

# **FAT TAXES: A WAIST OF TIME?**

From the **Institute of Economic Affairs**

## **PAYDAY MOANS: PROBING THE GENDER PAY GAP**

A woman with dark, curly hair is sticking her tongue out in a playful or defiant expression. She is wearing a grey sleeveless top and a black choker. She is holding a black sign with white text that reads "BAD BEHAVIOUR?".

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In this issue of **EA**, **Razeen Sally** assesses the **implications of the Brexit vote**. Can the UK look forward to **a future of free trade and much-reduced regulation**? Or will the decision to **leave the EU be disastrous**? Discover his thoughts on **page 56**.

Also in this edition, we explore **capitalism and the environment**. Some say the two can never go hand in hand. But on **page 25** **Christopher** and **Rachel Coyne** contend that **capitalism has created enormous environmental benefits** right around the world.

Our cover story takes a controversial stance on **Behavioural Economics**. Writer **Daniel Ben-Ami** says it's **the result of flawed thinking** – with **dangerous implications for individual freedom**. Find out more on **page 4**.

And on **page 22**, we have a tale of two Smiths and a tale of **two economics giants** – as **Nobel Prize winner Vernon L. Smith** pays tribute to the works of the **legendary Adam Smith**

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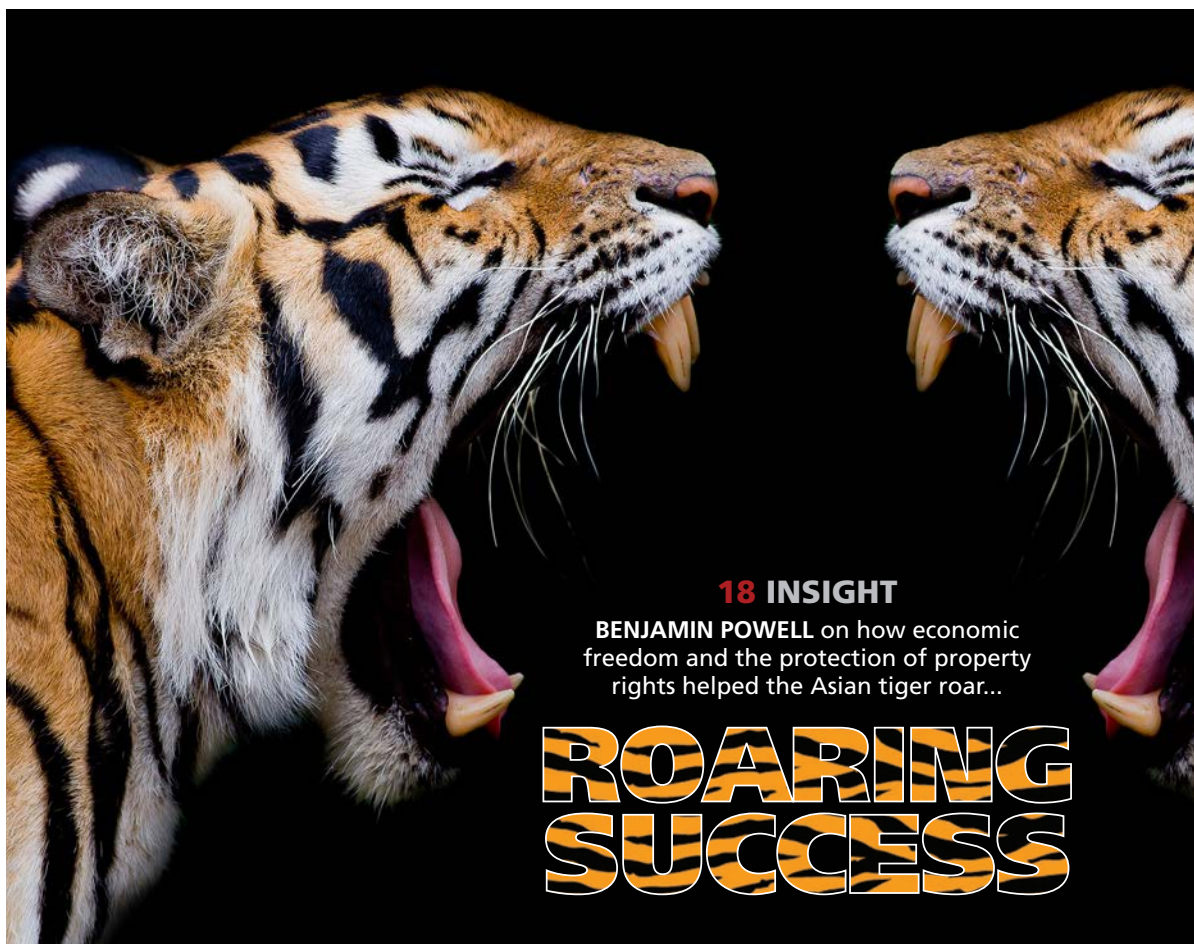


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A woman with a large, curly afro hairstyle is sticking her tongue out. She is wearing a grey sleeveless top and a black choker with silver studs. She is holding a black sign with white and red text.

# **BAD BEHAVIOUR?**

Behavioural economics is  
one of the latest fashions.  
But is it subject to "irrational  
exuberance", asks  
**DANIEL BEN-AMI**

**A**nyone who has what might be called an instinct for freedom is likely to baulk at being dictated to by experts.

A fundamental liberal principle is that individuals should have the autonomy to make their own decisions about how to run their own lives.

This insight goes back at least to the eighteenth century. Immanuel Kant, one of the greatest German philosophers, spelt it out in 1784 in an essay entitled *Was ist Aufklärung?* (What is Enlightenment?): "If I have a book that thinks for me, a pastor who acts as my conscience, a physician who prescribes my diet, and so on - then I have no need to exert myself. I have no need to think, if only I can pay; others will take care of that disagreeable business for me."

Overall the passage sounds strikingly contemporary. In the early twenty-first century we are plagued with self-proclaimed experts telling us how to do everything from eating healthily to parenting. The main difference with Kant's day is that we do not have to pay for guidance from above, or at least not directly. We are bombarded with unsolicited advice.

However, there is a key clause in Kant's comment that it is easy to miss. His argument hinges on the assumption that individuals are capable of thinking for themselves.

But what if that premise is false? What if ordinary people, those who are not experts, are incapable of thinking rationally?

That is the starting point for the edifice of the burgeoning field of behavioural economics.

Many of its proponents, such as Dan Ariely of Duke University, state bluntly that they view humans as irrational. The more sophisticated ones, such as Daniel Kahneman, a Nobel laureate at Princeton, talk more guardedly of 'bounded rationality'. Either way the assumption is that the human thinking process is fundamentally flawed.

One way this argument is sometimes expressed is the claim that humans are more like Homer Simpson than Mr Spock. Most people, in this view, are essentially idiotic and ignorant rather than logical calculating machines as epitomised by the Star Trek character.

Whatever metaphor is used it should be clear that if the claim of irrationality is true it undermines one of the foundations of mainstream economics.

From a behavioural perspective it is wrong to

view consumers as primarily driven by rational considerations. From this premise it is a short step to explain financial crises and economic downturns as essentially bouts of irrationality. The conclusion normally drawn is that experts should play a central role in directing economic activity.

It is important to recognise that such claims should not be rejected simply because they lead to objectionable conclusions. If the assumption of irrationality is true then, whether we like it or not, it should be accepted. The key question is whether it is indeed correct. There are at least three reasons to question it.

First, the claim of irrationality is often based on a caricature of orthodox economics. Even the most ardent mainstream economists do not generally claim that humans always act as perfect robotic calculators. People do not systematically



**ONE WAY THIS ARGUMENT IS SOMETIMES EXPRESSED IS THE CLAIM THAT HUMANS ARE MORE LIKE HOMER SIMPSON THAN MR SPOCK**

weigh up the costs and benefits of every minute decision they ever make.

In reality, the mainstream claim is that an assumption of a broad rationality should be the starting point for building a model of how the economy works. It does not preclude people from ever feeling emotions, making mistakes or miscalculating on the spur of the moment. Moreover, outside the economic sphere, say in relation to love or family life, people often make decisions on grounds other than economic rationality.

It is also common for behaviouralists to assert irrationality rather than to prove it.

For example, in a BBC Horizon documentary Daniel Kahneman, the Nobel laureate, gave the working habits of New York taxi drivers as an example of irrational behaviour.

His claim was that everyone wants taxis on rainy days but on sunny days fares are hard to find. So, he argued, taxi drivers should logically spend lots of time driving on rainy days when it is easy to find passengers. Sunny days, when there are fewer passengers around, are the best time for drivers to take time off.

But in reality many drivers do the opposite.

They work long hours on slow sunny days while knocking off early when it is rainy and busy. Rather than thinking about how best to maximise their income they simply aim to earn a set amount every day. Once they hit their target they go home.

Anyone who takes the trouble to talk to taxi drivers or even to think about the question will realise things are not so simple.

Some drivers say that, contrary to Kahneman's claim, there can be fewer people around when it is raining. For example, a potential passenger who

In addition, it is wrong to see economies as mere collections of individual consumers. Modern economies are complex entities with large numbers of producers as well as consumers.

Understanding weaknesses on the productive side of the economy involves examining such factors as low levels of business investment and profitability. The difficulties economies face demand careful examination rather than assertions that they are manifestations of market madness.

Indeed it is a rich irony that it is often experts, who in many cases are sympathetic to behavioural economics, who have exacerbated economic problems.

For instance, there is a reasonable case that some central banks contributed to the 2008-9 financial crisis by pursuing an overly loose monetary policy beforehand. Low interest rates contributed to the creation of

the financial bubble before the market crash. And, this leads to a fundamental issue.

Those who use behavioural economics often suggest that it implies a greater role for regulators or the state to "nudge" us in the right direction. But, are not regulators subject to behavioural biases too? Perhaps, for example, they systematically over-estimate their ability to perfect markets.

Behavioural economics should be seen as part

## THE CLAIM OF IRRATIONALITY IS OFTEN BASED ON A CARICATURE OF ORTHODOX ECONOMICS

is thinking of going out for a meal might decide to eat at home instead if the weather is wet. Other drivers claim that passengers tend to want to go on less lucrative shorter journeys, rather than long trips, when it is raining.

It is also likely that many drivers have set expenses to pay, whether it is for food or housing, every week. To be sure of meeting their commitments they may need to drive whatever the weather. On a sunny day they may decide they cannot afford to risk waiting for more lucrative rainy days to come along. The weather itself is uncertain.

In such cases there is probably no perfect solution which is right in all circumstances. It is likely the correct answer will vary according to particular local conditions and individual needs.

The key point is that it is wrong to simply assume that taxi drivers who work long hours in sunny weather are behaving irrationally. They may have rational reasons for driving when they do. Indeed they are likely to know a great deal more about how they run their own lives than even the most eminent professor.

Finally, the claim that economic downturns can simply be explained as bouts of irrational behaviour is crass. Such arguments tend to be based on simplistic assumptions. Often financial turmoil is treated as more-or-less synonymous with trouble in the real economy when the relationship between the two is complex.



## MODERN ECONOMIES ARE COMPLEX ENTITIES WITH LARGE NUMBERS OF PRODUCERS AS WELL AS CONSUMERS

of a broader assault on reason that goes back to at least the nineteenth century.

It attacks the primary liberal value of individual freedom on the spurious grounds that people are incapable of thinking clearly for themselves. On this basis it opens the way for both illiberal policy conclusions and flawed economics•

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# BOOMS, BUSTS & STAGNATION



Some analysts claim a phenomenon called 'secular stagnation' is responsible for the disappointing post-crisis economic performance. In other words, there are long-run forces to do with trends in saving and investment that will keep growth low. This article argues that the economy is still struggling as a result of the boom that preceded the financial crisis

CLAUDIO BORIO, ENISSE KHARROUBI, CHRISTIAN UPPER  
and FABRIZIO ZAMPOLLI

Productivity has been puzzlingly weak in the wake of the Great Financial Crisis.

This is especially so in the UK, where productivity growth since the financial crisis has been close to zero.

This has heightened concerns about secular stagnation – the view that a structural deficiency of demand has been haunting the world and crippling its productive capacity as persistent unemployment erodes workers' skills and investment slumps (Summers 2014, Teulings and Baldwin 2014).

Those who hold this view typically also argue that the financial booms – unsustainable increases in credit and property prices – that preceded the crisis were the price to pay for keeping resources fully employed.

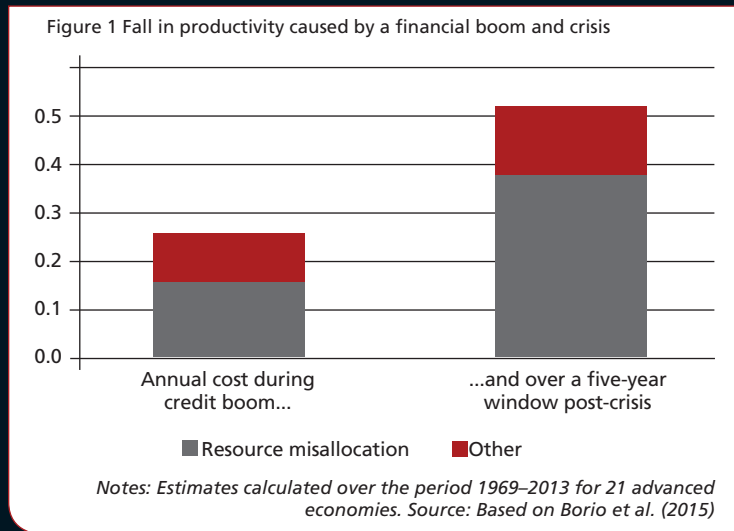
In other words, the trends in saving and investment were such that, without the credit boom, the economy would have under-performed earlier. However, once the boom turned to bust, the hidden demand deficiency re-emerged with a vengeance.

We are still suffering from the pre-crisis boom.

This narrative has some merit and has gained currency. And it is of course well known that the financial busts that follow booms weaken demand for quite some time. However, there is also another explanation.

The boom of the early 2000s might have distorted demand and had an impact on the allocation of resources in the economy.

In other words, because of the boom, and the associated credit expansion, firms made investments and took other decisions that would not be



sustainable in the long term.

This distorted the structure of the economy. The protracted post-crisis weakness therefore may reflect in no small measure the difficulties of correcting the resource misallocations that accumulated during the previous financial boom and which became apparent once a financial crisis subsequently broke out.

This is indeed what we conclude by examining the experience of 21 advanced economies over the last 40 years (Borio et al. 2015).

The hitherto unsuspected villain in this story is the misallocation of resources during the credit boom which had long-lasting effects.

The findings support the view that the disappointing developments we have been witnessing may be the result of a major financial boom and bust that has left long-lasting scars on the economic tissue (e.g. Bank for International Settlements 2014, Borio 2014, Borio and Disyatat 2014, Rogoff 2015) rather than the reflection of a structural, deep-seated weakness in aggregate demand.

