Summary 23 things they don't tell you about capitalism

Economics Governance & Business Ethics (Universiteit Utrecht)

Summary ''23 things they don't tell you about CAPITALISM''

Free-market policies had resulted in slower growth, rising inequality and heightened instability in most countries.

1. *There is no such thing as a free market*

The government is always involved. The free market is an illusion. If some markets look free, it is only because we so totally accept the regulations that are propping them up that they become visible. There are restrictions on trade, restrictions who can participate in markets, the stock market is under regulation, price regulations etc.

If wages and interest rate are politically determined, then all other price are politically determined, as they affect all other prices.

The debate about fair trade is essentially about moral values and political decisions, and not economics in the usual sense.

A lot of things that are outside the market today have been removed by political decision, rather than the market process itself. Economics is not a science but a political exercise.

When free-market economists say that a certain regulation should not be introduced because it would restrict the 'freedom' of a certain market, they are merely expressing a political opinion that they reject the right that are to be defended by the proposed law.

Breaking away from the illusion of market objectivity is the first step towards understanding capitalism.

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

Shareholders may be the owners of corporations but they often care least about the long-term future of the company.

Running the company for the shareholders often reduces its long-term growth potential.

Limited liability has made modern capitalism possible. Running companies in the interest of the shareholders does not even benefit the economy in average sense. The worst thing about shareholder value maximization is that it does not even do the company itself much good.

Despite being the legal owners of the company, shareholders are the ones who are least committed along the various stakeholders to the long term viability of the company. This is because they can exit the company most easily. It is more difficult for workers and suppliers, they have a greater stake.

Ease of exit is exactly what makes the shareholders unreliable guardians of a company's long term future.

Running companies in the interest of floating shareholders is not only inequitable but also inefficient, not just for the national economy but also for the company itself.

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

The wage gaps between rich and poor countries exist not mainly because of difference in individual productivity but mainly because of immigration control. Wages are politically determined. The high productivities of the rich, are only possible because of the historically inherited collective institutions on which they stand.

The example of immigration control reveals the sheer extent of market regulation that we have in supposedly free-market economics but fail to see. The speed and the scale of immigration need to be controlled.

Countries are poor not because of their poor people, but because of the rich people living in it. Poor people from poor countries are usually able to hold their own against their counterparts in rich countries. It is the rich from the poor countries who cannot do that.

It is their low relative productivity that makes their countries poor, so their usual diatribe that their countries are poor because of all those poor people is totally misplaced.

The rich of the poor countries should ask themselves why they cannot pull the rest of their countries up as much as the rich of the rich countries do.

Rich people in rich countries, they achieve this because they live in economies that have better technologies, better organized firms, better institutions and better physical infrastructure.

Countries who cannot be easily replaced by immigrants and thus may be said to be really being paid their worth, are as productive as they are only because of the socio-economic system they are operating in. It is not simply because of their individual brilliance and hard work that they are productive as they are.

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

We should not 'put the telescope backward' when we look into the past and underestimate the old and overestimate the new. This leads us to make all sorts of wrong decisions about national economic policy, corporate policies and our own careers.

The main reason why there are so much fewer domestic servants in the rich countries, is the higher relative price of labour.

With economic development, people (labour services they offer) become more expensive in relative terms than 'things'. As a result, in rich countries, domestic service has become a luxury good that only the rich can afford, whereas it is still cheap enough to be consumed even by lower-middleclass people in developing countries.

It is true, that without the washing machine (and other labour-saving household technologies), the scale of change in the role of women in society and in family dynamics would not have been nearly as dramatic.

Taken internet, when it comes to production processes, it is not clear whether the impacts have been so revolutionary, it had not much impact on productivity.

We vastly overestimate the impacts of the internet only because it is affecting us now. Human beings tend to be fascinated by the newest and the most visible technologies.

The distorted perspectives have real impacts, as they result in misguided use of scarce resources.

Technological forces have shaped economic and social developments under capitalism are much more complex than is usually believed.

