developed one, given that copying is easier than being at the technological cutting

edge, so we also expect an economy recovering from a total war being fought on its territory to grow faster than one which is not. So while the growth rates are true we cannot use them as proof that larger governments will create more economic growth.

The real problem with Chang's position though is that he confuses two entirely different things. He talks about employment inflexibility: the way in which it is difficult to get fired and thus the workers all feel secure. He also talks about the existence of a decent welfare state: unemployment pay, health care, retraining opportunities and so on. The problem is that he sees these as being equal: both increase the security felt by the workers and thus increase their flexibility. Which is untrue: they work in very different ways indeed.

It is true that a decent welfare state does lead to greater flexibility in the economy. The workers (and everyone else in fact) will be less stuck in their ways if they know that a change in the economy does not mean destitution. But job security works entirely the other way around: those who are too secure in their jobs will not accept any change at all. This reduces the necessary flexibility of the economy.

The reason that this becomes important is because Chang points to the Nordics as evidence of his assertion that you can still have decent economic growth with a large government sector: indeed that it increases growth to have a large such sector. But the very success of the Nordics argues against all of the other strictures about free markets and capitalism that he wants us to understand and adopt. For it is true that they do have large and generous welfare benefits: the unemployment pay, the retraining and so on. They also have decent economic growth. But what they do not have is the sort of regulation, planning and government intervention into the economy that Chang proposes.

Look behind the tax numbers (necessary to pay for those benefits) in the economic freedom index and look instead at everything else. They have less regulation of markets than we do, greater economic freedom than even the US, less intervention into capitalism than just about anyone other than Hong Kong. Which is what makes the places work of course: as Scott Sumner is fond of pointing out, Denmark might well be the most classically liberal economy on the planet underneath that welfare state.

All of which seems rather amusing. It is true that the Nordics are nice places to

live, despite those crippling tax rates (almost all of which are tumbling down). It is indeed true that they have had very decent economic growth over the years and decades. It is entirely true that they have a lavish social insurance system. But those economies work precisely because they ignore, and do absolutely the opposite of, everything else that Chang proposes a government should do to an economy. They are more free market and capitalist than even the US: which is why they work. Indeed, it is probably true to say that the only way in which you can have a social safety net like they have is if you allow capitalism and markets to let rip: how else can you possibly afford to pay for it all?

22. Finance moves more swiftly than the “real” economy and should be slowed

Chang’s twenty-second thing is the rather alarming suggestion that finance must be made deliberately less efficient. This is a very odd indeed thing for an economist to say, for our first assumption, right at the very start of the subject, is that the needs and desires of human beings are larger than the ability to assuage them.

Thus increased efficiency is always desirable as it means we can assuage more desires with our limited stock of resources. Indeed, we usually go on to say that something that is in infinite supply, as compared to demand or desire for it, is not actually an economic good. So deliberately calling for less efficiency, not as a side effect of something else but as an aim in itself, is almost a form of anti-economics.

The claim is that finance now moves more swiftly than the “real” economy. Thus we must slow it down otherwise finance will move too quickly for the said real economy. There is no evidence proffered for this assertion: it is simply asserted. People can buy and sell shares quickly which means that the money to build factories, something that takes some time, is not around, seems to be one lunge at a back-up. This is a very strange argument indeed as we do not seem to have any shortage of factories. Nor is there a shortage of investment to build them if

someone comes up with a good idea. Indeed, the world seems to be awash with VC funds, and with FDI, with bond funds looking for a good home for their cash. Far from finance not funding that “real” economy it is amazingly easy to get cash to follow an idea through, probably easier than it has ever been. And there are plenty of people, Nobel Laureates among them, who insist that the recent troubles were all about a global savings glut.

There is one shortage, this is true. Banks (especially UK ones) are unwilling to lend into companies. But this complaint is really just a disguised misunderstanding. Banks simply are not the appropriate place to get risk capital from: public markets or private investors are. And there is no shortage of that sort of funding at all. SMEs are not all that fond of it, true, because gaining such finance means giving up equity. This is as it should be of course: if you want risk capital you have to share the upside as well as the downside. Other than that there simply is not a shortage of capital for companies: so the basic complaint seems invalid. Maybe finance is running faster than the real economy. Finance has certainly messed up memorably in recent years as well.