Figure 1 summarises our key findings. It shows the loss of productivity per year of an assumed five-year credit boom followed by a financial crisis and then in the five years following the crisis.

There are a number of causes of the productivity slump. Slightly more than two thirds of the fall reflects the shift of labour to lower productivity growth sectors. Shifts of labour into a temporarily bloated construction sector play a key role.

For example, a credit boom is typically associated with low interest rates and a boom in construction and the building of houses, offices, retail outlets and so on that are not viable in the long term – the precise effects are different in different boom and bust episodes.

The subsequent impact of this labour misallocation is much larger if a financial crisis follows the boom. Thus, if there is a boom followed by a crisis, it casts a long shadow.

Think, for instance, of the painful rebalancing in the structure of production that Spain had to go through

following the pre-crisis boom.

If we take a ten-year episode made up of a pre-crisis boom, a financial crisis and then five years following the crisis, the cumulative impact amounts to a loss of productivity of some 4 percentage points.

## What can policymakers do in the bust?

The work that we have done on this problem attempts to measure the magnitude of the productivity loss following a crisis. We do not test a formal model that explains the mechanism by which the productivity loss takes place. However, possible mechanisms come to mind.

During credit booms, the expansion of credit affects different sectors differently. During busts, especially if there is a financial crisis, there tends to be a scarcity of credit and there is a need to reverse the misallocation of resources that happened in the boom.

Some sectors find it difficult to get credit to expand while others may get too much of the smaller pie, so that there is further misallocation of resources. However, the mechanisms

deserve deeper scrutiny.

This analysis also raises broader questions.

When considering the macroeconomic implications of financial booms and busts, it is important to go beyond the well-known and very real aggregate demand effects and to examine also what happens to the supply side of the economy.

The booms and busts damage the supply side of the economy by encouraging the misallocation of resources. Furthermore, 'supply side' policies are important to enable the misallocation of resources to be reversed.

The analysis also helps our understanding of the effect of monetary policy. Sometimes, monetary policy is thought of as being 'neutral' as far as the economy is concerned over the long run.

In other words, a lax monetary policy may create inflation but, in the long run, it will not affect aggregate supply and output. However, this work shows that, if loose monetary policy contributes to credit booms, then these booms have long-lasting, if not permanent, effects on output and productivity.

Furthermore, especially in the context of the current debate, it is worth noting that monetary policy may not be particularly effective in addressing financial busts.

This is not just because its force is dampened by debt overhangs and a broken banking system. It may also be because loose monetary policy is a blunt tool to correct the resource misallocations that developed during the previous expansion, as it was a factor contributing to them in the first place.

We therefore cannot expect low interest rates and quantitative easing alone to solve the problems caused by the financial crisis.

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<http://www.voxeu.org/article/financial-cycles-labour-misallocation-and-economic-stagnation>

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# EXPIRED LICENCE?

**PROFESSOR LEN SHACKLETON** examines a new book from the IEA which looks at the future of the BBC and calls into question the continued justification for the TV licence fee

In May the government published a White Paper setting out its vision for the BBC. While some changes were suggested, most commentators have seen the proposals as very limited. Technology, market competition and social change are making old assumptions about broadcasting difficult to justify.

Just before the White Paper appeared, the IEA published *In Focus: The Case for Privatising*

*the BBC*, a collection of essays covering such topics as the licence fee, new ways of viewing television, the nature of public service broadcasting, issues of bias in news reporting, innovative sources of competition and possible privatisation.

#### **The BBC and the licence fee**

As Philip Booth and Stephen Davies point out in the opening chapter, when radio was born

in the early part of the twentieth century the Post Office was tasked with issuing and charging for licences.

As yet there were no regular broadcasts. In 1922 radio manufacturers, working with the Post Office, formed the British Broadcasting Company to provide news and entertainment programmes.

At first this was funded by the sale of receivers, but as users of existing sets came greatly to outnumber new purchasers there was a need for continuing funding. In 1927 the company was nationalised, awarded a Royal Charter as the British Broadcasting Corporation, and given most of the revenue from the annual licence fee.

For many years the BBC was effectively a monopoly broadcaster. It offered what can be described as a 'club good', one provided for a fee to 'members'.

The same principle was maintained when television came along. It took its current form in 1946 when TV was re-established after World War II: a joint licence allowed people to watch TV and listen to radio.

The government maintained a broadcasting monopoly for decades. In effect it 'owned' the relevant part of the electromagnetic spectrum, which it allocated to various uses such as police and military communications as well as radio.

Given the technology of the day, only a limited number of potential channels were

available – although even back in the 1940s cable-based transmission was possible and could have allowed some competition for the BBC.

As usually happens with monopolies, however, the incumbents can offer all sorts of reasons why their position should be maintained.

The BBC for many years, particularly under its first Director-General Lord Reith, saw itself as having an overriding moral purpose to 'inform, educate and entertain' rather than compete in a marketplace.

Gradually this position was undermined. In 1955 ITV was launched, funded by advertising,

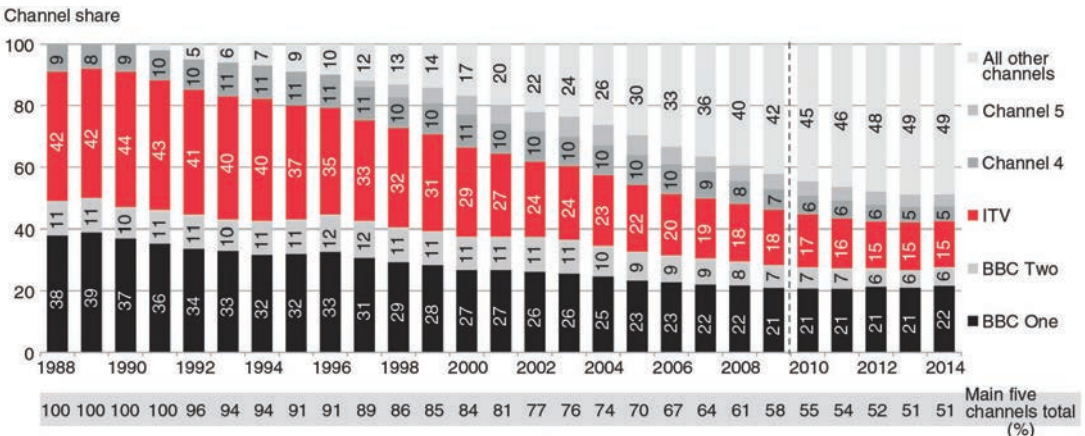
## FOR MANY YEARS THE BBC WAS EFFECTIVELY A MONOPOLY BROADCASTER



followed in 1982 by Channel 4 and in 1997 by Channel 5. Meanwhile the BBC had gained a second channel (BBC2) in 1964. From the late 1980s cable and satellite TV expanded competition further, while the switch to digital transmission greatly increased the potential for new channels.

Most UK households now have access to around 100 free-to-air channels, with hundreds more available on subscription. And

Figure 1: Viewer shares by channel, 1988-2014



increasingly popular Internet streaming services such as Netflix and Amazon allow viewers to watch what they want, when they want it, undermining the twentieth-century idea of a channel carrying daily timetabled content.

Figure 1 shows how this increased competition has reduced the BBC's share of television viewers over recent years.

Yet despite this, everyone in the UK aged under 75 (the very elderly are exempted) who watches or records any live television at all has to pay £145.50 to the government – even if they never watch the BBC.

Competitors regard this as anachronistic and unfair. While they have to raise revenue through advertising or subscription, the BBC is in effect financed out of taxation. It is also able to undercut commercial producers elsewhere by selling its subsidised output in overseas markets.

This unfairness is increased with the rapid uptake of new technology. You can now watch TV on a computer, a laptop, a tablet or a mobile phone without paying for a licence.

Young 'millennials' in the UK seem to be following those in the USA, where traditional viewing via a fixed television set is heading for minority status. This is facilitated by time-



## THE LICENCE FEE SHOULD BE SCRAPPED AND THE BBC SHOULD BECOME A SUBSCRIPTION SERVICE

switching facilities offered by the BBC iPlayer and similar services.

It means that many who benefit from BBC services, including a large and increasing number of people in other countries, do not pay.

There are ways to make more people pay for services from which they benefit. One might be a household levy, as in Germany. This could be collected via the council tax system. But those watching no television at all would be treated unfairly.

The idea that the BBC could finance itself through advertising, once popular, is now no longer credible given that more channels are competing for declining spending on TV advertising.

More radically, as Booth and Davies argue, the BBC's output could nowadays be encrypted

and only be available to subscribers. The licence fee could then be scrapped and the BBC funded in the same way as Sky or other subscription services.

### Public service broadcasting

The idea of turning the BBC into just another subscription channel is opposed by the BBC's defenders, who point to the organisation's mission, which differs from the commercial imperatives of ITV or Channel 5, let alone those of Sky or Netflix. They emphasise that the BBC is, above all, a public service broadcaster.

Public service broadcasting, as Cento Veljanovski argues in his chapter in the book, is held to be necessary because of some form of market failure in television and related sectors. This argument goes back many years, although the type of alleged market failure has been disputed.

At one time, shortage of broadcasting spectrum was the justification for the BBC's status as a regulated monopoly. As we have seen, that argument is undermined by technological change.

It used to be argued that television had the two key characteristics of a public good – which A-level students know to be 'non-

rivalness' and 'non-excludability'. Public goods may be underprovided in a free market and state provision could be justified.

A television broadcast is clearly non-rival, in the

sense that everybody with a TV can watch simultaneously. It used to be the case that nobody could be excluded, but now digital transmission means that exclusion is technically possible and the public good argument falls.

Another claim was that economies of scale in broadcasting justified the support of a monopoly provider. This argument doesn't seem too convincing today.

Digital and robot cameras, plus reduced staffing agreements as union power has waned, have reduced studio production costs. Larger international markets for English-language content mean that many commercial competitors are able to produce high-quality drama and documentaries themselves or in collaboration with other producers.

There was also an argument about externalities. For instance, having a national

public sector broadcaster brought the nation together and was seen as an important part of a common citizenship. This argument still has some salience at times of crisis or great national events, when many older viewers instinctively look to the BBC.

But in a diverse multicultural society viewing habits change and the BBC's audience has fragmented. Even successful programmes may only be watched by 4 or 5 million people rather than the 11 or 12 million (in a smaller population) who watched popular shows in the 1970s.

Probably the most powerful rationalisation for the BBC's

current status is the one which is nowadays difficult to make publicly. Economists call it the 'merit good' argument.

Left to themselves, it is said, most viewers would gorge themselves on the televisual equivalent of junk food – endless soaps, 'reality' shows, sport, cheap chat programmes and so on. They should instead have a balanced diet, including arts programmes, innovative drama, current affairs, religious programmes, regional productions and content which reflects the diversity of the UK population.

But while Lord Reith in the 1920s could unashamedly make the claim that people didn't know what was good for them, in our more democratic and less deferential age such elitism is a difficult sell.

A slightly more appealing way of making this case is to argue that in a diverse society people's preferences will differ between age groups, between regions, between ethnicities and so on.

The danger is that minorities with a strong interest in, say, classical music, ballet, unusual sports, challenging plays or specialist documentaries will be under-supplied when companies compete for large audiences.

Against this, many of today's most exciting and innovative documentaries, arts programmes and drama can be found on commercial channels and streaming services which find such niches profitable, possibly because they appeal to more affluent viewers.

To the extent that there is a definable need for subsidised public sector broadcasting, should the BBC continue to play the major role?

For many years commercial channels such as ITV or Channel 5 have had public service obligations relating to their content (for example, the provision of news, children's and religious programming). Channel 4 is a publicly-owned business supported by advertising, and it too has a public service remit.

In principle, as Veljanovski argues, the government could set up a public service fund, rather like the Arts Council, where broadcasters could submit bids for financing clearly-defined public service programmes. With this proposal, first mooted thirty years ago, there would be

## IN A DIVERSE MULTICULTURAL SOCIETY VIEWING HABITS CHANGE AND THE BBC'S AUDIENCE HAS FRAGMENTED



no need for a separate licence-funded BBC.

### News and current affairs – market dominance and bias?

In his chapter, Ryan Bourne draws attention to the BBC's dominant share in the news and current affairs market.

Approximately 75 per cent of television news watched in the UK is provided by the BBC, and it has a similar share of radio news.

A commercial organisation with a similar market share would be subject to investigation by the Competition and Markets Authority.

Particularly worrying is the dominance of the publicly-funded BBC in local and regional news reporting, at a time when local newspapers are in great difficulty with falling readership and advertising revenue.

Another related concern is the BBC's online presence: its website covers a vast range of topics including many non-news areas where it competes directly with commercial providers. For Bourne, this market dominance raises concerns about potential bias and its effect on political debate within the UK.

Politicians are very quick to accuse the BBC of bias, particularly when a member of their party performs badly in an interview or a policy is reported on unfavourably. The Conservatives accuse the Corporation of bias in favour of Labour, while the Labour Party detects a pro-Conservative bias. The BBC often argues that this proves its neutrality.

Bourne, however, takes a more objective view. He recognises that the BBC is highly trusted by its viewers and listeners. Drawing on data from News-watch (a monitoring organisation) he argues that bias is not a simple party-political issue, but more subtle.

He argues that there are three elements of potential bias in any news organisation – omission (of an appropriate range of views on a topic), selection (of what is newsworthy, and who should be asked to comment on it) and presentation (the context of news stories and how spokespeople are introduced).

These factors are not necessarily apparent to the viewing and listening public. No news organisation can ever escape these subtler biases, but greater competition could mitigate their effects.

In a separate chapter, Stephen Davies also discusses the issue of bias, drawing attention

subject, and may be opposed to the views of many sections of the population.

The sort of person who chooses to work at the BBC is signed up to this world view, which means that other views are marginalised and either misrepresented or ignored.

### The future of the BBC

The government's White Paper (*A BBC for the future: a broadcaster of distinction*), while recognising some of these issues, has disappointed many people, including the authors of the IEA book.

In setting out a plan for the next eleven years before the next Charter review, the White Paper recommends keeping the licence fee, and raising it in line with inflation.

It intends to charge people who use iPlayer: whether this succeeds in increasing revenue significantly is debatable. It will

almost certainly inconvenience existing licence-payers who will probably have to fiddle about entering their licence fee number before accessing this service.



## A PRIVATISED BBC COULD BE A WORLD PLAYER WITH HUNDREDS OF MILLIONS OF VIEWERS IN MANY COUNTRIES

to the internal culture of the BBC, and arguing that the processes of commissioning, production, delivery and presentation tend to produce programmes based on 'conventional wisdom'.

This involves ideas that people amongst the political and media elite rarely challenge, but which do not represent the last word on the

There will be a very limited experiment with commissioning public service broadcasting, though there will be wider opportunities for independent producers to get work at the BBC. The Corporation is to be encouraged to form partnerships with local news outlets. There is renewed commitment to diversity, a greater openness about the pay of top BBC talent, and the involvement of the National Audit Office in scrutinising BBC spending.

