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WILL AI TAKE YOUR JOB?

PLUS: TIM HARFORD on humble ideas that **change the world**


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WELCOME

Technological innovation and **fear** seem to go hand in hand.

In the Industrial Revolution of the 1800s, the Luddites feared that machinery would **take their jobs**. But what happened? **More jobs, more opportunities**.

And today, as we stand on the brink of another technological revolution, many fear that **Artificial Intelligence** will result in **mass unemployment**. But will it really?

In our cover story (page 10), we examine the potential **impact of AI** – and identify the **human skills** that will be in **massive demand** in years to come.

But it also seems that wherever innovation goes, so does **regulation**.

On page 15, we look at the **stifling effects** of **ever-increasing bureaucracy**, and see how it affects areas such as health and safety (page 18), the taxi industry (page 22) and Britain's small businesses (page 32).

But it isn't just regulation that **impedes innovation**. Sometimes **major breakthroughs** rely on a whole series of smaller changes before they can make an impact.

Best-selling author **Tim Harford** explores this phenomenon in a **brilliant précis** of his new book *Fifty Things That Made the Modern Economy* (page 4).

We're delighted to feature Tim in this issue of **EA**. As ever, we strive to bring you the **best writers in the world** on economics – and we trust it makes **fascinating**, and **essential**, reading.

Jamie Whyte
Editor
March 2018

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Institute of Economic Affairs

TIM HARFORD: DON'T FORGET the SMALL STUFF

The best-selling author on technological progress – and why the little things mean a lot

Fans of the 1982 sci-fi classic *Blade Runner* – and I am one of them – have to admit that the film has a few moments that, to modern eyes, look a little odd.

When our hero Deckard falls for "Rachael", he already knows that Rachael is a highly intelligent organic robot, with memories uploaded from a human.

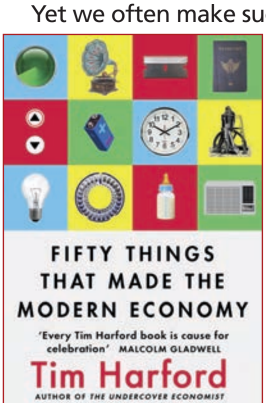
She is so sophisticated that she cannot be distinguished from a human without specialised equipment in the hands of an expert operator (such as Deckard himself).

Yet Deckard likes her. So, faced with an artificial intelligence in a synthetically organic body that has been schooled through a memory upload – how does he ask her out on a date?

Simple: he goes to a graffiti-scrawled public payphone in the corner of a bar and dials her number.

It's a jarring gap between the humble payphone and beguiling robot on the other end of the line.

Yet we often make such mistakes when imagining new technologies. We wrongly assume that a technology like "Rachael" could somehow appear, yet little else would change.



And we're hypnotised by the most sophisticated stuff. In doing so, we miss humble ideas that quietly change the world.

When I embarked on my latest project – a book and BBC series about "Fifty Things That Made the Modern Economy" – everyone I spoke to urged me to include Gutenberg's movable type printing press, which was developed in the mid-1400s, and which ushered in the reformation, mass literacy, the novel, the newspaper, and much else. It was, of course, a revolution.

Yet when I came face-to-face with a 1450s Gutenberg bible, with its dense black columns of glorious Latin text, I realised that there was another story to tell: the story of paper.

This is the economist in me speaking: without paper, the economics of printing simply do not work.

It is possible to print on animal skin parchment – Gutenberg did just that with some of his bibles.

But the whole point of a printing press is to mass produce writing at scale. To make that a profitable affair, you need a way of mass-producing a writing surface. That cheap, affordable writing surface is paper – now so cheap that we even use it to wipe (ahem) all sorts of things.

WE'RE HYPNOTISED BY THE MOST SOPHISTICATED STUFF…WE MISS HUMBLE IDEAS THAT QUIETLY CHANGE THE WORLD

Other revolutionary cheap-as-toilet-paper inventions include: barbed wire, the cheap fencing material which allowed the colonisation of the American west; the imperfect-yet-convenient MP3 music format; and the shipping container, a simple box that transformed global trade beyond anything the World Trade Organization could manage.

Of course, some innovations truly are revolutionary, producing effects that would have seemed like sorcery to previous generations: electricity is one example; the computer is another.

Such inventions fit our instincts about what "new technology" should be. They are a far cry from paper and shipping containers – much more like the mysterious organic robot Rachael.

Yet even here we focus too much on the cool technology itself, and too little about the everyday organisational and social changes needed to make it work.

Electricity could have transformed US manufacturing in the 1890s: the technology was ready. Yet it wasn't until the 1920s that electric motors delivered on their promise and productivity surged.

The reason for the thirty-year delay? As the economic historian Paul David explained, in a famous paper published in 1990, the new electric motors, which replaced steam engines, only worked well when everything else changed too.

Steam-powered factories had delivered power through awe-inspiring drive-shafts, secondary shafts, belts, belt towers, and thousands of drip-oilers. Replacing the single huge engine with a huge electric motor didn't change much.

Electricity blossomed only when factories themselves were reconfigured. The huge steam engine was replaced by dozens of small motors, drive-shafts by wires. Factories spread out, working on the logic of a production line rather than the logic of proximity to a drive-shaft. There was room to use ceiling-slung cranes – perhaps even room to introduce a few skylights.

Workers were given responsibility for their own machines, which meant that they needed better training and a different structure of pay and bonuses. The electric motor was a wonderful invention, once we changed all the everyday details that surrounded it.

I know as little about the future of technology as anyone else.

But I have learned three lessons by looking at its past. One: don't be dazzled by the clever stuff. Two: simple inventions can change the world; what matters is that they're cheap. Three: always ask, "To make this invention work, what else will have to change?" ●

Tim Harford is an economist, journalist and broadcaster.

He is author of *Fifty Things That Made the Modern Economy*, *Messy*, and the million-selling *The Undercover Economist*.

Tim is a senior columnist at the Financial Times. He also presents Radio 4's "More or Less" and the iTunes-topping series "Fifty Things That Made the Modern Economy".

Tim will speak at our upcoming **THINK** conference this June. For a chance to win tickets – and a copy of *Fifty Things* – please see page 26.

Photograph by FRAN MONKS.

LANGUAGE BARRIER

KRISTIAN NIEMIETZ says different languages don't just impede understanding – they inhibit trade too...

According to UNESCO, 230 of the world's languages have died out over the past sixty years, and many more will die out in the near future.

When the reduction in the global number of languages is covered in the media, it is always presented as a self-evidently bad thing.

For example, in an article entitled "Languages: Why we must save dying tongues", the BBC quotes a linguist who argues that "we spend huge amounts of money protecting species and biodiversity, so why should […] the one thing that makes us singularly human [not] be similarly nourished and protected?".

But from an economic perspective, it is not at all obvious why a reduction in the number of languages should be a problem.

Diversity of languages has costs as well as benefits, and it is quite possible that the cost of the 'marginal language' greatly exceeds its benefit.

If so, the implication would be that the current number of languages in the world greatly exceeds the optimum number.

Language plurality is a hangover from a time when people rarely strayed far from their settlements, and had no need to communicate with anyone outside of their own small community.

But in today's globalised economy, the cost of overcoming language barriers is a transaction cost like any other, comparable to the cost of overcoming physical or regulatory barriers.

And just as e.g. shipping costs or compliance costs are passed on to consumers in the form of higher prices, so is the cost of translating documents, hiring interpreters etc.

That cost is not trivial.

Translation and interpretation services represent a global industry worth $37billion (The Economist, 2015), roughly equivalent to the GDP of Lithuania.

Some see that as a good thing. "Languages are […]

boosting economic growth rather than being a cost", says Karl-Johan Lönnroth, the former director general of the European Commission's translation department (Euractiv 2009).

But they are a cost. We would be better off if we did not have to spend billions on remedying the fact that we don't understand each other.

Lönnroth's logic is a good illustration of what Bryan Caplan calls the "make-work bias", the tendency to mistake job creation for wealth creation.

Taking Lönnroth's argument a bit further, we would be even better off if we invented additional languages, in order to create even more jobs for translators and interpreters.

The problem is that unlike, say, restaurant meals or movies, the 'consumption' of translation services is not enjoyable in its own right.

They are necessary to overcome an obstacle, and we would be even better off if the obstacle had never been there in the first place.

The $37billion figure is only the tip of the iceberg.

It does not include the cost of things like language training, and even if it did, those are only the static costs.

Language barriers are, in essence, trade barriers, and like all trade barriers, they lead to a less efficient international division of labour.

They reduce trade, and they distort trade patterns (Srivastava and Green 1986). We probably trade 'too much', relatively speaking, with e.g. Australia and New Zealand, and too little with e.g. Japan and South Korea.

Language barriers also reduce international labour mobility.

Were it not for those barriers, it is unlikely that grotesquely high levels of youth unemployment in Spain, Greece and Italy would coincide with sectoral staff shortages in the Netherlands, Germany and Austria for so long.

But while language barriers reduce immigration overall, they also make the integration of immigrants harder.