5. *Assume the worst about people and you get the worst*

Self-interest is a most powerful trait in most human beings. However it is not our only drive. It is very often not even our primary motivation.

We need to design an economic system that while acknowledging that people are often selfish, exploits other human motives to the full and gets the best out of people.

Free-market economists, public officials, politicians and government bureaucrats, their pursuit of self-interest cannot be restrained to any meaningful degree because they are not subject to market discipline.

Other motives are often ignored such as: honesty, self-respect, altruism, love, sympathy and faith.

Successful companies are run on trust and loyalty rather than suspicion and self-seeking.

Good managers know that people are not tunnel-visioned self-seeking robots. They know people have 'good' sides and 'bad' sides and that the secret of good management is in magnifying the former and toning down the latter.

If everyone were really out to advance his own interest, the world would have already ground to a halt, as there would be so much cheating in trading and slacking in production. More importantly, if design our economic system based on such an assumption, the result is likely to be lower, rather than higher, efficiency. If we did that, people would feel that they are not trusted as moral agents and refuse to act in moral ways, making it necessary for us to spend a huge amount of resources monitoring, judging and punishing people. If we assume the worst about people, we will get the worst out of them.

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

Inflation may have been tamed, but the world economy has become considerably shakier. Hyperinflation undermines the very basis of capitalism by turning marketing prices into meaningless noises.

Free market economists suggest that inflation is bad.

There is evidence that excessive anti-inflationary policies can actually be harmful for the economy. It is because the policies that are aimed to reduce inflation actually reduce investment and thus economic growth, if taken too far.

Anti-inflationary policies have not only harmed investment and growth, but they have failed to achieve their supposed aim enhancing economic stability.

The fact is that the world has become more stable only if we regard low inflation as the sole indicator of economic stability.

The coexistence of price stability (low inflation) and the increase in non-price forms of economic instability, such as more frequent banking crises and greater job insecurity, is not a coincidence.

Attempts to bring inflation down to very low levels have reduced investment and growth, contrary to the claim that the greater economic stability that lower inflation brings will encourage investment and thus growth. More importantly, lower inflation has not even brought genuine economic stability to most of us. Liberalizations of capital and labour markets that form integral parts of the free-market policy package, of which inflation control is a key element, have increased financial instability and job insecurity, making the world more unstable for most of us.

Inflation has become the bogeyman that has been used to justify policies that have mainly benefited the holders of financial assets, at the cost of long-term stability, economic growth and human happiness.

7. *Free-market policies rarely make poor countries rich*

The performance of developing countries in the period of state-led development was superior to what they have achieved during the subsequent period of market-oriented reform.

All of today's rich countries have become rich through the combinations of protectionism, subsidies and other policies (to promote their infant industries) that today they advise the developing countries not to adopt.

Developing countries need to protect and nurture their produces before they acquire the capabilities to compete in the world market unassisted.

They government needs to regulate the market more actively and sometimes even deliberately create some markets.

The free-trade, free-market policies are policies that have rarely, if ever, worked. Most of the rich countries did not use such policies when they were developing countries themselves, while these policies have slowed down growth and increased income inequality in the developing countries in the last three decades. Few countries have become rich through free-trade, free-market policies and few ever will.

8. Capital has a nationality

Despite the increasing 'trans nationalization' of capital, most transnational companies in fact remain national companies with internal operations, rather than genuinely nation-less companies. Their core activities will stay at home.

The home country appropriates the bulk of the benefits from a transnational corporation.

A business will do what it has to do in order to increase its profit, even if it means hurting its home country by shutting plants down, slashing jobs, or even bringing in foreign workers.

There is no such thing as nationless' capital.

Few companies are truly transnational. The vast majority of them still produce the bulk of their outputs in their home countries. Especially in terms of high grade activities they remain firmly centred at their home countries.

There are good reasons why companies act with home-country biases. 1. Top business managers feel some personal obligations to the society they come from. 2. Real historical obligations to the country in which it has 'grown up'.