There are also internal governance changes, with a new unitary board instead of the current structure with an executive board and the BBC Trust which sets strategy. In addition the BBC is now to be regulated by Ofcom.

Despite these changes, the BBC's status is to remain essentially unaltered. The IEA authors would have preferred fundamental reform. In their view, the licence fee should be scrapped and the BBC should become a subscription service. It should withdraw from some areas where it competes unnecessarily with the private sector. It should no longer be a public body, but what form privatisation should take is open to further debate.

One view is that the BBC should be reconstituted as a members' organisation

### QUESTIONS FOR DISCUSSION

- Is the licence fee a fair and efficient way to fund the BBC? What are the alternatives?
- Is there a 'market failure' in broadcasting? If so, what is it?
- What is the difference between a 'club good' and a 'public good'?
- How might 'bias' in news broadcasting arise, and can it be eliminated?
- If the BBC were to be privatised, what forms of privatisation are possible?

like the National Trust, with the members – subscribers – being represented on its governing body.

Another possibility would be to set it up with a large trust fund and operate with a governance structure resembling that of the Guardian newspaper. Under both of these models some of the good features of the ethos of the existing BBC could be maintained.

A more radical approach is advocated by Tim Congdon in the final chapter of the book. He suggests a straightforward privatisation of the BBC on commercial terms.

He sees huge potential for a privatised BBC as a world player with hundreds of millions of viewers in many countries, rather than a business largely focused on the UK. The Corporation is at present a relatively small player worldwide: indeed its share of world markets is falling.

The UK has a comparative advantage in television and related media services, as a result of its history, reputation for quality and the English language, but the BBC cannot fully exploit this in the current framework.

In order to change this it needs access to large amounts of capital which will never be obtainable under the existing and planned set-

up, and greater freedom to form commercial partnerships.

Some claim that the government really wanted to adopt some of these ideas, but was constrained by wishing to avoid controversy at a time when the EU referendum was at the forefront of its thinking.

If this is the case, it suggests that the proposals set out in the IEA's publication will return to prominence well before the end of the BBC's new extended Charter.

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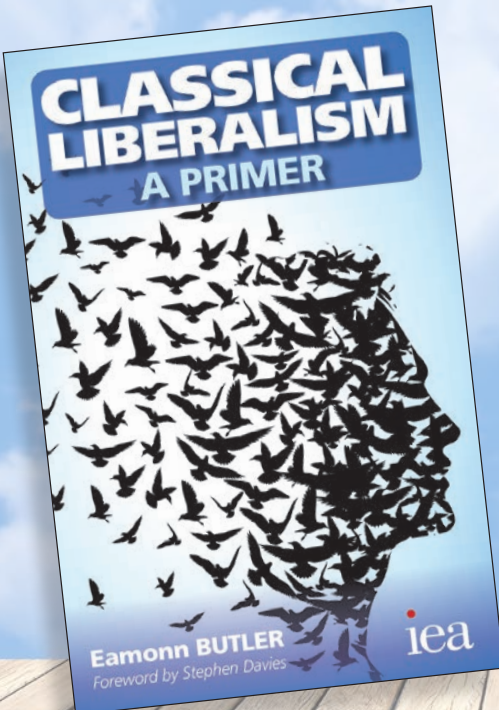


## FOR MORE...

Read *In Focus: The case for privatising the BBC* in full.

Download it for free at:

[www.iea.org.uk/publications/research/in-focus-the-case-for-privatising-the-bbc](http://www.iea.org.uk/publications/research/in-focus-the-case-for-privatising-the-bbc)



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# ROARING SUCCESS

The growth of Asia was based on an increase in economic freedom, relative openness and the protection of property rights – not protectionism and state planning, says **BENJAMIN POWELL**

**T**he rapid economic growth of East Asian economies after World War II led many to mistakenly believe that government industrial planning policies were the key to their success. Nothing could be further from the truth.

Although some industrial planning existed, it was a relatively large measure of economic freedom that is most responsible for their long-term development and prosperity.

The post war growth record of the East Asian “Tiger” economies is staggering. Hong Kong, Singapore, Taiwan, and South Korea all had pre-industrial standards of living with incomes significantly below \$500 per capita in 1950.

Japan’s industrial base had been decimated in the war and it had a similar per capita income.

In the span of a single generation all these economies grew to achieve first-world living standards.

Some have attributed the growth in these countries to national economic planning. Ha-Joon Chang goes so far as to claim that “there is now a broad consensus that the spectacular growth of these countries, with the exception of Hong Kong, is fundamentally due to activist industrial, trade and technology (ITT) policies by the state.”<sup>1</sup>

That “consensus” exists largely among a small group of scholars who have been repeating, in

varied forms, the same claims since the early 1980s. But their argument is unconvincing on both theoretical and empirical grounds.

### The industrial planning problem

State industrial planning involves a government agency selecting what industries should be promoted to best achieve economic development. Then, they funnel labour and capital to those industries through, direct cash or technology subsidies, trade policy that protects those industries from international competition, and controls on foreign investment and other regulations.

Ha-Joon Chang contrasts the industrial planning model with the standard textbook case for free trade. That textbook case, he claims, assumes that “productive resources can move freely across economic activities” but in reality, “this is not the case: factors of production cannot take any form as it becomes necessary. They are usually fixed in their physical qualities and there are few ‘general use’ machines.”<sup>ii</sup>

But this very fact, that capital is not homogenous or equally suited to all uses, creates an insurmountable problem for industrial planners.

If industrial planning were going to promote economic growth, the planners would need to have knowledge of what is the right capital to create and in which industries it should be created. But this

very knowledge is only revealed through the market’s competitive process.

In a free market, entrepreneurs bid against each other for labour and capital. They bid based on their expectations of the profits that their envisaged entrepreneurial venture will create.

In turn, these expectations reflect the expected costs of production of and the value that world consumers will put on different goods and services.

Free trade and freedom for entrepreneurs to move resources from one industry to another

is necessary to discover how resources are best allocated. No central planning body can replicate this process.

By bidding against other would-be entrepreneurs, those successful in securing capital and labour are forced to take into account the value that others thought that they could create with those very same resources.

The market’s competitive process is not perfect. Entrepreneurial mistakes are revealed through the profit and loss system. Some enterprises will go bust; others will thrive. It is only through this process that the knowledge of which capital goods should be created, and to which industries capital and labour should flow, is revealed.

State industrial planning interferes with this process of discovery. Through trade protection and subsidies the state biases the competitive bidding process in favour of particular industries – often selected because of the lobbying of interest groups.

Planners stifle the very process that discovers the knowledge needed to ensure that capital and labour is allocated to the right industries. Rather than rationally planning the economy, state planners’ attempts to steer the economy amount



**THE POST WAR GROWTH RECORD OF THE EAST ASIAN “TIGER” ECONOMIES IS STAGGERING. IN THE SPAN OF A SINGLE GENERATION ALL THESE ECONOMIES GREW TO ACHIEVE FIRST-WORLD LIVING STANDARDS**

to what Don Lavoie called, “the blind leading the sighted.”<sup>iii</sup>

Some advocates of industrial planning attempt to deny a need to “pick winners”. Robert Wade claims that: “‘Picking Winners’ implies that the potentially competitive industries are out there waiting to be discovered, as though the problem is to find those that most closely correspond with the economy’s given comparative advantage. The governments of Taiwan, Korea, and Japan have not so much picked winners as made them.”<sup>iv</sup>

<sup>i</sup> Chang, Ha-Joon. (2002) *Kicking Away the Ladder*. London: Anthem Press. P. 49.

<sup>ii</sup> Chang, Ha-Joon. (2008) *Bad Samaritans*. New York: Bloomsbury Press. P. 71.

<sup>iii</sup> Lavoie, Don. (1985) *National Economic Planning, What is Left?* Cambridge, MA: Ballinger Publishing Company. P. 4.

<sup>iv</sup> Wade, Robert (1990) *Governing the Market*. Princeton, NJ: Princeton University Press. P. 334.

Scarcity is a fact of economic life. Any industrial policy that favours one industry necessarily draws scarce resources away from other industries. So, planning in favour of one industry implies planning against others.

The state may make a “winner” out of what would have otherwise been a “loser” but it can only be done at the cost of harming another industry that would have been more efficient and created greater growth.

But, even when an industry that was favoured by industrial policy remains profitable when its subsidies are taken away, it is not an unambiguous sign of success. Given that the market was rigged, there is no way to evaluate the cost in terms of the value forgone in some other industry that would have been created absent industrial policy.

## How the ‘Asian Tigers’ roared

The fact that Taiwan, South Korea, Japan, and Singapore all had some amount of state industrial planning and all grew rapidly does nothing to show that the industrial planning caused the growth.

Hong Kong, which had no industrial planning, grew equally rapidly. More pertinently, countless African and South American countries practised industrial planning with disastrous consequences.

The real story of East Asian development is a story of economic freedom. Although some state planning existed in these countries, they were, on balance, mostly free market economies – much more so than the countries that they left behind. And the more they liberalised, the more they developed.

The *Economic Freedom of the World Annual Report* is the most comprehensive measure of how market orientated a country is.

In 1970, the first year data is available, Hong Kong was the freest economy in the world. Japan and Singapore were tied at 7th, Taiwan 16th, and South Korea at 31st ranked in the top 20 per cent of the index. This set the background for their development in the 1970s and 1980s.

It is interesting to see that, Japan has moved down the index as its economic performance has deteriorated and countries that embraced the central planning model, such as Argentina, languished near the bottom back in 1970 just as they do today.

As the exception that, perhaps, proves the rule, Chile is the one South American country that, in the last 20 years has embraced a market-based approach to development and, not only does it rank in the top decile for economic freedom, it also has the best outcomes in the region in terms of almost any measure of human development.

The connection between economic freedom and growth, unlike the supposed connection between protectionism and growth, fits with the larger empirical literature.

Hundreds of papers have found that levels of economic freedom are positively associated with higher long-run living standards.

There is also a strong theoretical connection between economic freedom and prosperity. An

## THE CONNECTION BETWEEN ECONOMIC FREEDOM AND GROWTH, UNLIKE THE SUPPOSED CONNECTION BETWEEN PROTECTIONISM AND GROWTH, FITS WITH THE LARGER EMPIRICAL LITERATURE



environment of economic freedom allows for the co-ordination of the decentralised knowledge that is spread across all the minds in an economy.

It allows prices to best reflect the real scarcity of resources and everyone's assessment of how those scarce resources can best be put to use.

Competition within this environment will tend to encourage the right capital in the right industries to best promote long-run prosperity because the system of profit and loss is able to discover the very information that industrial planners would need in order to be effective.

The rise of the East Asian economies occurred in spite of the presence of some state industrial planning. Their growth, like the growth of virtually all wealthy countries today, was made possible by adopting institutions that protect private property rights, respect the rule of law, and grant a large measure of economic freedom.

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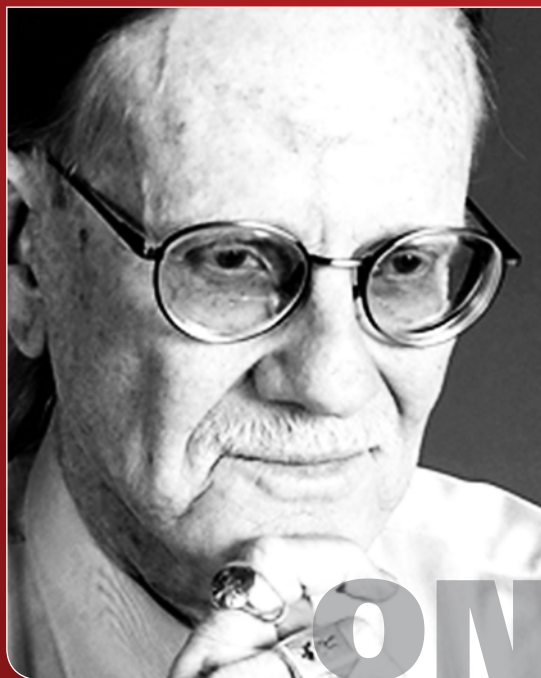
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# SMITH



# ON SMITH

In the latest of our interview series, Nobel laureate **VERNON L. SMITH** reflects on the lasting importance – and relevance – of his hero and namesake **ADAM SMITH**

## **Why should young economists study Adam Smith?**

Young students in economics and the humanities desiring to better understand the world in which we live and how it came about need to study the two great works of Adam Smith.

In 1759 Smith published his first book, *The Theory of Moral Sentiments* (Hereafter TMS). He considered it his most important work, although posterity would not judge it so. You would be wrong to assume that the best wisdom of the past is always integrated into modern sources of learning.

His second book was published in an eventful year for America, 1776. This was *An Enquiry into the Nature and Causes of the Wealth of Nations*. (Hereafter WN)

It was a spectacular success largely because it caught the attention of British and American intellectuals and politicians, particularly after the American Revolutionary war ended.

The book importantly influenced William Pitt, Prime Minister of Britain for 17 years. Countering the popular views of the time, Smith opposed slavery, empire, colonialism, mercantilism, and taxation without representation.

The book argued for free trade in direct opposition to the mercantilist policies of taxing the goods that Britain allowed to be imported into the American colonies.

His position was based on his penetrating mastery of the causes of national wealth creation, not on the political controversies of his time.

Mercantilism represented the heavy hand of undue influence by special interests – we call it “rent seeking” today.

For Smith this sort of crony influence was not merely unfair, it was an impediment to wealth creation. Smith was remarkably forward in interpreting current conditions, and speaking frankly – calling the shots as he saw them.

The book’s centrality to the issues of the day is indicated by the fact that the American colonies erupted on July 4th of the same year, a few months after the publication of WN, in protest at the tea tax – the last of a series of abusive policies as seen by the Americans.

Smith understood and sympathised with that cause, but did so as a loyal British citizen. The British were badly and unexpectedly beaten, and this together with the wise economic analysis of Smith enabled the start of an agonising re-evaluation in his country and in the colonial world.

**Adam Smith wrote about how the pursuit of self-interest promoted general economic welfare. Was he suggesting that people ought always to behave selfishly?**

Smith was the intellectual architect of a system of natural liberty which called for the removal of all imposed privileges of preference or of restraint: “Every man, as long as he does not violate the laws of justice is left perfectly free to pursue his own interest in his own way...” (WN, Vol 2, p 184).

But to understand what he meant by “the laws of justice” and “own interest in his own way” it is essential to read TMS.

Because of the enormous success of WN, people to this day do not read TMS. Consequently his essential message is easily distorted as people fail to grasp the pre-conditions that gave it context in Europe.

In TMS (pp 78-91; 109-120) we learn that, although every mature person is strictly self-interested, and fitter than others to take care of himself, none can look mankind in the face and suggest that this principle governs all his actions.

Rather, in the process of growing up in society, he learns to “humble the arrogance” of his self-interest in the light of what “others will go along with”. Only in this way do we

each become socialised and learn self-control in following the cultural rules of propriety.

This is because of our unique human capacity for “mutual fellow-feeling”. We naturally desire to reward others in response to their properly motivated actions of a beneficent tendency towards us.