In short, language barriers make us poorer. "But that's such a horribly boorish way of looking at it!", I can hear you say, followed by something about economists knowing the price of everything and the value of nothing. Foreign languages are not just an obstacle, you say, they are also enriching and rewarding.

WE'D BE BETTER OFF IF WE DIDN'T HAVE TO SPEND BILLIONS ON REMEDYING THE FACT THAT WE DON'T UNDERSTAND EACH OTHER

But while there may well be substantial non-financial benefits, there are also substantial non-financial costs.

If you are a polyglot who enjoys conversing in foreign languages, watching foreign movies and reading foreign books in the original, you may well be a net beneficiary from the current situation.

But even then, you will have experienced the frustration that comes with not understanding what people are trying to tell you, and with people not understanding what you are trying to tell them.

That frustration is a massive non-financial cost, and unless you reach a very high level of language proficiency, it will typically greatly outweigh any non-financial benefits.

What should be done about the problem of language oversupply? Nothing.

We are where we are, and path-dependency will keep us there for now. And that's bad enough.

But we should at least stop kidding ourselves that obstacles are a blessing. It is a good thing when languages die out. Ideally, they should be dropping like flies•

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Will AI take your job?

There've been grim warnings that Artificial Intelligence could create mass unemployment in the future. But is that really the case? RYAN KHURANA suggests otherwise...

Artificial Intelligence (AI) has become a buzzword, resulting in some mythologising of the technology and its likely effects.

Nowhere is this more evident than in the pessimism over its impacts on the labour market, with many politicians and journalists, and even some economists, predicting mass technological unemployment.

A 2013 study by Carl Frey and Michael Osborne at the Oxford Martin School, predicted that 47% of US jobs would disappear as a result of new technologies. Their methodology has been applied to countries all over the world, encouraging the idea that AI is a threat to jobs.

Yet both economic theory and history suggest that, although AI is likely to change the kind of jobs people do, it will not cause long-term unemployment.

To see why not, start with the fundamental unit of analysis in employment: namely, a job.

A job is not simply a task, but a complex combination of tasks. The economic output produced by someone doing her job is the result of completing tasks in tandem.

For example, a lawyer's job requires meeting potential clients, enticing these clients to be represented by the firm, understanding the client's needs, undertaking the necessary background research, arriving at conclusions, and expressing these to clients, among other things.

None of these individual tasks results in the economic output of the lawyer unless done in tandem with others.

AI technologies struggle with complex combinations of tasks outside their narrow specifications, despite often being superior to human labourers at specific tasks.

As robotics pioneer Rodney Brooks has said: "People hear that some robot or some AI system has performed some task. They then generalize from that performance to a competence that a person performing the same task could be expected to have.

And they apply that generalization to the robot or AI system. Today's robots and AI systems are incredibly narrow in what they can do. Human-style generalizations do not apply".

Rather than replacing people, these new technologies must work with them.

Their aptitude for tasks that people now spend significant time doing does not mean they will reduce the economic value of human labour. On the contrary, they will allow people to do more valuable work.

The introduction of the ATM illustrates the point.

Before ATMs first came into use, human tellers spent most

of their time giving customers their cash and updating their bank books. Because ATMs can perform these tasks more efficiently, tellers largely stopped doing them. But they didn't become redundant.

Instead, by taking over these time-consuming tasks, ATMs allowed human tellers to reallocate their time to more profitable activities, such as improving customer service and upselling bank products.

At the same time, ATMs reduced the amount of space and investment required to deal with essential banking functions, allowing banks to serve more locations at lower costs.

This is the general pattern of the way labour changes with the introduction of new labour-saving technology.

Rather than responding by simply doing nothing, people do new and more valuable work.

As with ATMs and bank tellers, this work is sometimes in the same area. But completely new kinds of work often result from

ECONOMIC THEORY AND HISTORY SUGGEST THAT AI WILL NOT CAUSE LONG-TERM UNEMPLOYMENT

the productivity gains and increased prosperity.

Who in 1980 would have expected that in 2018, tens of thousands of British people would work as personal trainers and yoga instructors?

New technology and the increased prosperity it causes change the human skills that are demanded. In the coming years, general skills such as emotional intelligence and communication, which AI technologies will find difficult to reproduce, are likely to be in increasing demand.

The demand for more specific skills demanded is harder to anticipate. But there is likely to be a temporary mismatch between the skills demanded and the skills available in the workforce, since changes in education tend to lag changes in the skills demanded, and training takes time.

The issue of a "skills gap" in many developed economies is likely to be exacerbated as AI becomes more prevalent.

Persistent skills gaps exist for many reasons, from low-cost university education allowing people to take courses with low labour market prospects, to state-run industries which lack dynamic wages to signal shortages, as in the health care and schooling sectors in much of Europe.

If unaddressed, the small pool of labour that has the skills for which there is growing demand would see its pay increase significantly, while the pay of the expanding pool of workers without those skills would decline.

In responding to the rise of new AI technologies, the focus should not be on redistribution or finding ways to protect current jobs from disappearing.

Rather, public policy should be reformed to make the labour market more dynamic, allowing new forms of contract (as in the gig economy) and a more fluid transfer between jobs.

Liberalising the education sector, so that it has the incentives and ability to respond more quickly to the changing demands of the labour market would also help to minimise the disruptions that AI is likely to create.

AI has the potential to vastly improve the productivity of modern society, and solve many of the current economic challenges surrounding low growth seen today.

IN COMING YEARS, SKILLS SUCH AS EMOTIONAL INTELLIGENCE AND COMMUNICATION ARE LIKELY TO BE IN INCREASING DEMAND

Its threat to work comes not from it replacing humans but, rather, from poor policies that keep people from adapting to the new skill demands●

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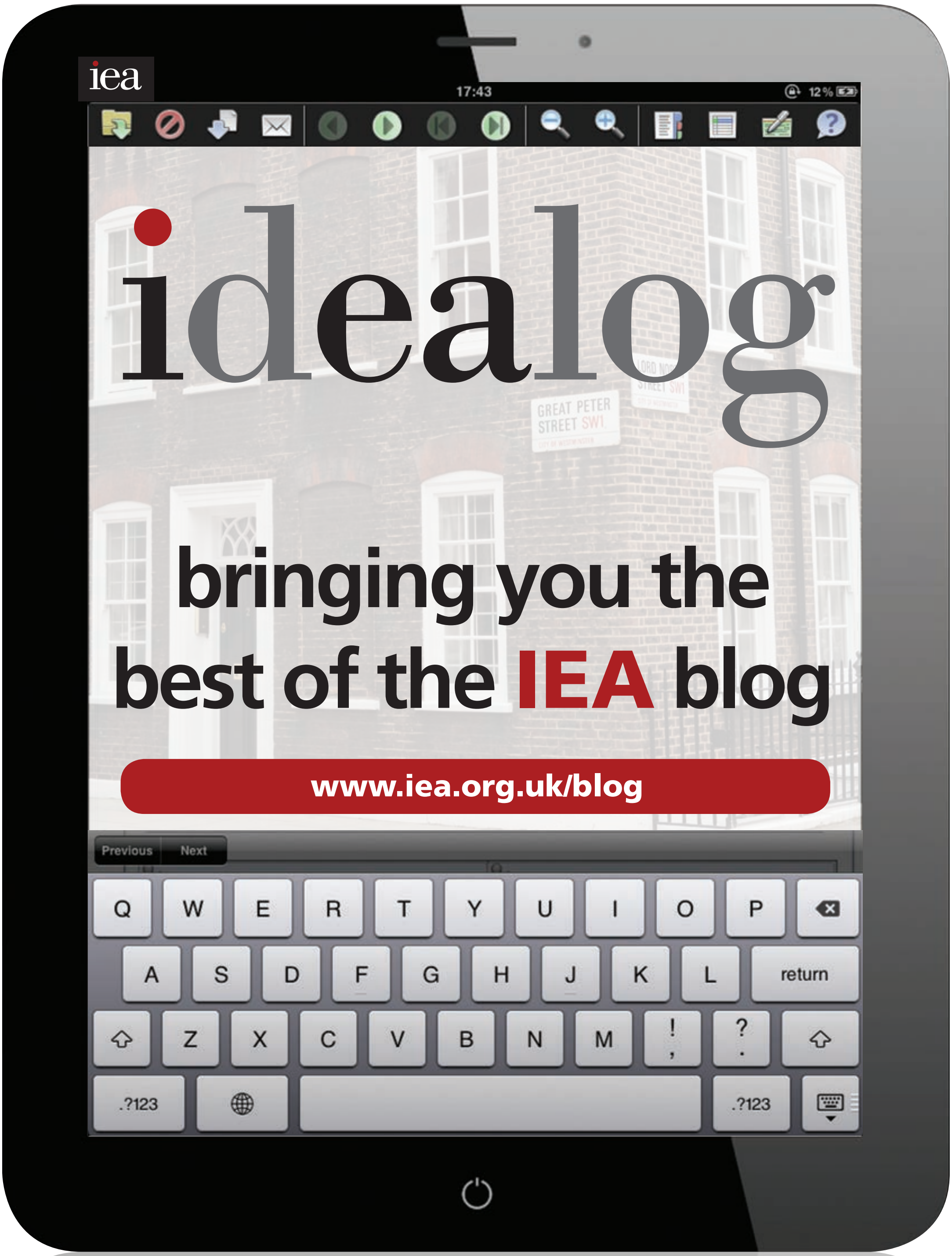
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NH-MESS?