These competences are usually embodied in people, organizations and networks of related firms, all of which cannot be easily transported to another country. They often need to have the right institutional environment in order to function well.

The most sophisticated activities that require high levels of human and organizational competences and a conducive institutional environment tend to stay home. Home biases are not only emotional or historical, but economical.

Especially for a developing country, whose national firms are still underdeveloped, it may be better to restrict FDI at least in some industries and try to raise national firms so that they become credible investors to foreign companies.

The fact that the acquiring firm operates in a particular industry, is not a guarantee of a long-term commitment to that industry.

Despite the globalization rhetoric, the nationality of a firm is still a key to deciding where its high-grade activities, such as R&D and strategizing, are going to be located. Nationality is not the only determinant of firm behaviour, so we need to take into account other factors, such as whether the investor has a track record in the industry concerned and how strong its long-term commitment to the acquired company really is.

9. *We do not live in a post-industrial age*

We may be living in a post-industrial society in the sense that most of us work in shops and offices rather than in factories. But we have not entered a post-industrial stage of development in the sense that industry has become unimportant.

Services have replaced manufacturing as the engine of growth, manufacturing is now a low-grade activity that developing countries such as China perform.

They have not become post-industrial in the economic sense. Manufacturing still plays the leading role in their economies. The real demand effect – that is the effect after taking relative price changes into account- is small.

The fall in the share of manufacturing in total output in the rich countries is not

Largely due to the fall in (relative) demand for manufactured goods, as many people think. Nor is it due mainly to the rise of manufactured exports from China and other developing countries. It is instead the falling relative prices of the manufactured goods due to faster growth in productivity in the manufacturing sector, that is the main driver of the de-industrialization process. Post-industrial employment, but not production.

Countries should not be lulled into a false sense of security by the fact that de-industrialization is due to comparative dynamism of the manufacturing sector, as even a manufacturing sector that is very un-dynamic by international standards can be more dynamic than the service sector of the same country. Knowledge based services are highly tradable. The manufacturing sector has an inherently faster productivity growth than the service sector.

Services are much less tradable, countries specializing in service are likely to face much more serious balance of payments problems than countries that specialize in manufacturing.

As for the developing countries, it is a fantasy to think that they can skip industrialization and build prosperity on the basis of service industries. Most services have slow productivity growth and most of those services that have high productivity growth are services that cannot be developed without a strong manufacturing sector. Low tradability of services means that a developing country specializing in services will face a bigger balance of payments problem, which for a developing country means a reduction in its ability to upgrade its economy.

11. Africa is not destined for underdevelopment

These structural conditions seem to act as impediments to development in Africa only because its countries do not yet have the necessary technologies, institutions and organizational skills to deal with their adverse consequences.

The real cause of African stagnation in the last three decades is free-market policies that the continent has been compelled to implement during the period. The lack of growth in Africa has not been chronic.

If the structural factors were so crucial, African economic growth should gave accelerated over time.

By suddenly exposing immature producers to international competition, these policies led to the collapse of what little industrial sectors these countries had managed to build up during the 60s and 70s.

The fact that all those structural handicaps are not insurmountable is proven by the fact that most of today’s rich countries have developing despite suffering from similar handicaps.

Rich countries do not suffer from ethnic heterogeneity not because they do not have it, but because they have succeeded in nation building.

What appear to be unalterable structural impediments to economic development in Africa are usually things that can be, and have been, overcome with better technologies, superior organizational skills and improved political institutions.

The main reason for Africa’s recent growth failure lies in policy namely, the free-trade, free-market policy that has been imposed on the continent through the SAP.

12. Government can pick winners

Governments can pick winners, sometimes spectacularly well. The government picking winners against market signals can improve national economic performance, especially if it is done in close (not too) collaboration with the private sector.

The ‘theory’ tells us that capitalism works best when people are allowed to take care of their own businesses without any government interference. They say: ’Government decision makers are driven by the desire to maximize power, rather than profit’.