**According to Smith, what was the origin of property rights, and why was this important?**

Just as we may empathise with those who behave well towards us, sometimes, we naturally feel resentment and a strong urge to punish those who intentionally choose actions that are hurtful to us.

For Smith, this is a more powerful sentiment than those arising from our feelings of beneficence. Feelings easily escalate becoming more than an eye-for-an-eye, and society cannot subsist.

This is why, after long practice, viable communities come to have “property rights”, once called “propriety rights”, which allow for the proportionate punishment of specific hurtful acts of injustice.

This is also why in the civil order of law the



**AFTER LONG PRACTICE,  
VIALE COMMUNITIES  
COME TO HAVE  
“PROPERTY RIGHTS”**

greatest punishment is reserved for murder, the most hurtful of all acts. Next, and calling for less punishment, are theft and robbery which, because they take from us what we possess, are greater crimes than violations of promises – breach of contract – which only disappoint us of what we expected.

Where a person has learned to be social and follow rules that discourage hurtful actions, she still follows her self-interest, but does so in the service of harmony with you. You follow the same rules and you both co-operate to your mutual benefit.

Those societies that achieve a high level of harmony, where most people are law abiding,

and people generally engage in mutually beneficial rule-following behaviour, also tend to be the wealthiest.

**What was Adam Smith's most important observation about the 'nature and causes of the wealth of nations', and how can the pursuit of self-interest promote the general welfare?**

Now that we have seen what Smith meant by natural liberty we can appreciate the causes of wealth creation.

Smith used the operations of a pin factory to dramatise the great wealth gains from the co-operative "division of labour" among tasks: or specialisation as we call it today.

Specialisation in the economy, however, occurs not by top-down orders, but is discovered naturally in people-to-people interactions, because of the human propensity "to truck, barter and exchange one thing for another".

With this key axiom, Smith shows that this propensity leads to prices; and prices facilitate comparison calculations. The farmer can discover that he can benefit (profit) by producing more pigs and less maize, buying his maize and selling his pigs in market exchange with others.

Through markets people form a vast co-operative network with each specialising in those activities for which they learn to be most productive, and each thereby profiting. As a result of each being more productive, the wealth of all is

increased relative to a world with no trade.

The basic theorem in Smith is that specialisation is limited by the extent of the market: the bigger the market the greater the possibilities for specialisation and beneficial trade.

Property rights, wherein each person has a natural right to the income produced by his own labour, and to the investment return on saving out of income, are a pre-condition for this wealth creation process to occur:

Smith's account, together with the innovation it encourages, defines a forward looking system based on merit, not a backward looking system of privilege.

This attitude change explains the enormous growth in per capita economic betterment beginning in Northern Europe in the 1700s, spreading westward to North America, to the rest of Europe, to Australia, New Zealand, Hong Kong, Singapore, and most recently to China, India and Asia generally. That growth, however, is hampered to the extent that people are not free in their economic and political choices.

The overarching themes in Adam Smith are firstly the sources of human social betterment in *The Theory of Moral Sentiments*, and secondly, the origins of human economic benefit in the *Wealth of Nations*•

Vernon L. Smith

Chapman University

2002 Nobel Laureate in Economics



## ADAM SMITH: THE WEALTH OF NATIONS

"[T]he certainty of being able to exchange all that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men's labour as he may have occasion for, encourages every man to apply himself to a particular occupation, and to cultivate and bring to perfection whatever talent or genius he may possess for that particular species of business."

(*Wealth of Nations*, Vol 1, p 17)

# Can CAPITALISM



## be GREEN?

Many believe capitalism and the environment are at odds with one another. But **CHRISTOPHER J. COYNE** and **RACHEL L. COYNE** say this view neglects the numerous environmental benefits generated by property rights

*"Capitalism v environment: can greed ever be green?"* This headline from *The Guardian* captures the standard view of the relationship between capitalism and the environment<sup>1</sup>.

According to this view, capitalism and the environment are necessarily at odds with one another. The only way for people to earn a profit, the logic goes, is to exploit the environment and, in the process, cause irreparable

environmental harms.

Based on this reasoning, many argue for the socialisation of property so that government can protect the environment from the harms done by capitalism. This common view is a fallacy.

The relationship between capitalism and the environment is positive sum, as private ownership and mutually beneficial exchange generate significant environmental benefits.

## The beneficial aspects of property right

Private property refers to the right to use, control, and obtain benefits from a resource, good, or service. This includes the right to exclusive use, the right to transfer property to others, and legal enforcement against invaders.

Property in this context can refer to buildings, but more usually will refer to land in agricultural use, forestry and fishing grounds. Property rights yield three key benefits.

Property rights incentivise private owners to use resources in ways that benefit others. In markets, a profit indicates that property owners have used their resources in a manner which is pleasing to consumers.

Secondly, private owners have an incentive to care for and manage their property. This is because property rights internalise the benefits and costs of the behaviour of owners.

## IF NOBODY OWNS THE FISHING GROUND, TRAWLER OWNERS WILL TEND TO OVER-FISH

If property owners exercise care in the upkeep of their property, they benefit in terms of the increased value of the resource. Likewise, if owners choose to allow their property to fall into disrepair, they incur the cost through the decreased value of the property.

Finally, property owners have an incentive to consider the long-term consequences of their actions. Owners have the right to future cash-flows associated with their property. This incentivises owners to ensure that their resources are sustainable.

For example, the owner of a fishing ground will wish to keep stocks buoyant because that will ensure the profitability of the resource in the long term is maximised. This, in turn, is reflected in the value of the resource at any given time. If nobody owns the fishing ground, trawler owners will tend to over-fish.

## Property rights and the environment

Once the benefits of property rights are appreciated, it becomes clear that well-defined property rights are crucial to maintaining and improving the environment.

Consider the incentives for property owners to

care for what they own and to consider the long-term consequences of their actions.

This reality is at odds with how many people view capitalism which is often characterised as the drive for immediate profits with no regard for the long-term consequences.

The example of fishing grounds has already been mentioned, about which there is ample evidence. There are other examples of natural experiments which allow for a test of the two competing views of property rights and the environment.

There has long been a concern about the declining elephant population in Africa due to the poaching of ivory. In Africa, there is variation in ownership rights over the elephant population. In some areas elephants can be privately owned while in others they are communal property.

An empirical study looking at the factors influencing the elephant population in Africa found that "countries with property rights systems or community wildlife programmes [which create residual claims over the well-being of the elephants] have more rapid elephant population growth rates than do those countries that do not."<sup>2</sup>

These findings make perfect sense when considered in light of the incentives created by property rights.

Clearly defined property rights incentivise owners to care for their property, which is reflected in faster growth of the elephant population in areas which allow for private ownership.

The lack of private ownership, in contrast, leads to the tragedy of the commons whereby a communal-resource system leads to overuse, as each individual considers their own costs and benefits while neglecting the broader implications of their actions.

Indeed, where there are no ownership rights in elephants, they are just regarded as a pest (they only bring costs to farmers) and therefore they are shot.

Property rights also allow non-profit organisations to engage in environmental conservation. For example, among other programmes, the Sierra Club often raises funds to purchase tracts of land which it then maintains or turns over to other entities that conserve the land. This illustrates the range of opportunities that private ownership offers for environmental conservation and improvement.

<sup>1</sup> [www.theguardian.com/sustainable-business/2014/nov/26/capitalism-environment-green-greed-slow-life-symposium-tony-juniper](http://www.theguardian.com/sustainable-business/2014/nov/26/capitalism-environment-green-greed-slow-life-symposium-tony-juniper)

<sup>2</sup> Michael A. McPherson and Michael L. Nieswiadomy. 2000. "African elephants: The effect of property rights and political stability," *Contemporary Economic Policy* 18(1): 14-26.

<sup>3</sup> [http://www.econlib.org/library/Enc/EnvironmentalQuality.html#IfHendersonCEE2-052\\_figure\\_018](http://www.econlib.org/library/Enc/EnvironmentalQuality.html#IfHendersonCEE2-052_figure_018)

More generally, the innovation that arises in a free economy yields numerous benefits.

It leads to less waste because there is an incentive to economise on resource use to cut the cost of production.

Consider, for example, the traditional drinks can which is made from aluminum. The first generation of cans, introduced over a half-century ago, weighed three ounces each; current cans weigh approximately one ounce.

This change was due to innovations in the production techniques which allowed producers to use less aluminum while producing a stronger can.

There are also significant long-term benefits to innovation. Over time, there have been advances in sanitation and medicine which have reduced, and often outright eliminated, many of the pollutants which plagued people in the past.

These long-term benefits are typically neglected in discussions of the environment even though the improvements in standards of living due to innovation and increases in wealth are truly staggering.



General economic progress and growth are positively correlated with better environmental quality. As the environmental economist Terry Anderson writes, "[t]he correlation between environmental quality and economic growth is incontrovertible. Comparing the World Bank's environmental sustainability index with gross domestic product per capita in 117 nations shows that richer countries sustain environmental quality better than poorer countries do. Indeed,

every systematic study of environmental indicators shows that the environment improves as incomes rise."<sup>3</sup>

There are theoretical reasons to believe that the direction of causation runs from economic growth to improved environmental quality.

Moreover, greater wealth affords citizens the opportunity to care more about the environment.

It is precisely because citizens in wealthy countries do not have to worry about the diseases and other pollutants that existed not long ago that they can, instead, worry about current environmental concerns.

People who are worried about where their next meal is coming from, or about dying from malaria, are not in a position to be concerned about endangered species or potentially rising sea levels.

Contrary to popular belief, the best environmental outcomes can only be secured through well-defined and well-enforced private property rights. Just as individuals have much to gain from capitalism, so too does the environment.

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## The implications for the environment


Appreciating the benefits of property rights is crucial for understanding the relationship between capitalism and the environment.

Contrary to popular opinion, markets and the environment are not at odds with one another. In stark contrast, well-defined property rights are important not just for maintaining the environment, but also for improving it.

One key implication is that, when discussing environmental issues, it is crucial to start by thinking about the current property rights arrangements, or lack thereof.

The absence of property rights leads to environmental harms, since private actors lack the incentive to take into account the full cost of their behaviours. Many environmental problems can be addressed by defining or clarifying property rights.

It is also important to remember that improvements in the environment do not occur in a vacuum.



IEA Discussion Paper No.73

# AND HOW MUCH DO YOU EARN?

Public pressure for government regulation of pay

Ryan Bourne and J. R. Shackleton  
August 2016

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35

Bad

56

Break

# ...if you live in the UK

**KRISTIAN NIEMIETZ** on the bleak prospects for British lung cancer victims

**T**he US TV series 'Breaking Bad' is about a middle-aged high school teacher, Walter White, who is diagnosed with lung cancer, and who is unable to afford the treatment his doctor recommends. Out of desperation, he embarks on a criminal career in order to raise the money.

Since the streaming of the final series, a cartoon with the (attributed) caption 'If "Breaking Bad" had been set in the UK' has been making the rounds on social media.<sup>1</sup> In the cartoon version, Mr White's doctor simply informs him that he is entitled to free medical care, and Mr White

decides to continue teaching. Thus the story ends, or rather, never begins.

The cartoon can be seen as a powerful defence of the National Health Service, with its universal coverage and free access to healthcare, based on need rather than ability to pay.<sup>2</sup>

In fact, in a British version of 'Breaking Bad', Mr White would have probably died soon after diagnosis. British lung cancer patients only have a one-in-ten chance of surviving the next five years<sup>3</sup>, which is the lowest survival rate in the developed world (see Allemani et al, 2015). The US rate is almost twice as high.

But forget the US, and

forget Japan and Israel, which do exceptionally well on this particular measure, as well. Survival rates in Italy, the Netherlands, Norway, Australia, Iceland, Sweden, Germany, Switzerland, Belgium, Canada, Austria and South Korea are also at least five percentage points higher than in Britain.

Given how common lung cancer is – with about 45,000 new cases diagnosed each year (Cancer Research UK, 2012) – a difference in survival rates of a few percentage points translates into large numbers of lives that could have been saved through better and/or timelier treatment.

<sup>1</sup> To be fair to the cartoonist, Christopher Keelty, the cartoon itself does not mention the UK, it just says "anywhere but America edition". But in the British healthcare debate, there is an implicit consensus to pretend that there are only two healthcare systems in the world, which are the NHS and the US system. Therefore, on social media, the cartoon was quickly reinterpreted to be about Britain.

<sup>2</sup> The notion was given some additional credence by the actor who had played Mr White, who said in an interview with the Rolling Stone magazine (10 June 2011): "if we did have universal health care [...] the show might not have worked".

<sup>3</sup> This is a so-called relative survival rate, which, roughly speaking, means it strips out those who die with lung cancer, but not because of lung cancer.

Had all the UK's lung cancer patients sought treatment in France rather than through the NHS, there would have been 1,780 additional survivors. Had they been treated in the Netherlands, another 2,300 people could have survived; had they been treated in Australia, it could have been 2,400, and had they been treated in Switzerland or Germany, it would have been around 3,000.

So in short, yes of course there could be a British version of 'Breaking Bad'. The main difference from the US version would be that a British Mr White would try to raise money in order to seek treatment abroad.

But, if the aim were to shoot a 'boring' version of 'Breaking Bad' (i.e. one with an easy happy ending), one could have set it in, for example, Austria.

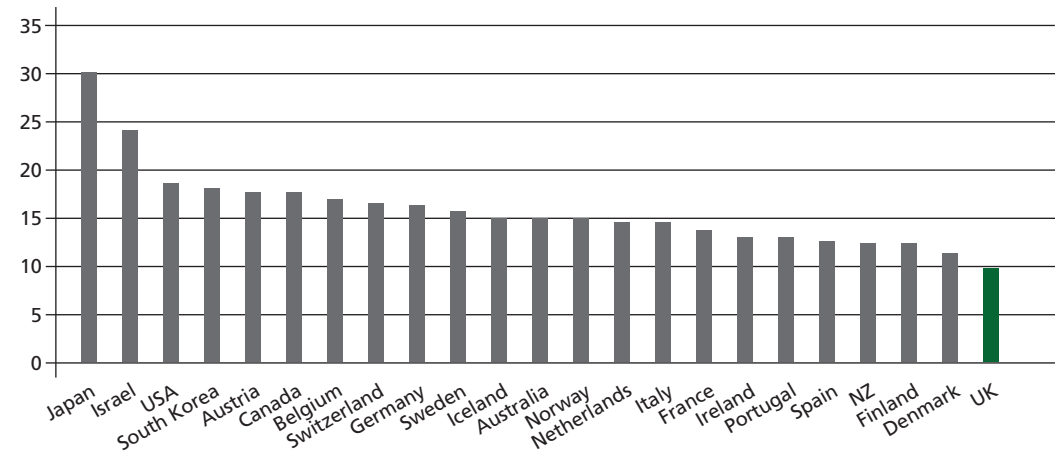
Unlike the American Mr White, an Austrian *Herr Weiß* would be protected against the risk of medical bankruptcy (although he may be asked for a moderate co-payment), and unlike a British Mr White,

Table 1: Number of lives that could be saved per year if British lung cancer patients experienced outcomes as good as those in other countries

If the UK's lung cancer patients had been treated in...	...this number of lives could have been saved:
Denmark	760
Finland	1,200
New Zealand	1,250
Spain	1,330
Portugal	1,420
Ireland	1,470
France	1,780
Italy	2,270
Netherlands	2,310
Norway	2,400
Australia	2,400
Iceland	2,400
Sweden	2,670
Germany	2,940
Switzerland	3,070
Belgium	3,110
Canada	3,430
Austria	3,690
South Korea	3,960
USA	4,040
Israel	6,320
Japan	9,120

author's calculation based on figures from Cancer Research UK (2012) and Allemani et al (2015)

Figure 1: Lung cancer 5-year survival rates for patients diagnosed 2005 – 2009



based on figures from Allemani et al (2015)

an Austrian *Herr Weiß* would also have a fighting chance of survival.