KRISTIAN NIEMIETZ ON THE NHS WINTER CRISIS

The NHS entered yet another winter crisis in December 2017.

On social media, a consensus on the causes of the crisis was reached quickly: it is all just because of underfunding. Fund the NHS adequately, and it will be second to none.

At first sight, this seems to contain a grain of truth.

We spend just under 10% of GDP on healthcare (mostly on the NHS, plus a bit of private spending). This is roughly in line with the OECD average and the EU average, but compared to our neighbours – most of which do not have comparable winter crises – it is not a lot.

Most countries in north-western Europe spend between 10.4% and 12.4% of GDP on healthcare.

Thus, there is scope for extra healthcare spending in the UK, and it would almost certainly lead to some improvements.

But overall healthcare spending is a huge aggregate. It includes primary care, pharmaceuticals, diagnostic tests, medical implants, medical devices, convalescent homes, a vast range of specialties, a vast range of hospital procedures, and so on.

To say that cross-country differences in this massive aggregate are to blame for cross-country differences in one quite specific outcome is a bit of a leap of faith.

Once we break this aggregate down just a little bit, we get a rather different impression.

Spending on the hospital sector (and the 'winter crisis' is really a hospital crisis) amounts to 4.1% of UK GDP. That is a completely normal figure by north-western European standards.

In contrast, France and Germany spend over 2% of GDP on medical goods, compared to around 1% in the UK. Maybe we would be better off if we increased spending in that category to their levels. But that would not solve the winter crisis in the NHS.

People who blame the winter crisis on a lack of money seem to assume that if healthcare spending were increased by, say, 10%, this increase would be distributed evenly across all the different subsectors of the health sector.

We would spend 10% more on nurses, 10% more on doctors, 10% more on syringes, 10% more on prescription drugs, 10% more on hospital beds, and so on.

This is not true. Healthcare spending is allocated according to clinical priorities.

Crudely put, you spend the first few pounds on conditions that are matters of life or death. If you then still have money left, you spend it on conditions that are not matters of life or death, but still seriously debilitating.

If you then still have money left, you spend it on conditions that are not seriously debilitating, but still very unpleasant. And so on. The last few pounds are spent on the conditions with the lowest clinical priority.

Put differently, if a reasonably well-off person made an extra £100 per year, they might spend it on dining out or on wine. But it would probably not buy them better bread, better butter or better eggs.

Similarly, by and large, an increase in funding makes a health system more generous, but it does not automatically make it better at dealing with its core function.

The winter crisis is a bread-and-butter crisis. The problem is not that the system is not generous enough, but that it is not fulfilling its core functions well.

Which suggests that the system is suffering from problems that money alone could not cure●

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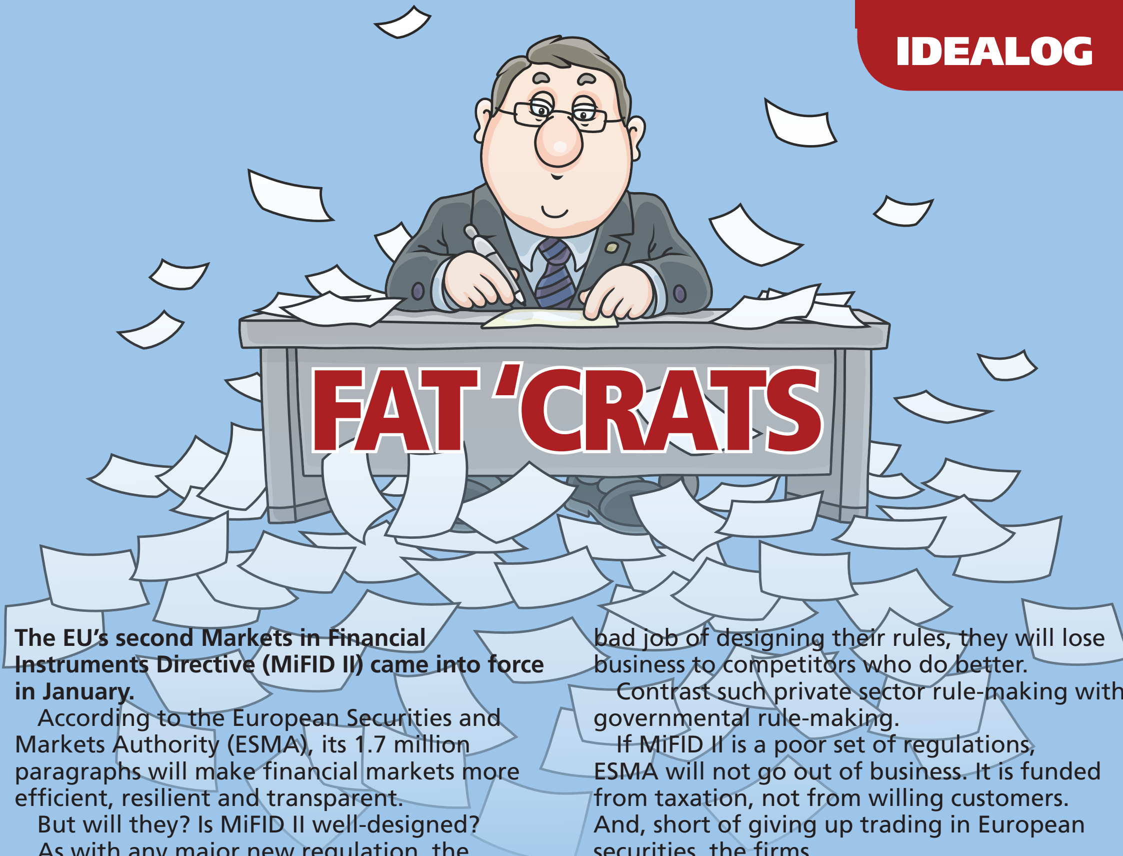

FAT 'CRATS

JAMIE WHYTE SETS HIS SIGHTS ON OVERBEARING BUREAUCRATS

The EU's second Markets in Financial Instruments Directive (MiFID II) came into force in January.

According to the European Securities and Markets Authority (ESMA), its 1.7 million paragraphs will make financial markets more efficient, resilient and transparent.

But will they? Is MiFID II well-designed?

As with any major new regulation, the effects of MiFID II will not be observable for many years, if ever.

Nevertheless, it's a safe bet that MiFID II is poorly designed, for a simple reason: the bureaucrats who made it need not compete for customers.

Cars, clothes, medical services and everything else tend to be shoddy when made by people who face no competition. Why should regulations be an exception?

Consider a stock exchange making its own rules, such as reporting requirements for companies listed on it and membership criteria for brokers.

If the rules are too lax, the exchange will be a perilous place for investors and it will lose business to exchanges with stricter rules.

Equally, if the rules are too onerous, companies will not list on the exchange and it will lose business to competitors with less onerous rules.

Competition makes stock exchanges offer rules that find a good trade-off between the interests of issuers and of investors. Those that don't will go out of business.

Stock exchanges are not unusual in imposing rules on their customers. It is unavoidable for many private enterprises – banks, insurers, universities and tennis clubs, among others.

And, as with stock exchanges, if they do a bad job of designing their rules, they will lose business to competitors who do better.

Contrast such private sector rule-making with governmental rule-making.

If MiFID II is a poor set of regulations, ESMA will not go out of business. It is funded from taxation, not from willing customers. And, short of giving up trading in European securities, the firms it regulates cannot "vote with their feet".

The bureaucrats of ESMA have no financial incentive to improve their regulatory product. Yet I am confident that they will do much work to revise it over the coming years. How else can they justify their ongoing employment?

Regulators funded from taxation benefit not from the quality of their rules but from the quantity of them. Rules that require revision are even better than rules that don't.

If you doubt it, ask yourself why the quantity of regulation grows every year along with the number of people employed in regulatory agencies.

Why were the last regulations never quite enough? Why was the first MiFID, which came into force in 2007, 1.7 million paragraphs short of the proper total?

For governmental regulators, failure is success●

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Oxsham

Oxfam's 2018 report on inequality was recently released to much fanfare.

And, just like those before it, rather than discussing actual poverty, it focuses on how the current wealth of the world is split between the top one per cent and the rest.

To solve this supposed crisis, their report also lays out solutions that call for the effective abolition of the modern capitalist economy.

It seems odd to me that a charity supposedly created to feed people shows so little interest in wealth creation.

Instead, Oxfam seems obsessed with pursuing policies that would slow down economic growth and leave us with a smaller pie than we all might otherwise have had.

Capitalism has been the greatest and most effective driver of prosperity and opportunity for the poor in our entire history.

As the Industrial Revolution got going in 1820, at least 84 per cent of the population of the entire world was below the modern definition of the poverty line (in real terms).

