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CAPITALISM IN CRISIS

Western capitalism has much to learn from Asia

Capitalism itself is not in crisis, but western capitalism is. This is a result of three strategic mistakes.

The first error was to regard capitalism as an ideological good, not as a pragmatic instrument to improve human welfare. Alan Greenspan was probably the greatest victim of this ideological conviction that markets always knew best. The former chairman of the Federal Reserve fully agreed with the Reagan-Thatcher thesis that governments should step aside and let the markets roll. As Mr Greenspan also believed that market traders were smarter than government regulation, he failed to regulate them vigorously. This has wreaked havoc on the world. But no Asian society, not even Japan, fell prey to this ideological conviction. Instead, Asians believe that no society can prosper without good governance. Indeed, in a way many of them have understood Adam Smith's message better. As he wrote in *The Wealth of Nations*, "the interest of the dealers ... however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public."

For capitalism to work well, governments have to play an essential regulatory and supervisory role. This was forgotten by many western governments. To make matters worse, the west spawned a huge new financial services industry that was widely perceived to have added a lot of "value". For a while, like all good Ponzi schemes, the industry seemed to create a lot of new wealth. Yet it is now clear that it added no real new value. Andrew Sheng, former Hong Kong central banker, has said, "how do financial engineers make five to ten times more salary than physical engineers year after year? Is there magic in the financial institutions' ability to create return on equity that is significantly higher than real-sector companies like automobiles or energy? The answer is that they create risks through leverage and interconnectivity which, every ten years or so, become realised losses that are fully underwritten by the public sector through tax bail-outs. The financial sector is being subsidised by all the holders of financial paper through zero interest rate policies. Their liabilities are still guaranteed by central banks. Finance has become the biggest free rider of all time."

This huge industry was allowed to "capture" the regulators whose duty it was to control and supervise its activities. AIG, which could have single-handedly destroyed the global economy, was allowed to choose a small regulator in Delaware to regulate its trillion-dollar operations. No one in Washington batted an eyelid.

The second strategic error was to forget the lessons that European capitalists learnt from the Marxist threat of the early 20th century. For capitalism to survive, all classes had to benefit from it. Social democracy was the European response to the threat of communism. Wages and welfare benefits of workers were increased. The capitalists became rich but the workers also gained. Even American capitalists, who were clearly not enamoured with the social democracy experiment, saw the value of increasing wages. According to Lee Iacocca, Henry Ford "shocked the world with what probably stands as his greatest contribution ever: the $5-a-day minimum-wage scheme. The average wage in the auto industry then was $2.34 for a 9-hour shift. Ford not only doubled that, he also shaved an hour off the workday."

Sadly, all the lessons that the west learnt then have been forgotten. Chief executives at some of America's largest companies earned an average of $11.4m in total pay – 343 times more than a typical US worker, according to a report by AFL-CIO, the labour federation. This rising inequality was a big challenge. Rising unemployment was an even bigger challenge. Asian governments fought off unemployment by creating incentive schemes to promote investment and employment. Western governments dismissed this as "industrial policy", an ideological heresy. And when western workers suffered, the capitalists retorted, "markets know best." Perhaps the time has come to for the west to learn from Asia how to manage the existential challenges of the capitalist system.

The third error made by the west was to aggressively promote the virtues of capitalism to the third world, including Asia, without realising that it had to educate its own populations on the critical concept of "creative destruction". Economics textbooks correctly pointed out that when the automobile was invented, the horse and buggy industry had to disappear. And when digital cameras emerged, Kodak film had to go. Yet, the masses were never told that they would have to learn new trades and skills as new competitors emerged from China and India.

Hence, when manufacturing declined from 27 per cent of US gross domestic product in 1950 to 11 per cent in 2009, no policymaker took note or corrective action. Nor did American leaders warn that workers would have to be helped to find new skills and jobs.

For all its flaws and defects, capitalism remains the best system to improve human welfare. This is why the whole world (barring North Korea) has accepted it, in one form or another. But it is also an inherently imperfect system, as Adam Smith warned us from day one. It requires careful government regulation and supervision. Asians never forgot this. The west did. Hence, the time may have come for Asians to reciprocate the generosity of the west in sharing capitalism with Asia. Western policymakers and thought leaders should be invited to visit the industrial complexes and service industries of Japan and Korea, Taiwan and China, Hong Kong and Singapore. There may be a few valuable lessons to be learnt here and there.

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