Lung cancer is not a special case: the pattern we see in the above graph is also, broadly, repeated for many other health outcome measures.

It is generally true that countries with competitive, pluralistic healthcare systems such as Australia, France, Japan, South Korea, Germany, Switzerland and the Netherlands do well across a wide range of measures (Niemietz, 2015).

It is also true that countries which have similarly uncompetitive systems, such as Ireland, Finland and New Zealand, often have problems that are similar to those of the NHS.

The smugness of NHS cheerleaders is therefore unwarranted. 'Access to healthcare' is not a binary variable; it is not something that you either 'have' or 'don't have'.

We all have access to some healthcare, but, apart from Bill Gates, none of us have access to everything that is medically possible.

A British Mr White would have access to healthcare, but not to the kind of healthcare that would give him a reasonable chance to survive.

- A cartoon has been making the rounds on social media, claiming that the TV series 'Breaking Bad' could not have happened in the UK. The story is about a man driven to extremes by desperation, because he is unable to afford medical treatment for his lung cancer. In the UK, this would not have made sense, because he would have had access to free NHS care.
- Outcomes, however, tell a different story. The UK has the lowest lung cancer survival rate in the developed world. The US rate is almost twice as high. In most of the developed world, survival rates are at least five percentage points higher than in the UK.
- Were the UK's lung cancer patients all treated in the Netherlands, there would be about 2,300 additional survivors every year. Were they treated in Switzerland or Germany, the number of additional survivors would be around 3,000.
- Patients in other developed countries would not have to worry about the risk of medical bankruptcy either. Universal access to healthcare is the norm, not the exception. The US, not the UK, is the outlier in this respect.
- But 'access to healthcare' is not binary, it is not something that people either 'have' or 'don't have'. Rather, we all have access to *some* healthcare, but most of us do not have access to anything that is medically possible. All health systems ration access in some way.

This is often the case where the state rations access to publicly provided goods and services through non-price mechanisms. We all have a right to access municipal parks, and they are free at the point of use. But if you live in an area where there are no parks nearby, or where the park is rundown, or blighted by crime and anti-social behaviour, that theoretical right of 'access' is not worth very much.

We should judge healthcare systems (and many other policy areas) by their outcomes, as measured, for example, by survival rates, and not by vague intentions or 'founding ideals'.

Judged in this way, the performance of the NHS is simply not especially impressive.

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**In some senses, journalism has become a public good because of changes in technology. This means there may be less investigative journalism than is desired. But, asks **LUIGI ZINGALES**, could academics fill the gap?**

**T**he year before last, a series of emails came to light that got the American Egg Board – an industry group whose members are appointed by the US secretary of agriculture, and whose

mission is to increase demand for eggs – into a bit of hot water.

The emails appeared to show the board producing a strategy for attacking a new kind of vegan (and therefore eggless) mayonnaise being

produced by a California-based company.

The emails came to the attention of a US senator, and the US Department of Agriculture launched an investigation. In the midst of the controversy, the CEO

of the egg board took early retirement.

The saga of the egg board was brought to public attention by the *Guardian*. It may be an obscure example of the “watchdog” role of the press, but its very obscurity shows how effective the press can be at policing people and institutions that the general public does not itself have time or access to monitor.

As traditional media, particularly print media, continue to adapt to changing technology and its disruptive effects, it is worth remembering that everyone has an interest in the press maintaining that watchdog role.

And it is not just to keep an eye on egg boards: a strong press is, amongst other things, an important defence against anti-competitive behaviour.

Normally, the only people who pay attention to a given regulatory topic have a big, compelling interest in that topic and are trying to push the agenda in the direction of their own interests, not necessarily in the direction of the common good.

One of the problems is so-called rational ignorance: it is rational for people not to become informed about issues because it is costly to become informed. As such, those who campaign about issues tend to have strong interests to protect – for example, incumbents in a market who want to prevent deregulation that would promote competition.

Hence, if we are to have good public policy, it is important to reduce this cost of information, and that is ultimately what newspapers do.

The media summarise and explain issues and, because they try to maximise their

subscribers, they write for a wide audience, making more people interested, and as a result, promoting public welfare.



### Educating decision makers

The general public is not the only target for newspapers. I have been on the board of two large companies in the past, and I learned well the importance of newspapers to corporate boards.

Companies are complex, and board members obtain only a small set of information, which is generally precooked by the corporate apparatus that brings information to the board.

When newspapers write about a company, it gives board members an opportunity to go in front of the board and say: “Look, there was this stuff; I read it in the newspaper. Can you please explain that to me?” This is a rare opportunity in which you actually get to ask them informed questions, and they find it a bit more difficult to precook all the material.

The important role that the media play is as relevant to civic governance as it is to corporate governance. By informing the public, the press creates a political demand for action that politicians can try to exploit by running a campaign on the issues.



### Information as a public good

For journalists, there are clear rewards in investing time and energy in investigative work: there is recognition, the prestige of getting a scoop, and accolades such as the Pulitzer Prize or the Wincott Awards.

But investigative work isn’t always as rewarding for newspapers in the same way. The reason is that information has many of the characteristics of what economists call a ‘public good’.

Information is non-rivalrous in consumption - my reading a piece of news does not reduce the relevance of the news, and it does not reduce your ability to read the same piece of news.

However, when it comes to the second element of a public good (the ability to exclude those who do not pay for the good or service) that is very much a function of technology.

In the 21st century it has become much easier to transmit information quickly around the world: access to information is much easier. It is now much more difficult to exclude non-payers from accessing the information.

In the old days, when a newspaper landed a scoop, everybody was rushing to the street to buy a copy and figure out what this marvellous information was.

Today, when you hear there is news, you Google it. Somebody has replicated most of the content in a perfectly legal way so you don't need to go to the original source. The institution that did the hard work doesn't even get a boost in revenue as a result of their effort.

As information becomes more easily distributed, the incentives to collect it go down, and the quality goes down as well.



### Investigative journalism as *haute couture*

If the information age has made this problem more severe, the problem has nonetheless always existed. Information has always had the first characteristic of a public good, and investigative journalists have always been a sort of add-on within newspapers that was not particularly profitable.

An analogy can be made here with haute couture for the fashion houses, which, if you look at that segment of the fashion business, is incredibly unprofitable. Very few people buy the extravagant dresses on display during fashion shows. They're too extravagant and too expensive.

But fashion houses pursue haute couture for two reasons. One is prestige: you see this new beautiful Valentino dress, and then you go and buy a more mundane

Valentino dress in a store. Why? Because the first dress represents an aspiration.

The second reason is that haute couture functions to attract talent. You want to have the most creative designers, so you let these designers go wild at the fashion shows, and then they also produce some more mundane lines of clothes that normal human beings can actually wear. It would be difficult for Valentino or Gucci to retain the most talented people if they could not do the most extravagant things.

But one fundamental condition of all this is that the fashion house has to be profitable as a whole. You can afford to do haute couture if you have a lot of cash flow. If you are struggling to survive, the first thing that goes is the haute couture line. After all, there is no point in investing in long-term prestige if you're not sure you'll make it to the end of the month.

Investigative journalism follows a similar model. *McClure's* did not make money with investigative journalism. But, *McClure's* was the most profitable and prestigious publication in the US during Theodore Roosevelt's time and, because of this, they could afford to use investigative journalists. And that added to the magazine's prestige. It added to its mystique and attracted the best talent, but it was not the bread-and-butter business model.

Now, you might say, "Wait a minute. Shouldn't a well-run company be run in the interest of shareholders, who don't really care about all these extravaganzas?" The answer is yes, but if you are in an oligopolistic business and you earn some rents, it makes sense to spend some of those rents to make sure nobody

can get into your business. You build barriers to entry by building prestige.

If you are the main business paper in a large city – the *Financial Times*, for example – and you are very profitable, it makes sense to spend some of those profits in creating credibility so that it is harder for competitors to enter the field. Plus, you attract the best talent, who will also write more mundane articles, exactly like the haute couture model.



### The impact of journalism's decline

The difficult time newspapers have had turning in a profit, combined with the diminishing returns to uncovering important information due to the ease with which that information is shared, has made things hard for investigative journalism.

And maybe I wouldn't particularly care, if it were not for the fact that it has serious consequences for political economy. A lot of the distortions we have seen in capitalism in the last 20 years are directly associated with this decline of the role of newspapers, and media in general, in keeping capitalism in check. Let me mention a few.

The first one is an extreme consolidation of industry. In the US there is much evidence of a massive consolidation in many industries. The banking industry is probably among

the worst offenders, but the trend is broader than that. This consolidation comes with higher prices and little resistance from anti-trust authorities or public opinion. Why? Because there is not enough sensitivity to it among the press.

The second issue is widespread financial fraud. In a paper, some colleagues and I estimate that one out of seven large financial companies in the US is involved in financial fraud. Every financial fraud tends to cost roughly one-fifth the value of the company. So if you add up the annual cost of financial fraud in the US, you get \$380 billion. But how many executives in the US went to jail as a result of the financial crisis? Zero.

Last but not least, we have had two major bubbles in less than 10 years in the US, and I argue that it is the result of a less investigative press. In 2000, Robert J. Shiller wrote his famous book *Irrational Exuberance*, in which he makes an acute observation: "It cannot be a coincidence that bubbles and newspapers were born at the same time".

The first financial bubble, as we know, was the tulip bubble, and it occurred at the time when the first financial leaflets were being created. It is only logical, since the fundamental characteristic of a bubble is that there is a collective state of euphoria. And how do you create a collective state of euphoria if you don't have a means of influencing people?

Newspapers can be the cheering crowd encouraging the inflation of financial bubbles, or they can be in the difficult position of trying to warn that a Trojan horse is actually a Trojan horse.

The latter is a tough task



## IN THE OLD DAYS, WHEN A NEWSPAPER LANDED A SCOOP, EVERYBODY WAS RUSHING TO THE STREET TO BUY A COPY AND FIGURE OUT WHAT THIS MARVELLOUS INFORMATION WAS

to take on; being part of the cheering crowd is a more profitable role. You can afford to be more vocally sceptical only if you have a solid financial base.



### How to support journalism

What can we do? Some people will look at this analysis and say: "Information is a public good. We should support it with taxation and financial subsidisation."

But I have seen what subsidisation of newspapers creates, and it is not pretty. After all, in Italy they subsidise newspapers, and if there is a bad press, it is Italy's.

But you can subsidise journalism in a variety of indirect ways. As many scholars have suggested, a lot of news is already subsidised by virtue of the fact that journalists read material produced by the government, by companies, and by NGOs, and produce news from it. This is an indirect form of subsidisation. And there is a segment of society that can and should do more of this

kind of subsidising of the press: academia.

Academia today looks much like the newspaper trade of 20 or 30 years ago: it is a business where there are a lot of rents because there is not a great deal of competition at the top, and where people consume those rents in research. Some of this research is completely irrelevant, or some of it is likely to be relevant only 200 years from now.

Maybe academics don't need to spend time doing investigative journalism exactly, but they should be using big data to expose what does not work in the capitalist system – or where corporations are protected from the capitalist system by regulation reinforced by rent seeking.

It is time for academia to pick up some of the slack left by the falling fortunes of many newspapers.

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*This essay is an edited version of remarks delivered as part of the Wincott Foundation's 2015 Harold Wincott Memorial Lecture, which took place October 29th, 2015, in London.*

## To **HULL** and **BACK...**

This Autumn we could be **at a school near you** – as we embark on a new series of **one-day sixth-form conferences** around the country.

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### SCHEDULE

#### OCTOBER 2016

Tuesday 11  
Tuesday 18

Holmes Chapel, Cheshire  
Stowe School, Buckinghamshire

#### NOVEMBER 2016

Friday 4  
Monday 7  
Wednesday 9  
Thursday 10  
Wednesday 16  
Thursday 17  
Wednesday 23  
Friday 25

Haydon School, North West London  
Pate's Grammar School, Cheltenham  
South Downs College, Hampshire  
Loretto School, Edinburgh  
City of Stoke-on-Trent 6th Form College  
The Judd School, Kent  
Oundle School, Peterborough  
Bromley High School, South London

#### JANUARY 2017

Tuesday 17  
Wednesday 18  
Monday 25

King Edward VI Grammar School, Chelmsford  
Prior Park College, Somerset  
Eastbourne College, East Sussex

#### FEBRUARY 2017

Wednesday 8  
Tuesday 21  
Tuesday 28

Wyke College, Hull  
The Portsmouth Grammar School  
Sedbergh School, Cumbria

#### MARCH 2017

Tuesday 7  
Wednesday 8

Tunbridge Wells Girls' Grammar School  
Forest School, North East London

#### APRIL 2017

Wednesday 5 April

Harrogate Grammar School

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We will be holding our **FREE** biannual **Teachers' Seminar** at the IEA 2 Lord North Street, Westminster, SW1P 3LB on **Wednesday 2 November**, from 9.45am – 3pm.

Topic for the day will be "From Economic Theory to Public Policy".

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If you're an A-Level Economics Teacher and are interested in attending either of these events, then please email [ssandor@iea.org.uk](mailto:ssandor@iea.org.uk) to reserve your place.



## SECOND THOUGHTS...

This summer we held our second annual **THINK** conference at the Royal Geographical Society in London.

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Please note, the application deadline for our Summer 2017 internship programmes is the 1st April 2017. You can find out more at [www.iea.org.uk/internships](http://www.iea.org.uk/internships)





# How THE TREASURY got in a STEW...

(and what dumplings can tell  
us about trade)

Even countries that are not efficient gain from opening their borders to trade. On this and other points, the recent Treasury White Paper on the EU was flawed and confused, says **TIM CONGDON**

**H**ow does participation in international trade and finance affect economies? Does a nation benefit from opening up its borders so that goods, services, capital and ideas can flow to and from other nations? Is free trade or protectionism the best policy?

These are some of the most familiar and basic questions in economics. A valuable by-product of the debate ahead of the 23rd June referendum on EU membership was that it stimulated new interest in theories of international trade and integration.