Even in 1990, more than a third of the world's population subsisted on less than $1.90 a day.

Today, that number is estimated to be below 10%, and more than 1.2 billion people have been taken out of extreme poverty in just the past 30 years.

The biggest gains have come in China and India, which together account for close to a third of humanity.

MARK LITTLEWOOD TAKES OXFAM TO TASK

In the 1980s, half of all Indians lived in absolute poverty. That figure is now down to about 20 per cent. In China, the absolute poverty rate has fallen from 88 per cent to just two per cent.

Both countries succeeded after they embraced pro-capitalist reform policies, including reducing tariffs, deregulation, privatising state assets, and welcoming foreign direct investment.

While neither China nor India are truly liberal, free market economies in quite the way we would understand the term, they have taken enormous strides in this direction – with impressive results.

Across the centuries since the Industrial Revolution, governments all over the world which cut barriers to businesses, protected private property, and abolished tariffs on international trade succeeded, while those which got in the way failed.

In the success stories, freeing trade and business broke apart an old economic model which had seen slow or non-existent economic growth, and replaced it with a vibrant economy where, today, we consider the economy growing at "only" two per cent an annum as a poor result.

This does not mean, however, that we should rest on our laurels. Millions remain in grinding poverty, and for them two per cent growth is unacceptably unambitious.

More needs to be done to break down trade barriers and to encourage more countries to replicate the policies that led countries like South Korea, Japan, and more recently China from grinding poverty to great wealth in a single generation.

This means advancing property rights and ending corruption in countries like Zimbabwe, privatising state monopolies in Venezuela, and working to abolish trade barriers such as the EU's Common Agricultural Policy.

Charities like Oxfam should be out leading the charge on these issues.

But instead of focusing on those who have too little, this report again relentlessly targets those the charity believes have too much●

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WILL

SAFETY MARGIN

JAMIE WHYTE argues that politicians should step away from health and safety regulation…

In all developed countries, governments regulate the safety of workplaces.

They insist that employers meet certain safety requirements, and threaten them with penalties if they fail to – including imprisonment in some cases.

The underlying assumption of such legislation is that, without it, workplaces would not be as safe as they should be. Too many people would be killed and injured at work.

But just how many people should be killed and injured at work each year?

The politicians who introduce workplace safety laws never address this question. If they did, they would soon see that their legislation is not merely unnecessary but harmful.

To see why, consider a similar question that all adults face. How many people should be seriously injured in your bathroom?

Bathrooms are dangerous. They get slippery and they are full of hard surfaces and edges. About 30,000 Brits are seriously injured each year from accidents in bathrooms. That's roughly 0.001 people per bathroom.

Is that too many, too few or about right? Or, to put it in practical terms, is your bathroom too dangerous, too safe or just safe enough?

"A bathroom can never be too safe!" That's what some will say. But no one means it.

Everyone's bathroom could be safer than it is. We could pad the edges of the bath to protect ourselves in case we slip and fall. We could have rubberised floors. We could take out the light fittings, which introduce dangerous electricity, instead lighting the room with battery powered lamps.

But we don't. To avoid the cost, in money and inconvenience, we are willing to bear the increased risk of accidental injury and death. Such safety measures cost more than the extra safety is worth to us.

Similarly, a workplace can be too safe. That happens when its safety measures cost more than they are worth.

Politicians tacitly accept this by not setting their standards as high as is strictly possible. They tacitly accept that a trade-off between safety and cost must be found.

But how should the optimal trade-off be found?

This is where politicians' legislative intervention goes wrong. Unregulated employers already have an incentive to make workplaces too safe: that is, to spend more on safety than it is worth to employees.

Here's why.

Imagine you were offered two jobs, identical in all respects except that the chance of accidental death is 0.6% a year in one and 0.1% in the other. You would choose the safer job unless the dangerous employer offered you higher pay.

How much extra will the dangerous employer need to offer you? Suppose the answer is £5,000 a year. Then this is how much you value the quantity of safety at stake, the 0.5 percentage point difference in your chance of accidental death.

Now suppose an employer could make your job this much safer by spending £4,999. Then he will make this safety improvement because it costs him less than the £5,000 he can save on your wages. He is £1 ahead.

A profit-seeking employer will make every safety improvement that costs less than the value employees place on it.

In other words, a profit seeking employer will find the perfect balance between safety and the cost of providing it.

Regulators can rest easy.

Actually, that's not quite right, because incomes are taxed.

When you demand £5,000 more to increase your chance of death by 0.5 percentage points, you are really demanding only £4,000 because you know that this part of your income is taxed at 20% (let's suppose). You receive only your net salary.

But employers pay your gross salary. An employer will still save £5,000 by providing safety that you value at only £4,000. So he will provide it even when it costs more than it is worth.

In our example, he will spend £4,999 to give you safety you value at only £4,000. Income taxes mean that safety will be over-supplied in an unregulated market.

If politicians want to find the right balance between safety and what it costs, the last thing they should do is force employers to provide yet more safety than they would if uncoerced.

Instead, they should eliminate all safety regulations and tax expenditures on safety at the marginal rate of income tax for the workers concerned.

They won't, of course. If they did, both wages and workplace injuries would increase.

This would be welcome, since it would reflect workers' preferred trade-off between wages and safety.

But the connection between increased incomes and deregulation would be invisible to campaigners.

They would notice only the extra injuries and deaths. And they would attribute them to a wicked neoliberal ideology that puts profits before people. Vote-seeking politicians would soon feel compelled to re-regulate.

Politicians are thus inclined to make regulations that override the preferences of the people they supposedly aim to help. But that's OK when no one can tell.

In politics, helping is not as important as appearing to help●

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HARD TO SWALLOW

CHRISTOPHER SNOWDON questions the wisdom – and effectiveness – of taxing sugary drinks...

"You can't just point at things and tax them," said the singer Myleene Klass to Ed Miliband in a TV debate about the 'mansion tax' in 2014.

But of course you can. Governments can tax virtually anything. The only question is whether it makes sense for them to do so.

From an economist's perspective, the best tax is the one which causes the least disruption to economic activity. Most people would agree that it is better to tax luxuries rather than essentials, and it is better to tax the rich than the poor.

If you are a politician, the best tax is the one that is least unpopular. Jean-Baptiste Colbert famously said that "the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing."

When George Osborne announced the introduction of a tax on sugary drinks in 2016, he may have had this dictum in mind.

The tax comes into effect in April and may yet prove to be unpopular, but it was warmly welcomed by health campaigners and the celebrity chef Jamie Oliver.

IF YOU ARE A POLITICIAN, THE BEST TAX IS THE ONE THAT IS LEAST UNPOPULAR

As an anti-obesity policy, it is unlikely to work, even in theory. Sugary drink consumption in Britain has dropped by nearly 50 per cent since 2003, but this has not prevented a rise in obesity.

The tax may help consumption fall by a few more percentage points, but the effect on overall calorie intake can only be trivial in a country where less than three per cent of calories come from soft drinks.

Various ‘fat taxes’ and ‘soda taxes’ have been introduced over the years, but nowhere in the world have they led to a reduction in obesity.

Mexico was hailed as a great success story after it introduced a sugary drink tax in 2014 and reputedly saw a six per cent decline in sales.

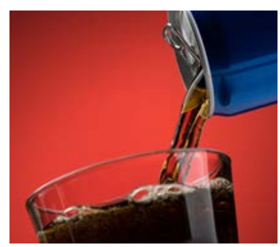
Even if this figure is correct – and it has been contested – it amounts to just 16 fewer calories consumed per day, a drop in the ocean when an adult male needs 2,500 calories to maintain a normal weight. Unsurprisingly, there is no suggestion that obesity rates have declined.

A large body of economic evidence shows that consumers respond to such taxes in a number of ways.

Most people do not change their shopping habits and simply take the hit. Some people purchase cheaper brands and shop in cheaper stores. Others switch to untaxed substitutes such as fruit juice and milkshakes which are equally energy-dense.

People respond to incentives, but not usually in the way the government intends. As a consequence, the effect on their calorie consumption is negligible and the effect on their waistline is non-existent.

AS AN ANTI-OBESITY POLICY, IT IS UNLIKELY TO WORK – EVEN IN THEORY



Health campaigners could argue that the sugar tax is worthwhile even if it has no direct effect on obesity because its revenue is earmarked for school sports and breakfast clubs.

But whilst these may be beneficial projects, there is no obvious reason why they cannot be funded out of general taxation, especially when a hypothecated sugar tax will produce unpredictable and dwindling revenues over time.

Nor is there any obvious reason to tax sugary drinks rather than, say, ice cream or chocolate. It could be argued that the government has to get money from somewhere and so it might as well target sugary drinks, but this sounds rather like pointing at things and taxing them.

In truth, the sugar tax was a political decision.

Osborne judged that plucking this particular goose would cause the least amount of hissing. He had organisations like Action on Sugar to back him up and he could present it as a health policy rather than a tax grab.

