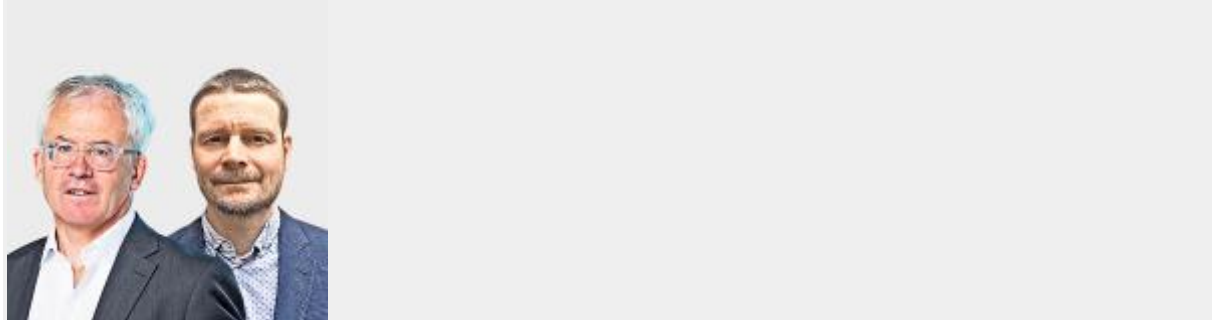


COMMENT

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The drift away from capitalism should be a cause for concern



One cheer for capitalism

David Miles and Tony Yates

Advocates of capitalism seem to keep a very low profile these days. In the UK this shows up in various ways: politicians on what used to be called the right seem rather embarrassed to advocate the merits of letting market forces guide the pattern of most economic activity; very many young people appear to think such forces are largely malign and generate unfairness rather than being an effective way of organising much economic activity. A 2016 Yougov poll found more support for socialism than for capitalism in the UK, and close to an equal split in the US and Germany. A 2016 survey conducted by Harvard University's Institute of Politics found that 51% of a sample of Americans aged between 18 and 29 did not support capitalism; just 42% did support it¹. Only amongst American respondents aged over 50 was there a majority that was in favour of capitalism.

The main opposition party in the UK is led by politicians who explicitly advocate large scale nationalisation of companies; they appear to be sceptical that there are benefits to having the allocation of resources guided by prices and they seem to think of profit as synonymous with exploitation. Their campaigning lives have been punctuated by expressions of uncritical support for socialist autocracies in South America and the former Communist bloc in Europe.

How has this happened? Does it matter?

First, how did it happen? To a significant extent this is an after-effect of the financial crash. That seems to have triggered a belief by many people that capitalism is inherently flawed. But what the financial crash revealed is that there were huge problems that were largely specific to banks and which then caused widespread harm outside the financial sector. Companies outside the financial sector were hit by problems that sat within banks – they were not the source of those problems. The problems were largely to do with massive leverage (a mountain of debt on a sliver of equity capital) in banks that had some unusually

¹ <http://iop.harvard.edu/youth-poll/past/harvard-iop-spring-2016-poll>.

risky assets. The answer to the problem – slowly being implemented – is for banks to use much more equity and less debt.

The other factor behind the surge in hostility towards private enterprise is the belief that the distribution of income and of wealth has become very much more unequal in recent decades. This seems to be accepted by a large proportion of people. But it is true neither at the global level nor in the UK. Careful analysis by the Institute for Fiscal Studies shows that income inequality [as measured by the gini coefficient] in the UK has been roughly flat for thirty years. The same is true for gini measures of wealth inequality in the UK. At the global level the fraction of the world population in absolute poverty has declined greatly over that same 30 years, mostly due to growth in China and India unleashed by the marketization of economic activity there.

Piketty's book – massively more bought than read – seemed to add theoretical respectability to the view that inequality will inexorably rise, an argument often deployed alongside the mistaken assertion that it has risen already. But its theories do not stand up to scrutiny, and its predictions are at odds with recent trends in the data; yet it has convinced many that capitalism must drive inequality higher.

In the UK in face of this widespread set of beliefs many politicians who might otherwise have seen great merit in private enterprise have either fallen silent or found it expedient to focus on its flaws. A potent example is the speed with which those pursuing the project of a hard Brexit, previously of the tribe most supportive of capitalism, have turned against senior voices in business and finance who have aired their concerns, invoking a conspiracy of 'crony capitalists' or 'elites' acting against the will of the people.

Does this really matter?

The optimistic view is that it is healthy that there should be scepticism about the benefits of laissez-faire capitalism and a recognition that the state should take on the role of correcting the many market outcomes that are undesirable. No one should think that free market outcomes are overwhelmingly efficient. Capitalism generates some bad outcomes and some very bad ones. That is why something beyond the night-watchman state is surely desirable. And where on the spectrum of mixed economy, welfare state models the UK should put itself, from the Thatcherite to the Scandinavian position, is rightly under continual review. On this optimistic view what is going on now is just a period of more intensive review.

But much of what we see today goes far beyond a recognition that the state needs to play a role in the economy and that some market outcomes are problematic. It is closer to a fundamental rejection of the role of markets and of the institution of private ownership of companies that create output.

It may be that what Churchill said of democracy is true of capitalism – the worst system for making most decisions except for all the other ones that have ever been tried. The record of what happens in countries when private enterprise is driven towards the fringes could hardly be clearer – it is a disaster.

E. M. Forster thought that democracy was worth two cheers. Surely capitalism is worth at least one. Right now it barely gets any. We should worry about that.

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