However, a fair comment is that non-economists were largely bemused by the exchanges, with far too much fuss made about the technical differences between the EU's customs union, the European Economic Area, the so-called "Swiss option" and the like.

This article identifies two types of benefit from international openness and shows how they are both important to the debate on EU membership.

The government's April White Paper on the long-term economic impact of EU membership and its alternatives claimed that the damage from leaving the EU would be enormous, perhaps as much as 10 per cent of national output, but was widely viewed as unconvincing and unsatisfactory.

It focused on only one of the two types of benefit, attributed this benefit to the wrong economist and did not set out a clear chain of argument connecting its premises to its conclusions.

### **Specialisation leads to gains from trade**

The first type of benefit from trade can be shown if we assume that the ability of nations to produce output (or their "production possibilities", for short) is not affected by their participation in international trade.

In this sense the situation is "static". It may seem odd that any gains could come in such circumstances, but the key is to notice that every nation – with its resources and technology given – could make several products.

By concentrating its finite resources on

a particular product, a nation has fewer resources available for another product. For society as a whole, the issue is how best to allocate resources between different branches of production.

When a country is closed to foreign trade, the balance between the resource commitments to two or more products is determined by consumers' preferences and relative prices within the one nation. When it opens up to international commerce, the relative prices of different products are likely to change, perhaps radically.

For example, an oil producing country will get a much better price for its oil if the country sells the oil on international markets than if it is all consumed domestically. It makes sense for nations to specialise according to their "comparative advantage".

Specifically, they ought to commit resources to those activities where the loss of other kinds

**EVEN IF A COUNTRY IS  
PRODIGIOUSLY EFFICIENT, IT STILL  
MAKES SENSE FOR THAT NATION  
TO SPECIALISE AND SELL TO  
OTHER COUNTRIES TO BUY THE  
THINGS IT DOES NOT PRODUCE**



of production is least (or, technically, to those activities "with least opportunity cost").

The ideas at work here are not intuitive, despite being fundamental to economic thinking.

A common mis-understanding is that, when one nation is more efficient (say, in terms of the labour input per unit of output) in every form of production, it will dominate its trade partners, sell things to other countries and never buy anything in return.

In other words, nations with an "absolute advantage" in every industry will destroy all the industries of competitor nations, which ought to impose tariffs and other controls to survive the onslaught of their super-efficient rivals.

For example, it is often argued by NGOs that, if Africa opened its borders to trade, its farming would be wiped out by, say, Brazilian or US farmers who may be more efficient (in an absolute sense) at producing everything.

That is all wrong. The people and companies who constitute a nation sell

goods and services only in order to buy other goods and services which they can consume. To produce for the sake of production would be crazy.

Even if a country is prodigiously efficient in every field of economic activity, it still makes sense for that nation to specialise according to comparative advantage and sell to other countries to buy the things it does not produce.

Consider two nations, one (Europa) with 100 million workers and the other (Britannia) with 50 million workers, able to make two things, bread and dumplings.

If both made only bread, let's assume that they could make the same quantity of bread, say, 100 million loaves. Evidently, Britannia with fewer workers is more efficient than Europa, while – without trade – the two countries can enjoy 100 million loaves of bread and no dumplings.

If, on the other hand, they commit all their workers to cooking dumplings and none to baking bread, assume that Europa could

	Plausible production with no trade		Production with trade	
	Bread	Dumplings	Bread	Dumplings
Britannia	50	30	100	0
Europa	50	50	0	100
Total	100	80	100	100

If they decide to trade, both nations do what they are relatively best at. Europa could make 100 dumplings and no bread, and Britannia could make 100 loaves of bread and no dumplings.

Although Britannia is more efficient at producing both bread and dumplings, it is relatively more efficient at producing bread. It therefore makes sense to produce bread and trade to obtain dumplings.

The two countries then exchange. Britannia sells some of its bread to Europa and Europa sells some of its dumplings to Britannia. With both more bread and more dumplings being produced (see table), clearly, there is a position whereby both sides can be better off.

Indeed, trade can make both parties better off for any combination of bread and dumplings that could be produced unless Europa only wants to consume dumplings and Britannia only wants to produce bread.

Britannia is “better” than Europa in both branches of production, in the sense of having higher labour productivity and an “absolute advantage”.

Nevertheless, despite being good at everything, it is sensible for Britannia to specialise in baking bread and to sell some of its bread production to Europa, while Europa limits itself to the manufacture of dumplings and sells some of them to Britannia.

Amazingly, almost by magic, trade improves consumption patterns even while both nations’ production possibilities – including labour productivity – are the same as before.

**The Treasury should have known better**  
The insight that, with productivity given, trade could improve consumption was one of the



**TRADE CAN MAKE BOTH PARTIES BETTER OFF FOR ANY COMBINATION OF BREAD AND DUMPLINGS THAT COULD BE PRODUCED**

produce 100 million dumplings and Britannia only 60 million.

Again, obviously, Britannia is more productive than Europa, because each of its workers produces (60 million/50 million) or 1.2 dumplings compared with (100 million/100 million) one dumpling in Europa.

Before trade, Europa can make 100 dumplings or 100 loaves of bread or some mix of smaller numbers of both. Also before trade, Britannia can make 100 loaves of bread or 60 dumplings or some mix of smaller numbers of both.

Let us compare plausible positions with and without trade. Europa could produce 50 dumplings and 50 loaves of bread and Britannia could produce 30 dumplings and 50 loaves of bread.

great achievements of David Ricardo in an 1817 treatise on *Principles of Political Economy and Taxation*.

Given that production possibilities are unchanged, here are the static gains from opening an economy to international market forces.

Although Ricardo's idea is basic to the case for international openness, it was not noticed at all in the government's White Paper.

The heart of the White Paper's defence of liberal trade relationships was quite different, that increased participation in international trade (for example, through membership of the European Union) boosted productivity and living standards.

## THE WHITE PAPER SEEMS LIKELY TO BE HEAVILY CRITICISED FOR YEARS TO COME AS AN EXAMPLE OF THE MISUSE OF ECONOMIC ANALYSIS FOR PUBLIC POLICY PURPOSES

The White Paper's thesis is sensible and has ample empirical support. Compare Singapore and Hong Kong, with their commitment over decades to absolute free trade, with North Korea and Cuba, which are largely shut off from the world economy.

But the White Paper thesis – of a *dynamic* link between openness and growth – has a quite distinct theoretical foundation from the principle of comparative advantage.

The seminal thinker was Adam Smith and the key book was his 1776 *Wealth of Nations*. Smith made two propositions, that productivity benefited from specialisation or, in his terminology, "the division of labour", and that the division of labour was limited by the size of the market.

By implication, the larger was the market because of openness to trade, the greater was the scope for specialisation and hence for productivity improvement.

The government's White Paper on the benefits on EU membership would have been more convincing if it had recognised that there are static as well as dynamic benefits from moves to free trade, and if it had attributed the dynamic benefits to the correct economist.

Unhappily, it attributed the dynamic benefits to Ricardo. As we have seen, this was not Ricardo's point at all. If the Treasury's economists had a better understanding of the history of thought, they would have known that Adam Smith was the right authority to mention.

Much else was wrong with the White Paper, which seems likely to be heavily criticised for years to come as an example of the misuse of economic analysis for public policy purposes.

Now the British people have decided to leave the EU, a practical test will be made of the White Paper's conclusion that their country will be 10 per cent worse off by 2030 than if it had remained in the EU.

The truth is that outside the EU the UK can resume its seat on the World Trade Organization and press more forcefully than before for renewed international trade liberalisation.

At any rate, both Adam Smith and David Ricardo would surely enthuse about the possibilities for increased international

openness that an independent Britain can embrace. Of course, in a democratic society the choice between free trade and protectionism will be determined by politics.

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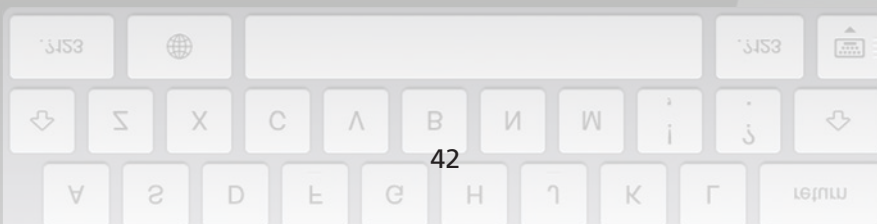
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# PAYDAY MOANS...

**The gender pay gap continues to attract passionate attention on both sides of the Atlantic.**

It has been known for many years that the size of this gap is associated with the relative proportion of men and women employed in particular occupations.

Male-dominated fields typically pay more than female-dominated ones. There are several possible explanations for this. One is the existence of compensating differentials. If working conditions differ, pay will reflect this.

For one thing, men are more likely to be in dangerous jobs with long hours. There is abundant evidence that such job characteristics carry a wage premium, other things such as education and experience being held constant.

Also if preferences over types of work differ, so will pay: women typically report a preference for working in jobs with intrinsic satisfactions – such as helping other people – while men are more money-oriented.

Of course many women do dangerous jobs, while many men work in caring roles. But pay gaps are based on averages.

In recent years some interesting evidence has emerged that, when increasing numbers of women enter a

formerly male-dominated occupation, earnings fall.

Why does this happen? Paula England, a Sociology Professor at Cornell University, is in no doubt that employers place a lower value on work done by women.

Her view has been echoed by Sam Smethers, the chief executive of the UK's Fawcett Society, who asserts "This shows that it's not women's work that is undervalued, it's women", while Jayne-Anne Gadhia, head of Virgin Money, says there is an "unconscious bias" against women.

Employers don't think in that way. Many of them are women

an occupational area, whether as a result of an expansion of graduates with particular skills, or as a result of migration, you surely expect a decline in relative pay. So an influx of women into a field is likely to lead to more competition and lower pay.

The issue here is that an influx of women (unless accompanied by an exit of men of the same magnitude) represents an increase in labour supply. The relative decline in pay occurs not because the newcomers are women, but simply because there are newcomers.

You may not like how these

**AS WOMEN ENTER AN  
OCCUPATION, AVERAGE PAY  
FALLS. SEXISM? NO. JUST  
SUPPLY AND DEMAND,  
SAYS LEN SHACKLETON**

themselves, of course. They want to get the best staff they can, male or female, and will pay what they have to do to get them. What they have to pay, though, is not necessarily going to remain the same over time.

When you get a big influx of potential employees into

changes play out, but to blame them on employer attitudes is unhelpful and just adds to the anti-business rhetoric of our chattering classes•

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# JUST the TICKET

The government has recently been considering responses to a submission on whether it should take action on ticket touts.

What exactly is the issue here? To take an example, a pop star (or agent, or concert

An original purchaser of the tickets might then sell them to somebody who is willing to pay a higher price and, in doing so, make a huge profit. This might be on ebay, hand-to-hand or through some other method.

## PHILIP BOOTH SAYS NON-TRANSFERABLE CONCERT TICKETS ARE PERFECTLY LEGITIMATE

producer) may take a decision that they wish tickets to go not just to those who can pay the most but to the widest possible fan base or to fans who have particular characteristics (for example, those who have joined a fan club).

In other words, the star, through their promoter, is willing to sacrifice immediate income in order to perform to a particular audience.

In some situations, it might be possible for businesses or motivated individuals to acquire a lot of cheap tickets and sell them on in this way.

Simon Jenkins has argued that allowing a secondary market ensures that tickets will go to those who value them most and that the pop stars who are complaining should give free concerts to the most avid fans. But, this misses the point.

Pop stars and promoters are entitled to price their tickets as they wish and distribute them how they wish: it is a private event.

If Simon Jenkins invited 100 people to a party at his home, he would not expect one of the invitees to sell his free invitation to a rich person – the invitation would be non-transferable. If pop stars wish to make tickets non-transferable, that is their right.

There may be all sorts of reasons why an institution such as a football club or a pop star want to have a diverse audience rather than the highest-paying audience.

A free economy does not just lead to a “value maximising” position as defined by the greatest amount of revenue raised, it provides an institutional framework within which people can pursue their aims and objectives whatever they may be. Being loyal to a fan base might be one such objective.

However, if you are a rich pop star or well-endowed football club putting on an event, what you cannot do is expect the government to do your work for you by making the act of selling on a ticket a criminal offence.

There are perfectly reasonable forms of enforcement that the promoters can use themselves. For example, ID checks or credit card checks can be made on entry. It is the organisers’ event; it is their problem; the technology exists to solve it; they should deal with it.

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Full version at:

[www.iea.org.uk/blog/simon-jenkins-is-wrong-non-transferable-concert-tickets-are-perfectly-legitimate](http://www.iea.org.uk/blog/simon-jenkins-is-wrong-non-transferable-concert-tickets-are-perfectly-legitimate)



# HAVEN-SENT

**In an Oxfam-coordinated letter, 355 economists claim that tax havens “serve no useful economic purpose” and do “not add to overall global wealth or well-being”. This is nonsense.**

National tax systems are often badly designed, and the interactions between them are even worse. Try to set up an international business and you will soon become bogged down in the international tax system. For anyone attempting cross-border business or investment, the main worry is the risk of double or even triple taxation.

Profits are legitimately taxed in the hands of the business that earns them and in the hands of the investors who ultimately receive them, but should not be taxed as they merely flow through intermediary investment managers.

If the investors and the businesses in which they invest are all in one country, that double taxation is usually removed by the tax system. But, if an investment fund is trying to attract money from sources in different countries, the system often cannot – or does not – cope. The role of offshore finance centres is to

give a neutral, stable platform where this international investment can take place.

Often the investors that use offshore centres are not even taxable (for example, they may be pension funds, charities and international organisations). They are just avoiding the complexities of paying tax that they would then have to try to reclaim or paying tax from which they really should be exempt.

Offshore finance centres also bring stability and a secure, familiar, well-understood legal system. Sadly a lot of countries do not have that and investors can use offshore financial centres as a reliable and secure place for investment.

These two points – the need for a neutral platform to collect and pool investment, and the need for a stable legal and political framework – are part of the service that offshore finance centres provide to the world.

But these services are most important for investment into developing countries and emerging markets, because collecting capital for a niche market requires investments to be pulled together and pooled from various sources.

An investment fund investing

in British companies, looking to attract British investors, will often be located in London, but if the fund is collecting investments from a range of countries to invest in a group of (say) Central American companies, then locating the investment vehicle offshore simplifies things considerably.

## RICHARD TEATHER LEAPS TO THE DEFENCE OF TAX HAVENS

The huge growth of international trade and investment over the last 25 years has lifted a billion people out of poverty – the biggest anti-poverty campaign in world history.

If the governments of the wealthy and powerful nations “end the era of tax havens”, they will cut off the best conduit of this investment and that great poverty reduction process will stall.

**Richard Teather**

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# THE GREAT ESCAPE

## Health, wealth, and the origins of inequality

ANGUS DEATON PRINCETON UNIVERSITY PRESS 2013

In 2013, two major books on inequality were published: Angus Deaton's *The Great Escape. Health, wealth, and the origins of inequality* and Thomas Piketty's *Capital in the 21st Century*.

