Summary of Part I

It's a paradox: none of the most successful economies of the world are market economies anymore. Learn how China, Norway and Switzerland do better by altruism and social welfare.

What is Economy?

- launching a new debate on the basics

>> by Alexander Dill

Part I: Market Economy and the Paradox of China
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>> Part I: Market Economy and the Paradox of China

When the Soviet Union went belly up in 1985, it looked like the *Endsieg* of capitalism, the triumph of the western schools and their prophets Popper, Keynes and Friedman, had arrived once and for all.

In 1990, the former socialist states finished entering what is still called the *market economy*. The paradox: the only country that didn't—preferring to keep on running a centralised communist system—is well on its way to becoming the number one economy in the world today: the People's Republic of China.

Not only economists are hard pressed to accept this fact. If communism and a market economy are not mutually exclusive, but actually harmonise with each other ideally, then nearly one hundred years of anti-communist paranoia would seem to be blowing in the wind.

The think tanks—or rather bunkers—in Boston, Washington, Chicago and New York are witnessing the demise of their corporate identity: the championing of free markets over protectionism and communism.

This year's Davos meeting motto, *The Shifting Power Equation,* has been widely interpreted as heralding the rise of new powers. Russia and India, far from embracing a market economy, made a big splash on the scene. Faithless neocons and evangelists of deregulation alike recognise that the most successful economies—according to the World Economic Forum's World Index of Competitiveness and the UN—are Switzerland and Norway.

A closer look reveals that neither nation embodies the classical definition of a market economy. Not only is Norway ruled by a left-leaning socialist (who also happens to be a woman), but it sports extremely high taxes, astronomical labour costs and a policy of strict protectionism. Like Switzerland, Norway is governed by politicians who are not corrupt and who take pains to avoid everything that might be called *political*. The ideological wars waged between Republicans and Democrats, Labourites and Conservatives or Social Democrats and Christian Democrats have no place in the brave new world of common sense.

It seems that the miraculous economic success of these world benchmark leaders is much more easily explained by the rules of socialist manifestos than the Ten Commandments of market economies. Everything seems to going wrong in Switzerland and Norway:

- Their own currencies obstruct foreign investment and trade
- High income levels impede full employment and competitive production
- Strong governmental regulations suffocate entrepreneurship
- The social security systems in these countries discourage personal risk and work like a second income tax
- Daunting customs and taxes corrode private wealth and inhibit private consumption

For starters, you can't simply settle down in these countries and start a business. *They* decide whom they need.
If Norway, Switzerland and China were used as case studies at Harvard Business School, business administration would become what economics by definition still is: a *social science*.
The discovery of social and human capital as the inexhaustible source of economic growth came relatively late to mainstream economics. It took six years for the World Bank to finish its Report on the Wealth of Nations.

For the first time, the report estimates social and natural capital. Francois Bourguignon, Chief Economist of the World Bank, nevertheless still ends with the eternal mantra of the market economy: "Growth is essential if developing countries are to meet the Millennium Development Goals by 2015."
Sorry, but how can an economy based on markets, supply and demand meet Millennium Development Goals ten years from now? Wasn't this idea the colossal blunder of all planning economies?
Was economic growth in China, where the word *economy* has only existed for about twenty years, the result of a millennium goal provided by Deng Xiaoping, the great reformer from Shenzhen?
If you visit Shenzhen today, you will be amazed at the number of BMW 7s and Mercedes S-Classes you see. Although few people own cars, the percentage of luxury cars is striking. Secondly, you will be surprised to find public servants every 200 meters. They take care of neatness, dig up the flowers at the roadsides or simply wait for your smile. The Governor's Palace of Shenzhen has the dimensions of the Great Pyramid of Giza and is, of course, called the *People's Palace*. When I visited the Governor of Shenzhen for the second time, my name was correctly written on my place card in his private restaurant, where I was served Coquilles St. Jacques. China is, after all, proud of its common affluence. It gives you the impression that the whole capitalistic effort was undertaken as a proof that the collective has more to offer than the individual.

Even rich Chinese dislike private invitations. Wealth is a completely public matter. If the hypothesis of self interest can be said to be the philosophical base of a market economy, you would have to add in China: It's in my own self interest that our country be as rich as possible. We would call this the spirit of altruism. Ernst Fehr from Zurich and Klaus Schmidt from Munich, economists researching altruism, challenge the dogma that self interest is the *sole* motivation for *all* people participating in an economy, noting that "This practice contrasts with a large body of evidence gathered by experimental economists and psychologists during the last two decades".

If we look for common benchmarks among economies as disparate as China, Norway and Switzerland, strong altruism will be one.

Economic success is seen as a collective result in these nations. That perspective corresponds with studies in entrepreneurship—like those by Sophie Boutillier—that identify the entrepreneur as a mediator of social capital rather than a single creator or conquistador.

What about pricing in such economies? A market economy has always meant following the rules of supply and demand. From Adam Smith on, the so-called *natural price* seemed to be the logical result of negotiations that considered factors like labour, technology and capital. A market economy represented a balance among different needs. "Market economy" therefore became synonymous with *justice*: if pricing is the result of fair negotiations, there should be no disadvantage for the individual—and therefore nothing preventing anyone from entering the market.