If that real economy does still get funded, as well as all the froth that is being complained about, then we cannot use the real economy not being funded as an excuse to do anything. It should also be noted too that much of the froth is actually the sharing of risk from those real world investments. The wheat futures market spreads the risks the farmer and the baker are taking: meaning that more funding can be offered as risk has indeed been spread. This continues out to even the most exotic markets. Sterling interest rate futures, as one example, mean that both borrowers and lenders can shift the risks of interest rate changes to speculators. This means that for the same amount of risk carried by lenders and borrowers, there can be more lending done. The froth does not detract from that real economy funding: it adds to the ability to increase the volume of it in reality.

One can hardly fail to be amused by one piece of evidence called in by Chang. He notes that the profitability of the finance sector has risen in recent decades. He uses this as the basis of a claim that obviously it should be pruned back. But profit, excess profit, as Adam Smith pointed out in not quite these words, is proof that you are adding value. So if profitability of finance has risen then this must mean that finance is adding more value. The idea that we want to stop people doing that is, again, almost anti-economics.

I suspect that the real basis of Chang's complaints about finance is that his attitude towards it is akin to a Victorian dowager's about "trade". We know that it goes on, is even necessary, but we most certainly would not want anyone we know to be associated with it.

23. We do not need economists to be able to run a decent economy

Chang's twenty-third thing is that we really do not need to have lots of bright economists around in order to be able to run a decent economy. This is most certainly true provided that the economy is still run along the right basic lines: which might be the part that we and Chang disagree about.

It is certainly true that all the time that markets, nothing but markets, does not quite work. A number of imperfections mean that we cannot just leave everything to voluntary action. We might point to natural monopolies as an example: someone, somewhere, has to stop them overcharging everyone. We do like the rule of law, which means we have to have government (sorry anarchists) and the taxes to pay for it (sorry everyone). There are more subtle problems out there: take externalities for example. By definition these are things that are not included in market prices and therefore are not considered in market transactions. We really cannot therefore conclude that markets will deal with externalities when the whole point is that markets ignore externalities.

So we are all happy with the idea that we cannot have an entirely and wholly pure market system. Nor would we want one that is entirely capitalist: most of us are

extremely happy about the idea that the Army is a State run organization. We tried private capitalism in this field, and the Wars of the Roses just do not have that good a reputation. Not from the peon and churl end of the telescope at least, which is where most of us would have been.

However, just because we cannot be purist about these things does not mean that therefore any intervention into the economy is just fine. This is what Chang is partly doing. Having shown that some intervention is demonstrably desirable he then goes on to conclude that the sort of intervention he desires has been demonstrated: which the previous 22 chapters might have dissuaded you of.

He is right on one thing, at least: we do not need vastly intelligent and highly educated economists running the place for us all to get gloriously rich. As Adam Smith himself said:

> Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice.

You will note there is nothing there about managing the exchange rate, regulating the bendiness of bananas nor even one word about the employment of economists.

So of what use actually is economics? If we do not need economists to run the country then what point in the entire intellectual exercise? As Ben Bernanke has observed:

> Having taken a stab at sociology and political science, let me wrap up economics while I am at it. Economics is a highly sophisticated field of thought that is superb at explaining to policymakers precisely why the choices they made in the past were wrong. About the future, not so much. However, careful economic analysis does have one important benefit, which is that it can help kill ideas that are completely logically inconsistent or wildly at variance with the data. This insight covers at least 90 percent of proposed economic policies.

If I am to be fair about economics there is very little in the corpus of knowledge that makes up the field that is really about making the world a better place. There

are plenty of attempts at such of course, and many more from people who would not know an econo if it came up and missed them. What there is out there are plenty of warnings about what not to do this because it will make the world worse. As PJ O'Rourke put it about the Soviet Union, shooting all the smart people and then killing off anyone trying to get rich does not great societal wealth make. We have a great deal of knowledge about things like that that we should not be doing. There are some areas where things have to be done: those natural monopolies, externalities and so on. They are, though, few and far between when you think of the vast possibilities of human behaviour.

The real point of economics is to struggle manfully with those very few things which must be done, shoot down in flames at least 90% of the things that are suggested we should do and then leave the rest of it, the vast majority of life, to people to do as they wish as long as they are not harming others or their right to do the same. This is the liberal idea of free people interacting voluntarily in a free market. Capitalism is just an offshoot of the rights to private property: and one of the lessons of the experiment that was the 20th century is that we do have the data about what happens when you try to do without that.

So, capitalism and free markets for all it is then. This, given that the last 30 years, as the two have spread through globalization, has seen the largest reduction in absolute poverty in the history of our entire species, is very probably a very good idea. After all, even if we do not need many economists or much economics to do it, the poor becoming rich is what we all want, is it not?