Though Deaton's book was ultimately vindicated by its author being awarded the 2015 Nobel Prize in Economics, it got a fraction of the international recognition gained by Piketty's.

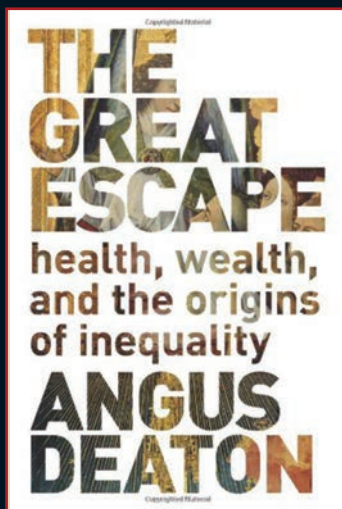
By and large, the very different fortunes of the two books can be explained by their respective messages.

Piketty and Deaton share a similar vantage point. They both care deeply about inequalities and they both belong to the political left.

Piketty's study came together with a slew of news on the widening of the gap between the rich and the poor in Western countries. Deaton's work, on the contrary, presented a cautious and yet positive case for increased well-being all over the world. The "great escape" is the great escape from poverty and death.

Piketty's unit of analysis is the nation state, Deaton looks into global dynamics. He reasons that, if we care about people rather than countries, we should be optimistic as living standards across the globe have been converging. Deaton clarifies that inequality is often a consequence of progress as not everyone gets rich at the same time.

"The Great Escape" is dense and carefully argued. I can only point out what I regard as its three most relevant



takeaways:

1. If you deal with inequalities, think about wellbeing, not only income or wealth.

Deaton writes at length about health, pointing out that increases in years of life are associated with economic growth. Life expectancy roughly doubled in the last two centuries, in non-OECD countries. This happened thanks to a dramatic decrease in child mortality, rooted in economic and social progress, particularly in better nutrition and living conditions.

2. Better living conditions come with economic progress, but economic progress is not something that can easily be parachuted in countries still oblivious to it. Historians have long been asking themselves why the Industrial Revolution happened in Europe, and in Britain in particular. In the past century, richer countries tried to foster investment in the poorer by sending them money. But, Deaton quotes

economist Peter Bauer who maintained that if all the conditions necessary for development other than capital are present, capital will soon be generated locally or become available on commercial terms. So, governments do not need to provide capital in the form of aid and doing so, in fact, can undermine other necessary conditions for development by strengthening local elites.

3. Since the fabric of economic progress is so delicate, be careful when you play with social engineering. The bravest of Deaton's pages are those devoted to the "much mischief" that was done "in the name of the international population control", which was taken to the extreme of so-called voluntary sterilisation that wasn't voluntary at all. The population explosion, for one thing, didn't plunge the world into doom and desperation. But, even if that danger was real, how do we dare to impose our choices on people, particularly when it comes to so intimate a choice as the decision to have babies? Coercion in this realm, no matter how humanitarian was the claimed motives, were in fact a most serious intellectual and ethical error.

The care with which Deaton researches problems has led to some brilliant work that deserves wide attention, especially among students.

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# THE RISE AND DECLINE OF NATIONS: Economic Growth, Stagflation, and Social Rigidities

MANCUR OLSON YALE UNIVERSITY PRESS 1982

Mancur Olson (1932-1998) is regarded as one of the founding fathers of public choice theory or 'the economics of politics' – a discipline that tries to apply economic ideas to explain political decision making.

In *The Logic of Collective Action* (1965) he provided many groundbreaking insights on how incentives affect individuals acting as members of groups and so improving our understanding of the results of collective and political action.

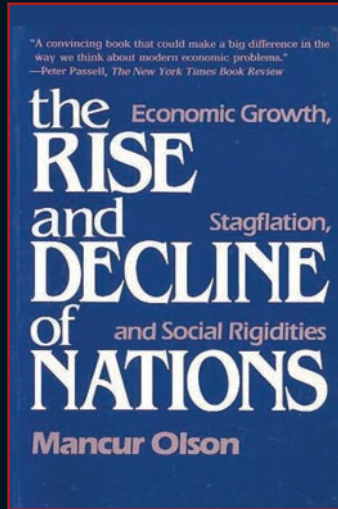
However, his 1982 work *The Rise and Decline of Nations* deserves even closer attention from those interested in institutional political economy and development studies.

It provides several insights into our understanding of the institutional dynamics of economic development and how it relates to the political process and the action of organised interest groups.

The book's structure comprises a first part which is mostly theoretical and a second part that applies the theoretical framework to analyse several historical and contemporary issues and cases in political economy.

The theoretical framework starts with a summary of the main ideas developed in *The Logic of Collective Action* and then draws implications for the action of organised interest groups in societies that enjoy some degree of stability over time.

Given their centrality to Olson's analysis, it is worth very briefly summarising some of the key findings laid out in



chapter 3:

1. Interest groups will have asymmetric bargaining power and optimal outcomes cannot be achieved via comprehensive bargaining (for example, public sector unions may have more bargaining power than hospital patients).
2. In stable societies organised interest groups tend to accumulate and flourish over time.
3. Smaller groups will tend to be better organised for collective action to influence government to promote their interests.
4. Organised special interest groups have, on balance, an adverse effect on economic growth and increase political divisiveness (for example, by promoting strikes or obtaining special privileges for businesses).
5. Distributional coalitions (which try to affect policy to increase the incomes to their members) react against new technologies that they

perceive as harmful to their special interests and therefore slow down their adoption (with negative impacts on economic development).

6. As distributional coalitions successfully accumulate over time, they increase the regulatory burden, the role of government and have a general negative impact on economic and social evolution.

Drawing from these implications, Olson links the growth, stagnation and the decline of nations with the dynamics of "distributional coalitions" their cumulative negative effects will – if unchecked – ultimately lead to societal collapse, paving the way for drastic institutional change. It can be argued that some of these affects are being seen today in Mediterranean countries.

There are, of course, multiple other variables that affect outcomes, but Olson's theory is a useful tool with which to analyse both historical and contemporary cases.

Above all, *The Rise and Decline of Nations* provides a solid case concerning the social harm caused by special interest groups acting through the political process and simultaneously reminds us of the importance of markets and competition in promoting sustained prosperity.

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## BRIEFING: Summarising and signposting essential reading we've seen elsewhere...

### The **IMPACT** of **SUPPLY CONSTRAINTS** on **HOUSE PRICES** in **ENGLAND**

In the last 40 years, real house prices have grown faster in Britain than in any other OECD country, significantly outstripping real income growth.

The gap between the UK and comparable countries becomes all the more striking when house size is taken into account. The average new-build house is close to 40 per cent smaller in the UK than in either Germany or the Netherlands, even though the latter is more densely populated.

Economists have long posited that Britain's outlier status in real estate prices is driven by tight supply constraints, i.e. the lack of available land for development in places where people want to live.

The paper's authors test this hypothesis empirically and investigate how much of recent house price growth is attributable to planning restrictions. They use data on house prices and earnings from 353 local planning authorities over 35 years from 1974 to 2008.

They find that, in the absence of planning constraints, real house prices would have risen from £79,000 to £147,000 instead of to £229,000, for the average dwelling, between 1974 and 2008.

In other words, house prices would be 35 per cent lower without regulatory restrictions on building.

But the authors find that, even if the South East had relaxed its regulations to a level similar to standards in the North East, house prices in 2008 would have been 25 per cent lower.

This paper provides robust empirical backing for the hypothesis that high house prices in England are primarily caused by planning restrictions.

**CHRISTIAN A.L. HILBERT** and **WOUTER VERMEULEN**

*The Economic Journal* Vol. 126  
Issue 591: 358-405. 2016

### **RIDE-SHARING, FATAL CRASHES and CRIME**

In recent years, ride-sharing applications enabled by smartphones have increasingly challenged the heavily regulated taxi sector in cities worldwide.

While proponents of these new business models highlight the convenience, attractive fares and good customer service of transport apps, sceptics have raised concerns about the safety of firms which are much less regulated by government than traditional taxicabs. In particular, it is alleged that the presence of transport apps could lead to higher accident and assault rates.

This paper examines the statistical evidence by comparing relevant variables – traffic fatality rates; arrests for driving under the influence (DUI), assault and disorderly conduct – across US counties.

The authors found statistically significant evidence of a reduction in traffic fatality rates. Specifically, they find that the arrival of Uber was, on average, associated with a 6 per cent drop in fatal crashes and an 18 per cent fall in fatal night-time accidents.

Each month that Uber operates in a county is associated with a 2.1 per cent drop in fatality rates. DUI arrests decline by between 9 and 18 per cent with entry into the market by Uber. Both of these are statistically significant.

The arrival of Uber is likely to have led some young drivers to ride-share rather than drive themselves, reducing accident rates. Similarly, the relative affordability and convenience of ride-sharing apps seems to have resulted in substantial numbers of people using apps rather than drink-driving.

**ANGELA K DILLS** and **SEAN E. MULHOLLAND**

*Working paper, Spring 2016: Available on the Social Science Research Network*

### **CAPACITY TO WORK AT OLDER AGES: EVIDENCE FROM THE US**

As life expectancy increases and populations age in many Western countries, the financial burden on pensions and healthcare systems will grow.

Raising the retirement age, and encouraging more people to extend their working life, are two common policy proposals to partly address this issue.

The authors of this paper explore whether older individuals – specifically, older Americans – enjoy good enough health to work in old age.

The paper asks two questions. Firstly, if people with a given mortality rate were able to work as much as people with similar mortality rates worked in the past, how much could they work?

Secondly, if older people with a given level of health were able to work as much as younger people with the same level of health, how much longer could they work? The findings suggest that older Americans have the health capacity to work significantly longer than they currently do.

Concretely, the authors find that, if the same relationship between employment and mortality rates prevailed as in 1977, American men would work an additional 4.2 years between ages 55 and 69.

Using estimates of self-reported health and comparing employment rates with those younger Americans who report similar health status, the authors find that older Americans are able to work 4.9 years longer than they currently do.

The paper suggests that there is considerable scope to increase labour force participation at older ages in the United States.

A similar exercise would have to be conducted for the UK to establish whether its conclusions apply to the British labour force.

**COURTNEY COILE**, **KEVIN S. MILLIGAN**, and **DAVID A. WISE**

*NBER Working Paper 21940. Cambridge, MA: National Bureau of Economic Research, 2016*

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# An **ILLIBERAL** VIEW of **NEOLIBERALISM**

An article from the International Monetary Fund's magazine, entitled 'Neoliberalism: Oversold?', has been making the rounds on social media.

This is not surprising: bemoan 'neoliberalism' in one way or another, and you are virtually guaranteed roaring applause on social media.

Nor is it surprising that IMF authors are taking such a stance, unless you ever fell for the urban legend that the IMF is a 'neoliberal' institution. But what is surprising is how narrowly the article defines the alleged 'neoliberal agenda'.

Free-market reforms include openness to foreign trade, deregulation of labour and product markets, and the liberalisation of areas of the economy which were previously subject to extensive state intervention.

Such an agenda has been pursued, with varying degrees of commitment, throughout the world since the late 1970s.

Where it has been pursued, and where it has not been undermined or offset by statist measures, the results have been overwhelmingly positive: a dramatic reduction in poverty, with 700 million people lifted from deprivation in China alone; greater access to water, electricity and consumer goods and a promotion of social mobility as entrepreneurship and credit were unleashed.

The article points out that recent balance of payments crises in Latin America and Asia occurred in the context of free capital flows. But this does not necessarily mean that, as the article implies,

## neoliberalism

ne.o.lib.er.al.ism

noun

a modern politico-economic theory favouring free trade, privatization, minimal government intervention in business, reduced public expenditure on social services, etc

Derived Forms

neoliberal, adjective, noun

free capital flows magnify the likelihood and impact of crises.

Rather, an examination of the countries involved shows that events were mainly driven by a lack of robust institutions – independent central banks, fiscally prudent governments, the rule of law – which both spurred public and private borrowing in the boom years and led foreign investors to call in their loans as soon as things turned sour. Argentina, Mexico and Thailand are all

macroeconomic headwind.

Furthermore, the recent experience of Ireland and Spain show that austerity can be expansionary when accompanied by a programme of liberalising reforms.

As far as developing countries are concerned, the main problem is that the state was not just large, but also astonishingly inefficient before liberal reforms were implemented. India's growth-choking 'permit raj' pre-1991 comes to mind.

Thus a market-driven agenda has provided oxygen for the private sector to flourish, with very beneficial effects on growth and real wealth at all income levels.

International bodies such as the IMF may worry about rising inequality as economic growth rewards some more than others within an economy.

But even a superficial look at the evidence from the past 35 years shows the amazing progress made – especially by poorer countries – under the so-called 'neoliberal agenda.' This progress is sadly overlooked in the article.

## **DIEGO ZULUAGA TAKES THE IMF TO TASK**

salient examples of this cycle.

By contrast, countries such as Chile with a better institutional framework have thrived under the free flow of capital. So has the UK, which until 1979 had strict capital controls in place.

There is no historical precedent in peacetime for the level of debt that many developed countries have reached in recent years. However, it is unlikely that economies with public debt-to-GDP ratios close to or exceeding 100 per cent are in a strong position to weather the next

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# WAIST OF TIME

THE GOVERNMENT PLANS TO TACKLE OBESITY BY IMPOSING PUNITIVE TAXES ON A HUGE RANGE OF PRODUCTS THAT LEAD TO WEIGHT GAIN. BUT **CHRISTOPHER SNOWDON** ARGUES THAT IT HASN'T DONE ITS ECONOMICS HOMEWORK...

**By taking on obesity as a political challenge the government is on course to spend many years and countless pounds trying to control the waist circumference of its citizens. It is a project doomed to failure.**

A literal 'fat tax' in which people are taxed on each kilogram of excess body weight might work but that, too, would be politically unacceptable.

Instead, the government is proposing a tax here and an advertising ban there. These policies seem to have been chosen because they have been used on smokers in the past rather than because they are likely to work in relation to the far more complex issue of obesity.

In an affluent country in which even the poorest fifth of the population spends only sixteen per cent of their income on food, taxes are unlikely to make any real difference to what people put in their grocery basket.

Food prices change all the time without significantly changing people's diet. Evidence from Denmark, which briefly implemented a fat tax a few years ago, suggests that higher prices make people buy cheaper brands and shop in cheaper stores while continuing to eat much the same food.

In other words, the demand for food in general is price inelastic, though people do substitute to cheaper brands because of the income effect of higher taxes.

Proponents of sugary-drink taxes draw comparisons with tobacco taxes. The latter have undoubtedly had some effect on reducing smoking rates over the years and yet the comparison does not stand up.

Not only are tobacco taxes

vastly higher than anything that could be realistically levied on food (cigarette taxes currently stand at around 700 per cent whereas the proposed sugar tax is 10 per cent), but tobacco taxes are aimed at all products that cause the problem.

