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

Written by **Tim Worstall** [2] | Thursday 6 June 2013

Our 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, as compared to demand or desire for it, supply is not actually an economic good. So deliberately calling for less efficiency, no, 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 be, erm, moving too quickly for said real economy. There's 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, isn't around seems to be one lunge at a back up. Which is a very strange argument indeed as we don't seem to have any shortage of factories. Nor of investment to build them if someone comes up with a good idea. Indeed, the world seems to be awash with VC funds, with FDI, with bond funds looking for a good home for their cash. Far from finance not funding that "real" economy it's amazingly easy to get cash to follow an idea through, easier than it has ever been I would wager. 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) being unwilling to lend into companies. But this complaint is really just a disguised misunderstanding. Banks simply aren't the appropriate place to get risk capital from: public markets or private investors are. And as I say, there's no shortage of that sort of funding at all. SMEs aren't all that fond of it, true, because gaining such finance means giving up equity. Which is as it should be of course: you want risk capital you've got to share the upside as well as the downside.

Other than that there simply isn't a shortage of capital for companies: so the basic complaint seems invalid. Maybe finance is running faster than the real economy. Finance has certainly screwed up memorably in recent years as well. But if that real economy does still get funded, as well as all the froth that's being complained about, then we can't use the real economy not being funded as an excuse to do anything. And it should be noted too that a lot 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. Thus meaning that for the same amount of risk carried by lenders and borrowers there can be more lending done. The froth doesn't detract from that real economy funding: it adds to the ability to increase the volume of it in reality.

And I must say that I was most 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 that must mean that finance is adding more value. And 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 Victoiran dowager's about "trade". We know that it goes on, is even necessary, but we most certainly wouldn't want anyone we know to be associated with it.

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