Sometimes being too close to the situation can actually make it more, rather than less, difficult to see the situation objectively.

Even though businessmen may generally know their own affairs better than government officials and therefore be able to make decisions that best serve their companies interests, there is no guarantee that their decisions are going to be good for the national economy.

The government picking winners may hurt some business interests but it may produce a better outcome from a social point of view.

If we remain blinded by the free-market ideology that tells us only winner picking by the private sector can succeed, we will end up ignoring a huge range of possibilities for economic development through public leadership or public-private joint efforts.

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

The rich got the bigger slice of the pie all right, but they have actually reduced the pace at which the pie is growing.

We need the electric pump of the welfare state to make the water at the top trickle down in any significant quantity. There is no good reason to presume that upward income redistribution will accelerate investment and growth.

If giving more to the rich is going to benefit the rest of the society, the rich have to be made to deliver higher investment and thus higher growth through policy measures and then share the fruits of such growth through a mechanism such as the welfare state.

14. US managers are over-priced

US managers are over-priced in more than one sense. 1. Compared to their predecessors. 2. Compared to their counterparts in other rich countries. Also overly protected. The managerial class in the US has gained such economic, political and ideological power that is has been able to manipulate the forces that determine its pay.

It is an illusion to think that executive pay is something whose optimal levels and structures are going to be, and should be, determined by the market.

15. We are not smart enough to leave things to the market

People do not necessarily know what they are doing, this is because of bounded rationality.

We need to deliberately restrict our freedom of choice in order to reduce the complexity of problems we have to face.

Government regulations works, especially in complex areas like the modern financial market, not because the government has superior knowledge, but because it restricts choices and thus the complexity of the problems at hand, thereby reducing the possibility that things may go wrong.

When the Nobel Prize-winners in financial economics, top bankers, high-flying fund managers, prestigious colleges and the smartest celebrities have shown that they do not understand what they are doing, how can we accept economic theories that work only because they assume that people are fully rational. We need regulation exactly because we are not smart enough.

Simon's theory shows that many regulations work not because the government necessarily knows better than the regulated, but because they limit the complexity of the activities, which enables the regulated to make better decisions.

So many complex financial instruments were created that even financial experts themselves did not fully understand them, unless they specialized in them (and sometimes not even then).

Financial instruments need to be banned unless we fully understand their workings and their effects on the rest of the financial sector, and moreover, the rest of the economy.

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

There is remarkably little evidence showing that more education leads to greater national prosperity and higher economic growth. Much of the knowledge gained in education is actually not relevant for productivity enhancement, even though it enables people to lead a more fulfilling and independent life.

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.

The east Asian economies did not have unusually high educational achievement at the start of their economic miracles. Mechanization is the most important way to increase productivity.

Swiss paradox – Low higher education, high economic growth

Education is valuable, but its main value is not in raising productivity.

Our overenthusiasm with education should be tamed, and, especially in developing countries, far greater attention needs to be paid to the issue of establishing and upgrading productive enterprises and institutions that support them.

18. What is good for GM is not necessarily good for the US

Despite the importance of the corporate sector, allowing firms the maximum degree of freedom may not even be good for the firms themselves, let alone the national economy.

Sometimes, it is in the long-run interest of the business sector to restrict the freedom of individual firms so that they do not destroy the common pool of resources that all of them need, such as natural resources or the labour force.

Regulations can also help businesses by making them do things that may be costly to them individually in the short run but raise their collective productivity in the long run. What matters is the quality of business regulation.

In the last four decades, GM has tried everything to halt its decline except making better cars, because trying to make better cars itself was, well, too much trouble.

Sometimes regulations help business by limiting the ability of forms to engage in activities that bring them greater profits in the short run, but ultimately destroy the common resources that all business firms need.

Sometimes, regulations can help businesses by forcing firms to do things that may not be in their individual interest but raise their collective productivity in the long run.