It is not yet clear whether it will cause significant economic disruption – probably not – but it is certainly regressive, not only because it takes a greater share of income from the poor, but because people on low incomes tend to buy more sugary drinks in the first place. Similar taxes in Denmark and Illinois were repealed because they were seen to disproportionately hurt people on low incomes.

Perversely, this could be the true appeal of such taxes to governments. They give politicians the rare opportunity to tax people who we normally feel squeamish about taxing: the poor, the unemployed, even children.

Not only can they get away with it, they can feel virtuous about it •

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POWER STEERING!

It's time for regulators to take the brakes off taxi drivers, says DIEGO ZULUAGA

Last year, Transport for London (TfL) revoked Uber's licence to operate in London – a decision Uber is appealing.

This was exactly the wrong response to disruption of taxi markets caused by the smartphone-enabled ride hiring platforms, such as Uber.

Instead, TfL should recognize that this new technology calls into question the need for any regulation of the taxi business at all.

Like most state interventions into markets, the regulation of taxis was prompted by good intentions and plausible arguments about passenger welfare.

Before the advent of GPS and mobile apps, passengers hailing a cab couldn't easily compare offers and bargain with drivers. Imperfect information about driver qualifications and intentions meant that an unregulated market might have resulted in a large share of customers being routinely fleeced.

Since repeat purchases were unlikely, it could pay for drivers to defraud passengers, which in turn would have attracted all sorts of undesirable characters into the business.

Thus it was believed that maximum prices, minimum vehicle standards and driver qualifications, and other features of taxi markets, must be fixed by statute.

Regulation didn't entirely eliminate the potential for fraud – indeed, in some countries taxi drivers are (not wholly undeservedly) regarded as unscrupulous racketeers – but it did arguably ensure that the market didn't unravel, as markets with large informational asymmetries are liable to do.

Yet, even if regulation was well-meaning and warranted, it quickly turned from an

attempt to protect the welfare of passengers into an instrument to shield taxi drivers from competition.

Consider licensing, which puts a cap on the total number of taxis that can operate in a market.

While they are a common feature of many taxi markets in Europe and North America – and about a third of the UK's local authorities – quantity restrictions don't in fact serve the welfare of passengers in any obvious way.

In fact, they probably damage consumers' welfare, since a cap on taxi numbers means it is more difficult to find a ride.

Nor are drivers particularly well-served, since they must pay hefty sums to purchase a licence, and this figure will be equivalent to the profits they can extract from being the privileged few in an uncompetitive market.

In New York City, a medallion required to drive a yellow cab could fetch up to $1 million before the advent of Uber. Licence prices have, predictably, plummeted since the arrival of ride-sharing apps, and those who speculated in medallions have found themselves in the red.

How about technical restrictions, which don't directly cap numbers but make entry more difficult?

According to specialist taxi websites "the Knowledge" of London takes 3.5 years to acquire. Add to that expenditures on lessons, a motorbike and other necessities for acquiring a licence, and the price prospective black cabbies face is steep. No wonder they have so fiercely opposed competition from those without the Knowledge – first pre-booked minicabs and now mobile apps.

But the fact remains that the Knowledge, which may have been necessary in the past, is now a luxury.

Thanks to GPS, drivers have been liberated from memorising the streets of London. Add to that the ability to locate drivers and passengers on one's phone in real time, to know their car make and licence plate, and to find out about the driver's credentials via past user reviews, and the scope for statutory regulation to provide anything valuable has been dramatically shrunk by innovation.

THE FACT REMAINS THAT 'THE KNOWLEDGE' IS NOW A LUXURY

This doesn't mean that regulation itself is shrinking. In fact, there is a great deal of private regulation undertaken via platforms such as Uber.

Only drivers with a high enough rating are allowed to use the app; there are standards as to which type of car may be used for Uber's different services; prices are set by the app and vary according to supply and demand, with Uber taking a fixed share of all transactions.

It is in the interest of platforms to have sensible regulation which keeps passengers safe, because otherwise their reputation would sink and users on both sides – drivers and passengers – would swiftly move to another platform.

To thrive in a changed environment, London black cabs need to become their own 'platform', meaning a distinctive brand which sets its own standards, much like Uber does, and makes the most of its comparative advantages such as the Knowledge and the iconic status of London taxis.

Black cabs could work together via the London Taxi Drivers' Association – the sector's main trade body – to jointly set prices, vehicle standards, driver numbers, and so on. They would thereby be jointly responsible for the reputation of their trade and its future prospects.

That would enable a considerable scaling back of statutory regulation, with the problems of rent-seeking and stagnation which it often brings, and its replacement by a variety of market-tested regulatory frameworks that would evolve according to changing tastes and technologies.

A greater variety of suppliers and services has been the experience in other jurisdictions which deregulated taxis, such as New Zealand.

It is time for TfL to hand back the levers of regulation to passengers and drivers, who know best what is good for them and are now able to achieve it with the help of technology

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ADVANTAGE RICARDO

Adam Smith is usually seen as the founder of economics, but here we turn the spotlight on David Ricardo, the brilliant (but little-read) economist who first established the principle of comparative advantage

David Ricardo is generally acknowledged as one of the greatest economists, yet he is also one of the least read.

This reflects one of his main qualities, captured by John Kenneth Galbraith, who wittily and accurately described him as a man of great lucidity of mind and terrible obscurity of prose.

He was a brilliant thinker with an extraordinary ability to capture the theoretical essence that underlay the complexity and apparent confusion of the actual world.

But his analytical clarity was not matched by gifted exposition. He was also a person with an interesting life story, not least in becoming one of the few economists to make a huge fortune – by speculating on government debt and the outcome of the Battle of Waterloo no less!

While Adam Smith is usually seen as the founder of economics, it is actually Ricardo who first developed what we might call "the economic way of thinking".

His great contribution

was to lay bare and clarify the underlying nature of apparently complex phenomena by reducing them to simple yet well founded models. He was the first economic modeller.

One example of this was his using an economy consisting of just one activity (farming) and one product (corn) to make clear the principle of diminishing marginal returns, one of the greatest insights of economics.

Other examples were his demonstration that the costs of financing government activities from current tax revenue, or from short term and high interest debt, or from perpetual and low interest debt were effectively the same.

And he explained how you could simultaneously have a larger share of total income going to profits with a declining return on capital – something that is highly relevant today.

However, his greatest achievement, published just over two hundred years ago in 1817, was the principle of comparative advantage, unveiled in his seminal work *On the Principles of Politcial Economy and Taxation*.

Using the model of two countries (England and Portugal) and two products (wine and cloth), he showed by a deceptively simple argument that even if Portugal was more efficient at producing both products than was England – that is, the resources used to produce a given amount were less in Portugal – it would still make sense for Portugal to specialise in wine and England in cloth and for the two countries to exchange the goods for each other.

If they did this, there would be more goods in total produced even while nothing else (the amount of resources or the technology used) had changed.

Riccardo's insight was that the critical factor is not the absolute cost of production (the amount of resources used) but the comparative cost to each country of doing one thing at the expense of another (given that resources used for making one product can't be used to make the other).

COMPARATIVE ADVANTAGE IS THE FUNDAMENTAL PRINCIPLE OF SOCIAL COOPERATION

Take another example of two neighbours, Jack and Jill. Jill is a brain surgeon and much better than Jack at that. She is also a better gardener than Jack.

However every hour she spends in the garden is an hour she cannot spend doing surgery, so the cost to her of doing gardening is high.

For Jack, by contrast, the cost of doing gardening is much less, since he is a hopeless surgeon.

So it makes sense and leaves both parties better off if Jill concentrates on surgery and pays Jack to look after her garden.

This is an insight with extraordinary and far reaching implications. It means, for example, that even if you are the most inefficient and incompetent person (or country) in the world, there will always be something that it will make sense for other people to pay you to do so that they can concentrate on something they are even better at.

It means that in policy regarding trade, unrestricted free trade is always and everywhere the welfare maximising policy. This would be true even if you were the only country in the world practising it. So every country should adopt this policy unilaterally and not wait for others to play along.

Even Ricardo failed to grasp the full significance of his insight.

His example looked at trade between people in England and Portugal. But the fact that the goods crossed national borders is irrelevant.

Sometimes traders are in different political jurisdictions (e.g. London and Tokyo), sometimes the same (e.g. Leeds and London). But the principle and relationship is exactly the same.

Comparative advantage is actually the fundamental principle of social cooperation.

It is because of trading for mutual benefit to take advantage of comparative costs of production that we live in complex and wealthy societies rather than as impoverished individuals in self-sufficient households•

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TIME TO THiNK ...

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WIN TICKETS!

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To win, all you have to do is read Tim's article on page 4, and then give us the titles of two other books he's written.

Email your entry to **EAcompetition@iea.org.uk** by **Friday 27 April** and you could be a lucky winner!

(Top of the) FIELD TRIP

This Spring and Autumn we're travelling to schools right across the country.