A tax on cigarettes, pipe tobacco and cigars effectively taxes all smoking whereas a tax on certain soft drinks does not tax obesity, rather it taxes one small component of

companies, he portrayed it as a nudge to get manufacturers to reformulate their products with less sugar.

This is a strange demand to make of an industry that has been producing low-sugar and zero-sugar varieties for decades.

Consumers are aware that artificially sweetened drinks contain no calories. If they tasted as good as the sugary originals, they would dominate the market.

**EVEN THOSE WHO  
CAMPAIGNED FOR THE  
SOFT DRINK TAX NOW  
ADMIT IT WILL HAVE  
LITTLE OR NO EFFECT  
ON OBESITY**



energy intake which is neither a sufficient nor necessary cause of obesity.

Moreover, whereas a tax on cigarettes only affects smokers, a tax on soft drinks affects obese and non-obese people alike.

In technical terms, the government is choosing to tax one out of a range of close potential substitutes – so people will substitute an untaxed sugary product for a taxed one. In other words, there are other products that have a significant "positive cross-price elasticity of demand".

Even those who campaigned for the soft drink tax now admit that it will have little or no effect on obesity. Instead they argue that it is a 'symbolic' act, and perhaps it is. When George Osborne announced his 'sugar levy' on soft drink

Alas, most people prefer the taste of sugar and so the health-conscious consumer has to decide if he is prepared to sacrifice flavour for fewer calories.

This is the key trade-off with food in general. For good evolutionary reasons, people find low calorie food less flavoursome than high calorie food.

The government can tell manufacturers to use less sugar in their products but they cannot force people to buy them.

So long as people have money in their pockets and freedom to choose, the chances of the state dictating what we eat are vanishingly small •

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# LION'S SHARE

**For wildlife to thrive, it must be valuable. This means allowing economic activity related to wildlife – including the right to hunt, says ecologist MIKE NORTON-GRIFFITHS**

**T**he international furore following the killing of Cecil the lion in Zimbabwe in 2015

inflamed the debate on the contribution to wildlife conservation of sport hunting.

The evidence is strong that, outside protected areas, wildlife prospers and more living space is made available under the following conditions:

- There are wider, rather than narrower, opportunities for economic exploitation
- Ownership and user rights to wildlife are more devolved to the owners and users of land rather than less devolved
- Benefits flow transparently and fairly to both producers and consumers of wildlife goods and services
- Wildlife authorities adopt

enabling rather than purely regulatory and enforcement roles.

It is when these policy issues have been dramatically changed that we see their importance. For example in Kenya, in 1977, all consumptive use of wildlife, including sport hunting, was banned.

Following the ban, opportunities for economic exploitation were restricted to photo-tourism and the state monopolised all wildlife ownership and user rights. As a result, benefit streams from wildlife abruptly ceased.

Revenues from wildlife shrank by about 90 per cent. As a result wildlife production became uncompetitive compared with livestock and agricultural production and, by the year 2000, Kenya had lost some 60 per cent of her wildlife (Figure 1). [insert figure one about here]

This loss is a telling indictment not only of a

failed conservation policy but also of the abject failure and ineptitude of “professional conservationists”, government and NGOs, who sat by idly while Kenya’s wildlife vanished under their very noses despite the millions of dollars invested by them in wildlife conservation.

More recently Kenya’s grass-roots “conservancy movement” in which individual or groups of landowners and landusers have pooled their access rights has significantly improved matters.

Tourist operators must now pay an agreed monthly rental for access to their land independently of the number of visiting tourists. In the areas covered by these agreements, wildlife populations are showing clear signs of recovery.

## **Success in the South**

While Kenya was pursuing its restrictive policy, extensive

wildlife industries developed throughout southern Africa, especially in South Africa.

Wildlife became, like livestock, fully tradable. New legislation was passed to devolve ownership and user rights to landowners and landusers who could now capture the great majority of wildlife generated revenues. In addition, close working relationships were forged between the state and private sectors.

While Kenya hemorrhaged 60 per cent of her wildlife, South Africa's wildlife numbers increased by more than 20 times. The difference between them in terms of the added value to wildlife is particularly striking.

Recently a cape buffalo sold for breeding at auction in South Africa for US\$5,000,000; in contrast the meat from a poached buffalo in Kenya would fetch, after paying off the police and the Kenya Wildlife Service, around US\$500.

We now see there are

**ALLOWING HUNTING AND ALLOWING WILDLIFE TO BE HARNESSSED IN OTHER WAYS... IS THE BEST WAY TO ENSURE THAT ALL HAVE AN INTEREST IN PROTECTING WILDLIFE**

two quite different kinds of protected areas for wildlife conservation: those formally demarcated and protected by the state as National Parks, Reserves and Forests and those protected by landowners and landusers in response to economic incentives as conservancies,

game farms, ranches and hunting areas.

The conservation of lions demonstrates the importance of both kinds of protected areas. Lions require space because of their social system: young males leave the pride

and wander far afield until they are strong enough to take over a pride by killing the resident male and his cubs.

This is how Cecil took over his pride, as did his father and grandfather before him, and is how Cecil himself would have been finally deposed.

But, few of the state-

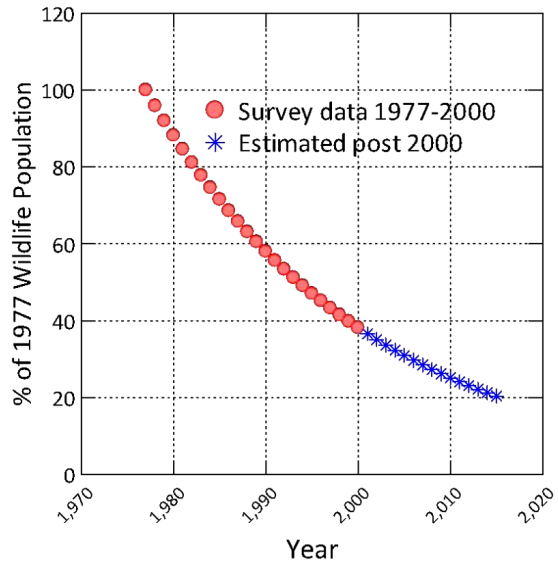
protected areas throughout Africa are large enough to support significant numbers of lions, the majority of which live on land currently protected by economic incentives.

In southern Africa the wide range of economic opportunities open to landowners and landusers makes the economic landscape much more extensive and more favourable to lions than in countries such as Kenya.

In other words, allowing hunting and also allowing wildlife to be harnessed in other ways to extract economic value is the best way to ensure that all have an interest in protecting wildlife•

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Figure 1 KENYA – loss of wildlife following the 1977 hunting ban





# SHELL SHOCK

## Averting Brexit Disaster

**DEREGULATED MARKETS AND FREE TRADE AREN'T THE MOST LIKELY OUTCOME OF THE EU 'DIVORCE' PROCESS, SAYS **RAZEEN SALLY****

The British (or rather the non-London English and Welsh) have decided to leave the EU. I think this is a very bad, and potentially disastrous, decision.

I was appalled by the Leave campaign. But the deed is done. Now the UK must contain the damage and turn it into opportunity.

My starting point is that of a "sceptical European" (Ralf Dahrendorf's term, not mine). For all the EU's faults, I still thought it prudent to stay inside.

First, the UK has gained enormously from the Single Market, far outweighing the budgetary and regulatory costs of membership. Brexit

will be costly in the short-term, given uncertainty over future arrangements with the EU, with probable long-term damage. The evidence is overwhelming, from a tsunami of official and non-official studies in the UK and elsewhere.

Second, Brexit risks the break-up of the Union, starting with Scotland. And third, Europe faces existential challenges: perhaps from a flood of refugees from the Middle East and North Africa; but more so, externally, from Vladimir Putin's Russia, and, internally, from a toxic cocktail of left-wing and right-wing populism.

These problems will probably

get worse, not better, with a fragmented EU, especially with the UK outside it.

In my view, much of the Leave campaign behaved with wanton recklessness. The official campaign never fleshed out a credible post-Brexit plan. And many of its arguments came from the gut, without regard to evidence, logic, intellectual examination, or indeed basic facts.

First came the demonisation of evidence from "experts". Then followed the economics of fantasy. The problems of negotiating new terms with the EU were minimised, with totally unrealistic assumptions of UK bargaining power with a much larger (and newly

jilted) partner. So were the challenges of negotiating new free-trade agreements with non-EU trading partners.

In general, serious trade economists do not believe that more intensive trade with far-flung emerging markets will compensate for trade losses with neighbouring large, prosperous markets in the EU. The contention that trading better with the Commonwealth and a cultural Anglosphere will trump trade with the EU is fanciful – as I can testify sitting here in Singapore.

Worst of all was many in the Leave campaign's stance on immigration. The UK, like other prosperous, ageing societies, needs more migrant workers. The freedom to move and work within the EU is one of its biggest successes – also for the UK.

Restricting or removing the right of people in other EU member-states to live and work in the UK would be the single most illiberal act since Mrs Thatcher took office in 1979.

Most shamefully, by whipping up the false demon of immigration, many in the Leave campaign made a Faustian Pact with little

Englishers.

Dark, illiberal forces have been unleashed. I fear the UK will take an illiberal turn outside the EU, starting with more controls on immigration. How can this be averted? How can the UK become more liberal outside the EU as some in the Leave campaign genuinely do want?

First, it is vital the UK preserves full access to the Single Market, including the freedom of movement of people (though this will now be very difficult to sell domestically).

Second, the UK should start unilaterally deregulating areas not under EU control, such as taxation, expenditure, labour markets and land use planning (which it could have done in any case as an EU member).

Third, it should draw up plans for unilateral liberalisation where EU constraints apply, especially in non-EU trade, agriculture, energy and the environment.

On external trade, the UK should aim to continue as a member of existing EU free-trade agreements (FTAs) through “grandfathering” provisions. And, separately, it should go for new “deep

integration” agreements with the USA, Japan, and other capable and willing trading partners.

It could apply to join the North American Free Trade Agreement, which brings together the USA, Canada and Mexico, and the Trans-Pacific Partnership, which brings together the USA, Japan and nine other Asia-Pacific countries. Other FTA candidates are the Pacific Alliance in Latin America, China, the ASEAN countries, India and Brazil.

This is the optimistic scenario that many of the classical liberal and libertarians who voted for Brexit would, no doubt, like to see. However, the tone of the Brexit campaign overall was such that it is not the most likely outcome.

If the UK veers in a more illiberal direction, then classical liberals and libertarians who campaigned for Brexit must take their share of the blame.

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# Don't lean on this tower of PISA

Over recent decades, the idea of evidence-based policy has gained ground in many areas. In education many commentators look at the OECD's Programme for International Student Assessment (PISA) survey, which produces scores measuring educational performance in dozens of different countries. They assume this organisation knows what it takes to perform well.

This is not the case, however. OECD

Take the issue of competition from independent schools. The PISA report tells us that the share of children attending independent schools is unrelated to countries' performance.

Andreas Schleicher, the OECD's education director, often refers to this non-existing correlation as evidence that competition does not raise standards.

So do representatives of the left-of-centre think-tank IPPR, who argue that

leading to quite significant efficiency gains.

According to this research, a 10-percentage point increase in independent-school enrolment shares raises achievement by about 10 PISA points and decreases costs by about 5.6 per cent.

Using methods designed to unveil causal relationships, the study blows the OECD's methods out of the water.

Another example concerns school autonomy – which measures the extent to which schools are free to make their own decisions. The OECD concludes that autonomy in combination with state accountability has a positive impact on PISA scores, while autonomy by itself has negative effects.

However, academic research shows that the impact of autonomy by itself is positive in developed countries, although accountability increases this positive effect.

These are just two examples. The OECD's analysis of effective practices fails to provide us with answers and so does the supposed best-practice approach more generally.

Searching for characteristics shared by high-performing countries' education systems isn't a recipe for

## GABRIEL HELLER SAHLGREN SCRUTINISES THE OECD'S STUDENT ASSESSMENT

recommendations are based on cross-country comparisons and the characteristics of high-performing nations. But just because certain policies have been adopted by countries with good results, it does not mean that those policies caused those good results.

In fact there may be many other explanations. Looking to the OECD's analysis for answers on what produces effective education systems is therefore a leap in the dark.

this conclusion demands an answer by advocates of independent providers.

Well, here's the answer: proper academic research does in fact find positive effects of independent-school competition on PISA performance – and also that pupils in state schools benefit just as much as pupils attending independent schools.

The study that uses the most robust methods finds that competition both raises PISA scores and lowers costs,

understanding what makes them perform well.

Why? Because 'best practice' approaches always derive from often engaging, but ultimately pointless, stories: if you're only looking at successful education systems, it's impossible to know whether the policies highlighted have caused, been irrelevant for, or even impeded their performance.

Indeed, the approach typically leads to cherry picking, an exercise in which pundits emphasise the policies they happen to like and ignore the rest. As Jay Greene, professor of education reform at the University of Arkansas, has argued, best practices are therefore in fact the worst.

But if this is the case, why do politicians continue to refer to the OECD report regarding what constitute effective policies?

Well, analysing research requires an understanding of what makes it good and what makes it bad. And unfortunately, unlike the PISA report, economic studies aren't very accessible to non-economists.

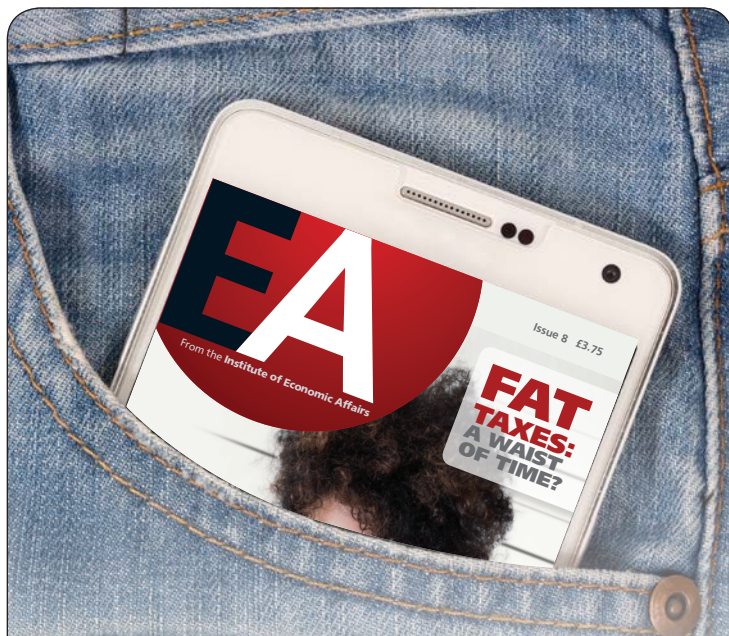
And it's easier for politicians to highlight ideas that are popular in the teaching profession, such as collaboration, rather than ideas that are unpopular, such as competition – even though the latter receives more support in the literature than the former.

It's also understandable that policymakers look for an easily interpretable guide on how to reform their education systems to produce better results. But the OECD report isn't that guide. The sooner they realise this the better.

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