Weeding out the "socially not useful”

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Weeding Out the “ Socially Not Useful”, 2008report In his classic essay “ What is seen and what is not seen” (written in 1848 and published in July 1850) the shamefully underrated and neglected French economist Frederic Bastiat (1801-1850)1 declares that what distinguishes a bad economist from a good one is that the bad one can only see what is to be seen, while the good one also discerns the as yet unseen consequences that are bound to follow the visible effect of an action.

Present benefits must be painfully paid for in future costs, while present sacrifices tend to be generously rewarded in the future. The good economist must, of course, weigh up the merits of a law, a policy or an institution by taking account both of the effects he (and others) can see and the future consequences he foresees (and others do not). Stated this way, there is a built-in test that makes it very easy to tell the good economist from the bad one: we only have to watch the consequences as they emerge with the passage of time. Events will show up what the bad economist has overlooked and what the good one has correctly foretold. Bastiat, in his summary introduction, states the problem in terms of a choice (to change something or to keep it the way it is) and the future, as yet unseen consequences of that choice. However, the choice also involves another, different implication that is unseen but unlike the one that will emerge in the future, is condemned to remain unseen. For the choice of a law, a policy or an institution has one effect that is not seen but will be, and another namely the future state of affairs that would have prevailed had that choice not been made. This is the state of affairs that we forgo, that might have come about but did not, “ what we do not see” and never will.

It is what in modern economics is called opportunity cost the bad economist tends to ignore and the good one can only approximate by educated guesses, intelligent conjectures. Though Bastiat does not explicitly mention it in his summary of " What is seen and what is not seen," most of his examples also deal with " what might have been." It is probably fair to credit Bastiat with the discovery of the concept of opportunity cost. When by mid-2008 near-hysterical panic-mongering got the better of a banking system that was admittedly over-extended, but that can by its very nature not resist a collapse of confidence even if it is ever so well capitalised to start with, governments guaranteed countless billions of bank assets and injected into key banks countless millions of equity and loan capital. Much of this money has since been repaid with ample interest.

Some of it remains tied up in rather messy situations, but the operation as a whole, despite strident cries about the taxpayer having to rescue the fat cat bankers, will probably at least break even. The banking system, though a bit shaken, was saved. The opportunity cost" between five and ten major European banks being temporarily unable to repay deposits (especially the large and volatile wholesale deposits of institutions) on demand" might have been higher than the cost of government intervention. The rescue thus looks well worth it, though some diehard critics think letting big banks fail would have had salutary long-run effects. The parallel operation of propping up the economy by raising public spending is, contrary to average opinion, less evidently justified.

The major European states will have run deficits of 8 to 12 per cent of GDP between 2008 and 2011 if not beyond. The effects on the national debt and

the budgetary strain of servicing it looks too frightening to contemplate. That problem, however, is outside the scope of this essay. The court of popular opinion has irrevocably judged that all the havoc, disorder and misery is the fault of the banks and the greedy bankers running them.

Though it should know better, educated opinion has rallied to this judgment and is busily engaged in explaining how the financial system has caused the “ crisis” and how radical “ systemic change” is needed to prevent another one before we know where we are. Most of these reformers seem to want a tame, playing-by-the-book banking system that turns its back on innovation, wizardry, own-account trading, derivatives, securitisation and the financing of buyouts and corporate wheeling-dealing. Instead, it should limit itself to the routine financing of the production of “ real”, tangible goods and earn only moderate, “ morally acceptable” profits. It would be a nice research project to try and estimate the opportunity cost of this reform programme. If it is carried out, which the baying of the revenge-hungry renders very probable, two functions of the system will be impaired: the smooth and audacious reallocation of capital in response to changing profit prospects, and the reallocation of risk from where it arises to where it is most readily borne. The opportunity cost of the reform is the enhanced efficiency that these functions would ensure if they were left unimpaired” an efficiency that “ is not seen”.

The most ominous of the reformers, however, seek reform of the financial system not by stricter regulation and moral suasion, though they are in no wise against these things. What they propose is a radical short cut: they want simply to weed out the part of the financial system that is not socially

useful. It is the gut feeling of many that the proper function of the economy is to supply the population with wholesome home grown food, no-nonsense long-life garments and decent housing. The rest, the services sector, is debatable. Public services, mainly law and order, health care and what goes by the courtesy title of “ education”, are more or less all right.

Beyond these, however, what is left is what an inglorious British Labour leader and Prime Minister of the 1970s, Harold Wilson called the “ candyfloss economy”. As the name tells us, it is not “ socially useful”. Hence it must be a candidate for weeding out. No lesser authority than the Governor of the Bank of England has publicly suggested that the British financial services sector is too big and it would be a good thing to cut it back to size.

Liberal economists and philosophers must be shaking their heads in troubled disbelief. In what sense, in what perspective is an industry “ too big” if, taking good years with bad, it is vastly profitable and is getting bigger? A service is profitable if Everyman, the businessman and the final consumer, buys it. Buying it is the one indisputable way he has to show that he wants it.

But Superman is unimpressed by what Everyman wants. He wishes Everyman to get what he needs. For only what he needs is “ socially useful”. Superman, looking on from his lofty perspective, has a shrewd idea of what is socially useful. A true humanist, he would gladly give Everyman the chance to help define it, but the latter can only speak by spending his euros and dollars. That, as we have seen, merely expresses wants, not needs, and in any case some have more of it and hence speak louder than others” on

both these counts, it just wont do. It remains for Superman to speak all by himself for Everyman.

Superman, of course, is not only the Governor of the Bank of England, but all those who have the supreme arrogance to assume the role, as well as the chance or the sharp elbow to occupy the pulpit. The last time such men and women could actually decide what was socially useful, what was to be weeded out and what was to be fostered and expanded, was when they were members of the Central Committee of the Communist Party of the Soviet Union. The reader will perhaps join me in trusting that history is not getting ready, in some less odious disguise, to repeat itself. report report