Sixth Form A-Level and IB Economics students will hear from speakers at the top of their fields on topics including "Behavioural economics", "Should we be worried about inequality?", and "To build or not to build? The economics of major infrastructure projects". **These conferences are FREE to attend.**

SCHEDULE

Oakham School, East Midlands	Wednesday 14 March
Highlands School, North London	Tuesday 20 March
Reading Blue Coat School	Thursday 4 October
Loretto School, Edinburgh	Thursday 8 November
Bromley High School, South London	Friday 23 November

If you're interested in attending one - or you'd like to host a conference at your school – please contact Sophie Sandor: **ssandor@iea.org.uk**

INTERN-ATIONAL

We have internship opportunities all year round – for sixth form students right up to recent graduates – so if you're interested in joining or just want to find out more, please visit our website.

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Each intern produces a supervised research project, chosen by themselves with guidance from senior IEA research staff.

Application deadline: Friday 30th March 2018.

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We provide a dedicated week of work experience for 120 sixth formers in three groups held across the summer.

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Application deadline: Friday 30th March 2018.

WHAT INTERNS SAY ABOUT THE IEA

"Thank you for such a wonderful experience. The programme was really well organised - I enjoyed it so much and came away with a wealth of information and contacts. I will definitely recommend to others!"

"Thank you for a great week on the Sixth Form Internship. I enjoyed the talks and the chance to debate different ideas with others. I came away from the week knowing I definitely want to study economics at university!"

"Thank you for a wonderful experience at the IEA. The internship was really intellectually stimulating & developed some key debating & presentation skills. Sad to have to say goodbye to everyone - I really enjoyed it."

Whatever kind of internship you undertake you will be a part of the IEA family and be able to take part in the activities staged by the Institute. Interns also remain a strong part of the IEA network as alumni.

To find out more details about these internships, visit: **iea.org.uk/internships**

SWOT ANALYSIS...

With exams coming up, we've put together a comprehensive guide linking relevant IEA resources to AS and A-Level Economics specifications for AQA, Edexcel and OCR.

You can download a pdf of the guide you need by visiting: **iea.org.uk/student-resources**

WHAT JUSTICE MEANS

MARK LITTLEWOOD highlights a seminal work on equality of opportunity, removal of poverty, and freedom

In 1971, American political philosopher John Rawls published his seminal work, *A Theory of Justice*.

Rawls was seeking to provide a coherent intellectual framework to explain our liberal intuitions.

In particular, his tome can be seen as a rebuttal of utilitarianism, the belief that the moral thing to do is whatever maximises the greatest happiness of the greatest number.

Utilitarianism has never sat comfortably with those who subscribe to individual rights or freedoms.

In theory, a utilitarian believes that some members of society can be legitimately, even arbitrarily, impoverished, trampled upon or killed, if the overall impact on aggregate human happiness is positive. The 1% can be brutally sacrificed for the betterment of the 99%.

Rawls devised an alternative moral construct which seemed to better capture our essential moral intuitions and to answer key questions about how we should organise society.

His conclusions have specific relevance to the debate about inequalities of wealth and income which dominate much of contemporary political debate.

HIS CONCLUSIONS HAVE SPECIFIC RELEVANCE TO THE CONTEMPORARY DEBATE ABOUT INEQUALITIES OF WEALTH AND INCOME

A Theory of Justice posits that the institutions and arrangements human beings should adopt would be those that we would agree to in an "original position" behind a "veil of ignorance".

If we strip away all of the things that might make us partial or biased – the talents or skills we will be born with, our gender, sexuality, religious or political views – then we can fairly determine how we would approach the rules which would govern how we will be governed in the lottery of life.

Behind this veil of ignorance, we are rational and self-interested human beings.We want the best outcome for ourselves, but we don't yet know what our lot will be as we enter the world.

Rawls doesn't suggest that this pre-birth ceremony or contemplation actually takes place, simply that this is a sound basis upon which to determine the fundamental principles of society.

Rawls contends that we would favour a system of universal basic rights and liberties and of equality of opportunity.

When it comes to who has what level of resources – either wealth or income – he suggests we would adopt the "difference principle".

We would choose a distribution of resources which is of most benefit to the poorest member of society. Inequalities are acceptable according to Rawls, but only in so far as the poorest person benefits.

Let's imagine a simple society of just three people. Behind the veil of ignorance, we don't yet know whether we will be born as Tom, Dick or Harry. Imagine we need to choose between two possible distributions of income:

D1: **Tom 20 Dick 7 Harry 6**
D2: **Tom 7 Dick 6 Harry 5**

Rawls is clear we would pick D1. It is a much less equal distribution of resources than D2, but Harry, the poorest member of society fares better under the first scenario.

It doesn't matter to Rawls that affluent Tom is much better off as long as impoverished Harry is somewhat better off.

Of course, some will look at the thirty-three "points" available to distribute in D1 and argue that the ideal solution would be to agree to:

D3: **Tom 11 Dick 11 Harry 11**

But it might well be that D3 simply isn't an option.

Perhaps to get to the 33 points we have in D1 as opposed to the mere 18 in D2, we need to unleash Tom's supreme entrepreneurial talents and offer him substantial rewards.

Perhaps we wouldn't manage to do this if we only rewarded him 11 points as in D3 and we would instead slip into a D2 situation where things are more equal but everyone is worse off.

Rawls' theory is not without its critics.

INEQUALITIES ARE ACCEPTABLE ACCORDING TO RAWLS, BUT ONLY IN SO FAR AS THE POOREST PERSON BENEFITS

Some argue he places rather too much emphasis on the position of the poorest as opposed to the average member of society. But his approach remains a useful tool in potentially justifying inequalities.

In deciding whether a distribution is fair, we should ask ourselves not whether it is equal, but whether it benefits the poor, even if it benefits the rich to an even greater degree●

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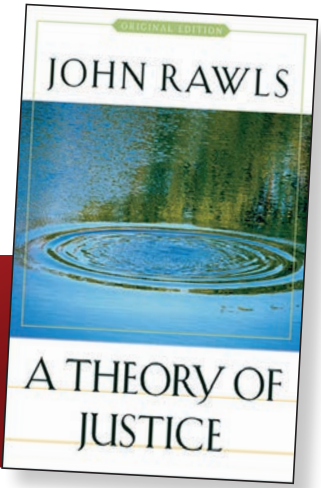
FOR MORE

A Theory of Justice is available in a Harvard University Press paperback



TRADE as a WEAPON

Trade is fast becoming a strategic weapon for politicians to make foreign policy. Here PIETER CLEPPE reviews a new book which examines the risks – and the upsides – of this approach

In *The Weaponization of Trade*, authors Rebecca and Jack Harding make the case that a fourth stage of globalisation began in 2013 and 2014, with a decline in global trade and a change of political discourse.

They consider the period from the 19th century until 1945 to be the first stage of globalisation, a period of "conflicts centered around trade".

They define the cold war era as the second period, where they consider trade to be dominated by "mercantilism" and the period from 1990 onward as the third period of globalisation, where it was believed that "everyone gained from free trade and multilateralism in economic terms".

Rebecca Harding is the former chief economist of the British Bankers' Association, while Jack Harding has an academic background in security policy.

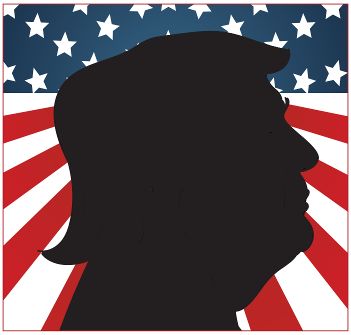
The book links economic and security aspects to build the case that trade is being weaponised, which clearly carries some risks but also has an upside.

They contend that "in the last two years, (...) anti-globalization rhetoric is no longer the domain of a bunch of student radicals sitting outside G20 summits. It is mainstream, and it is the daily language of the most important politicians in the world".

They note that "in 2016 the WTO reported the highest monthly average increase in the number of protectionist measures by its members since 2011, with 154 restrictive measures being introduced. Trade did decline in nominal value terms by approximately 15% between 2015 and 2016, but this was as much a function of the collapse of commodity prices as it was of trade restrictions".

The book points out that although "trade in itself is not violent", "the language around trade has been 'weaponized'" as a useful tool for politicians to do foreign policy – the most notable example being US President Donald Trump making statements on trade policy to pressure China on North Korea.

According to the authors, trade can be indirectly violent, as "trade in certain sectors – most obviously arms – can supply the means for violence in a target state or region", citing Western arms sales to Saudi Arabia, which is currently waging a war in Yemen, as an example.



It enables countries to "build influence" in foreign policy due to successful economic performance. They cite China, Japan and Germany as examples of states that are exerting "soft power", given how their trade surplus makes others dependent.

However, they see weaponising trade as a less damaging alternative to actual war and a "substitute for direct intervention".

The book also discusses the impact of trade sanctions – for example, against Iran – writing that "trade [with Iran] has slowed markedly since HSBC was first fined $1.9billion in 2012 over money laundering".

They see it as proof of the power of US regulators, but add that Iran "has had strong trade despite sanctions, because of its relationships with Turkey and Russia" and that the effects vary from country to country.

As much as the book provides a good analysis, it perhaps depicts the period between 1990 and 2014 as a little bit too rosy.

It's true that in words Western politicians were then more sympathetic to trade but, in practice, a lot of subsidies and tariffs persisted.