Many regulations help preserve the common-pool resources that all firms share, while others help business by making firms do things that raise their collective productivity in the long run.

What matters is not the absolute amount of regulation, but the aims and contents of those regulations.

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

Capitalist economies are in large part planned governments in capitalist economies practise planning too, albeit on a more limited basis than under communist central planning. It's about planning the right tings at the right levels.

Central planning (in communism) became difficult due to the complexity.

European and East Asian examples show that planning in certain forms is not incompatible with capitalism and may even promote capitalist development very well.

It is what the appropriate levels and forms of planning are for different activities. The prejudice against planning, while understandable given the failures of communist central planning, makes us misunderstand the true nature of the modern economy in which government policy, corporate planning and market relationships are all vital and interact in a complex way.

20. Equality of opportunity may not be fair

Equality of opportunity is the starting point for a fair society, but it's not enough. Unless there is some equality of outcome, equal opportunities are not truly meaningful. Equality of opportunity is something to be highly cherished.

It is tempting to argue that, once you ensure equality of opportunity, free from any formal discrimination other than according to merit, the market will eliminate any residual prejudices through the competitive mechanism. This is only the start, a lot more has to be done to build a genuinely fair society.

A certain degree of equalization of outcomes is necessary, if we are to build a genuinely fair society. In order to benefit from the equal opportunities provided to them, people require the capabilities to make use of them.

Equality of opportunity is meaningless for those who do not have the capabilities to take advantage of it. There has to be some minimum equality of outcome in terms of parental income, if poor children are to have anything approaching a fair chance.

A more equitable approach would have been to help the displaced workers find a new career through decent unemployment benefits, health insurance even when out of a job, retraining schemes and help with job searches.

Excessive equalization of outcomes is harmful. Nevertheless, equality of opportunity is not enough, unless we create an environment where everyone is guaranteed some minimum capabilities through some guarantee of minimum income, education and health care, we cannot say we have fair competition.

Equality of opportunity is absolutely necessary but not sufficient in building a genuinely fair and efficient society.

21. Big government makes people more open to change

A well-designed welfare state can actually encourage people to take chances with their jobs and be more, not less, open to changes.

Greater insecurity may make people work harder, but it makes them work hard in the wrong jobs.

When people know they will have a second chance, they will be much more open to risk-taking when it comes to choosing their first job or letting go of their existing jobs.

A large welfare state is not incompatible with high growth.

However if welfare state is well designed, with a view to giving workers a second chance, it can encourage economic growth by making people more open to changes and thus making industrial restructuring easier.

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

The problem with financial markets today is that they are too efficient. It has become more efficient in generating profits for itself in the short run.

The speed gap between the financial sector and the real sector needs to be reduced, which means that the financial market needs to be deliberately made less efficient.

What makes financial capital necessary for economic development but potentially counterproductive or even destructive is the fact that it is much more liquid than industrial capital.

Exactly because finance is efficient at responding to changing profit opportunities, it can become harmful for the rest of the economy.

We need to rewrite our financial system so that it allows firms to make those long term investments in physical capital, human skills and organizations that are ultimately the source of economic development, while supplying them with the necessary liquidity.

23. Good economic policy does not require good economists

Good economists are not required to run good economic policies. The economic bureaucrats that have been most successful are usually not economists.

Conclusion

Free-market economics has led to lower economic growth, greater economic instability, increased inequality and finally culminating the financial crisis.

8 principles

1. Capitalism is the worst economic system except for all others.
2. We should build our new economic system on the recognition that human rationality is severely limited.
3. We should build a system that brings out the best, rather than the worst, in people.
4. We should stop believing that people are always paid what they deserve.
5. We need to take ‘making things’ more seriously.
6. We need to strike a better balance between finance and ‘real’ activities.
7. Government needs to become bigger and more active.
8. The world economic system needs to unfairly favour developing countries.

The last chapter of the book, the conclusion, is a good read for an overall overview of all the 23 chapters in the book!