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23 Things We're Telling You About Capitalism XII [1]

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Our twelfth thing about capitalism that we're not told is a masterpiece of straw manning. We're 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. QED, the free marketeers are wrong.

But that isn't actually our argument: we don't insist that government, or planning, can never produce a winner. Only that it's 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 got overturned along with the head of state, the roads were unused and the steel mills, as I've already mentioned, were built with gay abandon and then left to rot.

Chang's response to this is that South Korea managed it though! POSCO was set up as a state planned and run, financed, company and it has ended up as a thriving steel company. Even though S. Korea didn't 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.

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 blokes generally don't end up with good looking women by observing the beauty of Simon Cowell's latest squeeze. We could refute ugly men never by such an observation, but not generally. So it is with our observation that governments are generally bad at picking winners, generally make bad investment decisions, is not refuted by the observation that one government, once, managed to invest in a decent enough steel company.

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

The second is that the power to direct the economy as S. Korea did in the time Chang is talking about isn't something that's available in a free society. You'll note that I've mentioned this before but it's 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. But I do rather think we'd all agree, being the good little liberals that we are, that whatever the economic results of such plans we'd rather not have a General as dictator with the power to insist upon such things. As indeed we don't and as I've been pointing out, as a result we would get planning driven by democratic concerns, something very different.

The third argument is that Chang is entirely ignoring opportunity costs here. Which is astounding in 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 there's no free lunch). The actual argument is not whether government can decree that a steel mill, or a shipyard, gets built. Nor even whether such projects will make a return on their investment, survive into the future. It is rather whether that money and investment would have produced better returns if employed in another manner? What could S. 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's talking about it's not really economics. For as I say, opportunity cost is 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's 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 realisation that the government plans hadn't 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'd still like to have the Games. Or even to stick them in Athens, which already had all the stadia 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. Whereas the free market sector does indeed look at error, agree that it's an error, and closes it down.

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

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