One of the reasons that the UK voted to leave the EU was precisely the perception that the EU had been diverting away from its core business of opening trade and was hampering the British in their quest to trade more with the rest of the world.

The Trump administration is currently insisting that trade isn't fair because US trade partners are avid fans of stealth protectionism in all kind of ways.

Trump's solutions that risk tit-for-tat protectionism are clearly ill advised, but is it so bad that Anglo-Saxon countries are complaining about the existing weaponisation of trade in the rest of the world?

US commerce secretary Wilbur Ross recently remarked that "there have always been trade wars. (…) The difference now is US troops are now coming to the ramparts".

TRUMP'S SOLUTIONS THAT RISK TAT-FOR-TAT PROTECTIONISM ARE CLEARLY ILL-ADVISED

Obviously, it's a pity that the US doesn't choose to "lead by example" by demonstrating the economic growth resulting from opening up trade unilaterally but instead threatens with tariffs.

Then, perhaps it's welcome to have the Americans reminding the rest of the world that instead of complaining about Trump they could perhaps reduce their own protectionism, hoping that this is seen as a more benign alternative than going down the path of trade wars•

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FOR MORE

The *Weaponization of Trade: The Great Unbalancing of Politics and Economics* by Rebecca Harding and Jack Harding, published by Perspectives, is now available in paperback.

SHOULD BANKS TAKE MORE RISKS?

TIM CONGDON assesses the impact of tighter regulation on banks' customers – especially small businesses – and asks if that's good for the UK economy

Everyone active in business and finance knows that banks have been more tightly regulated since the Great Recession of 2008. But surprisingly, little work has been done on the impact of tighter regulation on banks' customers, particularly on those customers who borrow or try to borrow money.

The consensus is that banks took on too much risk before the crisis of a decade ago, that too many banks went "bust", and that society benefits from an ultra-safe banking system.

But has official pressure to make banks safe cut off credit from small- and medium-sized businesses, and so undermined investment and entrepreneurship? And is society made worse-off by the resulting loss of business opportunity?

Shortly after the Lehman bankruptcy of September 2008, the leaders of the G20 group of nations met in Washington to agree that the Bank for International Settlements (based in Basel, Switzerland) and the International Monetary Fund should oversee a new set of rules for the banking industry.

While the new rules are complex and wide-ranging, their focus has been on raising the amount of capital needed to cover the risks in banks' portfolios of loans and securities.

whereas before 2008 banks could have equity capital that, as a minimum, was 4 per cent of assets, nowadays that figure has been raised to 7 per cent.

If banks have the same level of capital as before, an increase in the capital/asset ratio can occur only if assets fall. Indeed, with capital given, a move from a capital/asset ratio of 4 per cent to one of 7 per cent requires a drop in assets of over 40 per cent.

Before 2008, British banks' assets consisted almost entirely of claims on the private sector, mostly in the form of loans. For the people and companies that used loans to finance investment in homes and businesses, a contraction of bank loans of 40 per cent would have been most unwelcome and sometimes catastrophic.

An argument can be made that the shrinkage of banks' risk assets from autumn 2008 led to the destruction of money balances, as some borrowers were forced to pay back loans earlier than expected.

The crash in money growth then led to the intensification of the recession. The officially-mandated increase in capital/asset ratios therefore had the paradoxical short-run effect of worsening the problem it was intended to solve.

But defenders of the new bank capital regime, known as Basel III, might still insist that in the long run the benefits will outweigh the costs.

Much depends on how large a reduction in bank credit is eventually recorded and on the types of credit which suffer the largest retrenchment.

Happily, the British banking industry has responded to the challenge by greatly increasing its capital base. The shareholders' funds of the UK's large banks more than doubled from £143 billion at the end of 2006, some months ahead of the financial meltdown, to £288 billion at the end of 2014.

The strengthening of the capital position has prevented bank lending to the UK private sector from suffering a cataclysmic reverse. It has not had to be slashed by the 40 per cent figure implicit in the headline change in capital/asset ratios. Banks have been able to duck and weave, and protect their customers from the full blast of the regulatory cold wind. Even so, bank lending to the private sector has fallen sharply relative to national output.

In analysing the UK statistics, we need to exclude an irritating set of organisations known to statisticians as "intermediate other financial corporations" or quasi-banks, and to track the numbers for lending to the genuine non-bank private sector.

HAS OFFICIAL PRESSURE TO MAKE BANKS SAFE CUT OFF CREDIT FROM SMALL AND MEDIUM SIZED BUSINESSES?

If we do so, the data tell us that the ratio of lending to national output peaked at just above 145 per cent in the first quarter of 2009. Over the six years to mid-2015 the ratio fell to under 120 per cent and may now be stabilising at roughly this figure.

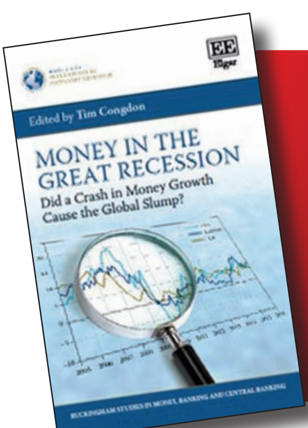
Some observers might say that the curtailment of credit is unfortunate, but far from earth-shattering. In their eyes, the new stricter capital regulations (Basel III) will confer the major long-run advantage of a more stable economy.

They would claim that the plus points from greater stability will outweigh the disadvantage of a reduction in bank credit equal to about a quarter of national output, which has been identified here.

But this is to overlook a crucial effect. As the Basel III recapitalisation drive has been intended to make banks safer, the new rules have been less hostile to safe lending than to risky lending.

The safest kind of lending over the decades has been lending to individuals for the purpose of home ownership. Banks do need to hold more capital relative to residential mortgage assets than before 2008, but the shift is small and manageable.

Not surprisingly, UK banks' mortgages – nowadays over half of banks' assets – have not changed much relative to national output.

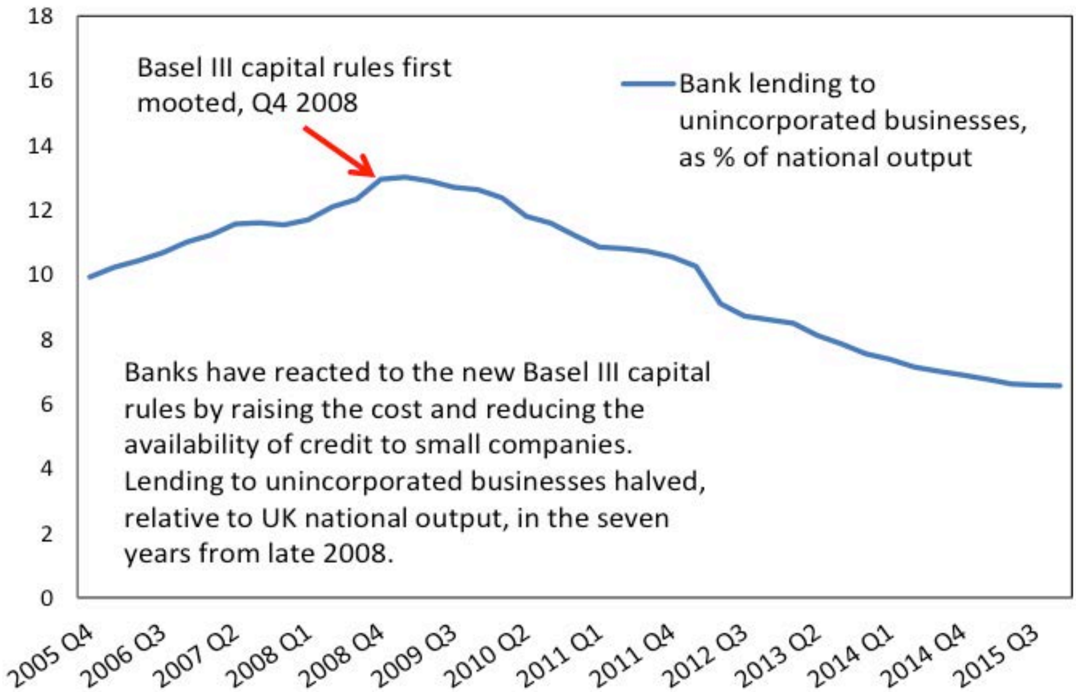


FOR MORE

Read *Money in the Great Recession*, edited by Tim Congdon and published by Edward Elgar Publishing.

Rise and fall of bank lending to unincorporated businesses in the UK

Data are quarterly, author's estimates using Bank of England and Office for National Statistics data



RELATIVE TO NATIONAL OUTPUT, BANK LENDING TO THE SMALLEST OF SMALL COMPANIES HAS FALLEN BY ABOUT A HALF SINCE THE FINANCIAL CRISIS

But if bank lending to the private sector in total has dropped by a quarter relative to national output, and if safe mortgage lending to households has not gone down at all on the same basis, what must have happened to risky lending to companies? It must have tumbled.

That is exactly what the official numbers show. The problem is at its worst for small- and medium-sized enterprises, which are often the heroes of speeches from Treasury ministers.

Unincorporated businesses are the smallest of the SMEs. A series in the Bank of England's database shows that at the end of 2008 bank lending to unincorporated businesses was just above £50 billion. But by 2015 this had dropped to little more than £31 billion.

Relative to national output, bank lending to the smallest of small companies has fallen by about a half since the financial crisis.

Is that really a positive development for the supply-side efficiency of the British economy? Can a case be made that financial regulation, and in particular Basel III's hostility to risk, has gone too far?•

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Soundbite

STAND OUT from the CROWD

Should you have a part-time job while studying?

You might rather spend time perfecting your online profile, playing with your Xbox or just hanging out with your friends.

But the evidence strongly suggests that a part-time job is a good investment for your future.

Working when young doesn't only give you some independent spending power. It also builds confidence, self-esteem, a sense of responsibility and other basic life skills.

It gives future employers some basis for taking you on rather than somebody else, helping you to stand out from the crowd in a fiercely competitive jobs market.

Young people who combine work with full-time education are markedly less likely to be unemployed five years later, and earn 12-15% more on average, than those who do not.

Yet the numbers working while studying have dropped sharply.

Twenty years ago, well over 40% of all 16-17 year olds had a part-time job while at school or college. The figure is less than 20% today.

As for younger teenagers, employers need to apply for a licence to employ those under 16, and the number of these child employment permits fell from 29,498 in 2012 to 23,071 in 2016.

Why has this happened? As with any change in employment patterns over time, a range of influences are involved.

Surveys and vox-pop interviews suggest that numbers have been falling as a result of increased parental affluence (meaning less financial pressure on young people to work) and the growing demands of school examinations. Exam pressure

LEN SHACKLETON ON GETTING A HEAD START IN THE JOBS MARKET

is sometimes reinforced by the negative attitude of teachers to students' employment.

There has also been a decline in the availability of traditional "children's work", such as newspaper rounds. Compulsory work experience for schoolchildren, which often led to part-time jobs, was scrapped in 2012, and this has probably not helped.

Demographic change is another, less obvious factor.

Over a quarter of secondary school students now come from minority ethnic backgrounds, and data show that those of Indian, Pakistani and Bangladeshi heritage in particular are much less likely to have part-time jobs.

Discrimination may play a part in this, but it also reflects cultural attitudes and the unavailability of employment opportunities in some areas where there are high concentrations of minorities.

Economists argue that regulation also plays a part.

Minimum wage legislation has raised the cost of employing children and young people. Even though the minimum wage rates for young people have not risen as much as for adults, they have still increased significantly in real terms since the late 1990s.

More importantly, perhaps, the rules surrounding the employment of schoolchildren are complicated, vary considerably from area to area, and have been tightened in recent years.

For instance, milk deliveries, once a staple of teenage employment, are now forbidden by many local authorities. There have been new restrictions on the weight of newspapers to be carried by youngsters. Rules on term-time working have been tightened for under-16s. Internships and unpaid work experience are now much more restricted.

As anybody working with young people now needs to be checked by the Disclosure and Barring Service, and health and safety at work rules have been tightened, small businesses in particular may find it too much trouble to take youngsters on.

Regulation in other areas also impinges: tighter rules on selling alcohol, tobacco, knives and various other goods mean that under-18s can't do some retail jobs that they once could.

In his 2012 review of employment law for the Conservative-Liberal Democrat coalition, businessman Adrian Beecroft argued that the employment rules for children and young people could be greatly simplified and the permit system scrapped. Nothing came of this.

The pressures currently seem to be in the opposite direction, with UK politicians seeking greater restrictions on some types of employment by young people. A recent case has been the demand to restrict modelling opportunities for under-18s.

Our politicians might do better to take inspiration from New Zealand where, by contrast with most developed countries, a much more permissive attitude has been taken to child employment, which is more widespread than in today's Britain.

A good deal of evidence has been accumulated that this has few negative consequences.

For example, a recent longitudinal study looked at the lasting effects (up to age 32) of schoolchildren's paid work on a wider range of factors than future employment.

These included psychological wellbeing, smoking, drug and alcohol use. Its lead author concluded that moderate levels of part-time work seemed to have no detrimental effects in New Zealand. It seems very likely that the same applies in the UK.

Nobody is suggesting that very long hours of work outside the classroom are necessary or desirable, and young people certainly need time to relax and socialise as well as study.

But paid work at the weekends or in school holidays could be a good use of some spare time●

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Don't FEAR the FUTURE!

Nearly every popular economic fallacy reflects fear of the future.

Although unjustified, such fear is understandable. We're familiar with, and have more or less adjusted to, what exists. But we don't know the future, so it frightens us.

Consider, for example, international trade.

When British people buy more imports, a typical and immediate effect is destruction of some existing UK jobs. Likewise for new labour-saving techniques.

In both cases, economic theory and history make clear that new and better jobs are eventually created and living standards improve.

Economics and history also make clear that to prevent such trade- and technology-induced job churn is to stifle economic growth.

The more unrelenting and widespread are policies that prevent this job churn, the more surely almost everyone is condemned to a future of poverty.

(If you doubt me, consider that in 1860, about half of all jobs were in agriculture. Now ask how prosperous we would be today if our government back then had successfully protected agricultural jobs from being destroyed by then-emerging technologies such as long-distance rail transport, refrigeration and chemical fertilisation.)

People who demand economic growth while decrying economic change and its disruptions are deeply inconsistent.

Fear of the future also explains much support for battling recessions with increased government spending – preferably via larger budget deficits.

Letting recessions run their course, so unprofitable investments are liquidated and those resources are redeployed

DON BOUDREAUX SAYS PESSIMISM INHIBITS ECONOMIC PROGRESS

to more-productive uses, is not popular.

Surely one reason – in addition to mere impatience – is that no one amid any recession can say for certain just what those new and better productive uses are.

Yet another government policy fuelled, at least in part, by fear of the future is economic regulation.

We demand, for instance, that the European Medicines Agency (EMA) peer into the future of all new pharmaceutical products and medical devices before we can purchase them.

We want the EMA to permit us to buy only products that it determines are sufficiently safe and effective.

Yet, in fact, no pharmaceutical product – indeed, no product of any sort – is perfectly safe.

Demand for a future free of risks of medical treatments' severe downsides is not only foolish, it's fruitless.

The only way to assure no such unhappy surprises is to prohibit any and all medical advances.

But, obviously, such a draconian prohibition would mean worse, not better, medical care. We'd be stuck with older, less advanced drugs and devices.

And while the consequences of using these older products are more familiar than the consequences of using new products, those familiar consequences would also, on the whole, be worse.

The European Union's seizure of the role of deciding for 500 million Europeans whether a pharmaceutical product is acceptable is justified as an attempt to protect us from a dreadful future.

But because the EMA discourages the development of new drugs and devices, it actually fills our future with more pain and unnecessary death●

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GIG ISSUE...

STEVE DAVIES TOUTS HIS VIEWS ON THE SECONDARY TICKET MARKET

There are some questions or issues that are very revealing for the economist.

That is, they make manifest the degree to which many of the public have a way of thinking that is positively hostile to basic economic insight and principles.

One of the best examples is the resale of tickets to events, and the part played by people who acquire tickets with the aim of reselling them – 'touts' or 'scalpers'.

The way this works is simple. Primary ticket originators (venues, organisations, artists) produce tickets that give a right of access to an event or performance, usually for a fee.

They distribute these tickets in a number of ways: some are sold directly to end users who wish to attend the event, others are given out (often at a steep discount) to 'insiders' of one kind or another (this amounts to around 50% in most cases), while some are given over to agencies who then sell them directly to end users. In these cases, the tickets are made available at the original price.

Some of the people who get the tickets in one of these ways then look to sell them on at a higher price.

In addition, there are people who make a living by buying as many tickets as possible at the original price and then selling them on at a higher price. These are touts or scalpers.

The general public view is that this is an outrage that should be prohibited or at least severely restricted, for example, by allowing resale but only at the original price.

All of this is very strange for an economist. People can only resell at a profit if there are willing buyers prepared to pay the higher price.

Assuming economic rationality, this must be worthwhile for the buyers. Moreover, if tickets command a price higher than the face value, this must mean that the original price was below the market clearing price.

One response is that this is because the touts have caused a shortage by buying up tickets and they are now profiting from it.

This contradicts both economic theory and empirical fact: if people buy up any commodity at one price and the price then rises as a result, then as soon as they release the held back commodity for sale the price will fall to its actual market clearing level.

This happens very rapidly, so the opportunity to make supernormal profits is effectively non-existent.

In fact, this is not what is going on anyway. People who buy large numbers of tickets in this way are anticipating that the price will rise because the initial price was too low. If they guess right, they make a profit; if wrong, they make a loss.

They are speculative middlemen performing their classic function of ensuring that scarce resources end up in the hands of those who value them most.

To deny this is to claim either that tickets are a different kind of product from any other (absurd) or to believe that people should never buy at a low price to sell at a higher price, and that the price of goods should not vary in response to supply and demand but should be fixed in some way.

This is to deny the very essence of economics●

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