In China, Norway and Switzerland, you will find the opposite scenario. Few economies build up stronger obstacles to joining their markets. Few countries have more tricks up their sleeves for thwarting start-ups from the outside. In Switzerland, you have to hire a local administration board. In China, the only way to settle down is via a joint venture. In Norway, you have to learn Norwegian to obtain a work permit.

Naturally, each of these three countries boasts a different USP: Switzerland is the benchmark leader in financial services, China looms large in industrial production and Norway is at the helm of sustainable oil sales. But the fact remains that the fiscal and institutional conditions are set up by a strong governmental authority in each case. This authority is legitimated by pluralist democracies in Norway and Switzerland, and by a one-party democracy in China.

But in all three countries the government is backed by a strong majority of citizens who uphold its conditions. The results are very low criminality, abundant opportunities for higher education, extreme legality and enduring internal stability.

Are they market economies in the classical sense? If today the benchmark is competitiveness, they are. And the economies of Brazil, Russia, Saudi Arabia and India, with their enormous iniquities, will remain forever unstable unless they start to cultivate fairness, reciprocity and altruism.

Market economists underestimate the long-term potential of social and human capital because you can't measure it in GDP per capita. The econometric approach yields a false forecast for developing countries: Not all leading economies are market economies and singular elements of market economies cannot be transferred to societies whose civil life is not based on the rational balance of individual self-interest. The far religions, traditions and other collective identity rules ensure social equality , while mantras like profit, effectiveness and growth risk failure. The post-Soviet states and most of the emerging states are given a paradoxical message: They should cut off their public sector and open their markets, but the benchmark leaders are quite successful with the opposite approach. We may call this a *double-bind* situation.

How close is China to the US economy? Closer than we estimate. Recognising that 48% of the GNP in the US is generated by one sole customer—the state of America—including the $470 bn spent on the military and war, and keeping in mind that the US has total debts of about $8 tn while China boasts savings of a minimum of $1tn, even a revaluation of the Chinese RMB wouldn't change that much. Most Chinese exports are impervious to currency risks, because they supply an international demand. .No other country, including India, could fill these orders. A decline in world trade would weaken not only China, but Europe and the Arab World as well. Communist China’s distinction of holding the most social and human capital in the world is reflected by the number of patents it holds: In 2006 China registered more patents than any other country.

The market economy experienced its heyday during the twin eras of *Reagonomics* and *Thatcherism*. New Zealand in particular surfaced as one of the rare species of national economies to have been successfully influenced by the economic policies of these schools in the so called *Rogerism*. Today New Zealand has a Current Account Deficit (CAD) of 9% of its GDP and Aaron Drew from the Reserve Bank of New Zealand speaks of *macroeconomic imbalances*.

Today, macroeconomic issues have become a part of engineering; as Gregor Mankiv from Harvard says: "Having recently spent two years in Washington as an economic advisor at the time when the U.S. economy was struggling to pull out of a recession, I am reminded that the subfield of macroeconomics was born not as a science but as a type of engineering. God put macroeconomics on earth not to propose and test elegant theories but to solve practical problems."

So was the whole debate on market economies and Keynesian theory little more than Quixotic tilting at windmills?

When it comes to macroeconomic engineering, the Chinese, Swiss and Norwegians don't listen to Harvard or Oxford economists. Do they create multiple hybrid solutions in their economies without having an overview of the big picture?

Does practical engineering in national economies work better the less an economy is regarded as a homogenous system? That would explain why China ignored ecological issues for such a long time, only to discover them at the very moment they found a practical way to solve them.

Successful states feel free to emphasise the private and governmental sectors of their economies as they see fit. One day entrepreneurship is promoted, the next day the state overtakes key economies. When Norway became aware of its surplus tax revenues, it devised a unique fund: More than €100 bn was invested in foreign markets and equity to keep oil profits coming in for decades to come. Alaska, the only state in the world offering a guaranteed basic income to its citizens, accomplishes this with a national fund fed by the revenues from the taxation of the exploration of its natural commons.

A Lexus hybrid vehicle doesn't make a fundamental decision between running on fuel or battery. Both sources are used in the most effective way. The communist-market economies are *hybrid* and unencumbered by ideological taboos. They may employ double the number of people in the public sector than they really need, but they won't give a dime to a company that goes under and puts thousands out of work. In Switzerland and Norway, rich people have to contribute to the social security system. An investigation of China’s new millionaires showed that 80% of them were the children of high-ranking functionaries in the communist party. In a brand new Airbus 320 flying between Beijing and Shenzhen, I once sat next to an old woman. I learned that she paid $10 for that flight—round-trip. This fare was not due to a last-minute bargain—the elderly obtain cheap tickets from the state to visit their families. And China has 200 million senior citizens!

In the Emirates, the same hybrid drive is at work in privately-owned states: Dubai, Kuwait, Abu Dhabi and Bahrain are planned economies in every sense of the word and provide very communist services to their own people, such as free medical care, free housing and free education. So do tax havens like Liechtenstein, Monaco and Luxemburg and prosperous merchant cities like Vienna, Zurich and Hamburg.

That doesn't mean that the market economy has run out of steam; it has never been put into practice in its pure form. At the same time, the hybrid models discussed above cause us to question the essentials of neoliberal thinking:

- If altruism is so prevalent in strong economies, why do we still promote egoism and self-interest in our societies as essential for economic competitiveness?
- If strong governments prevent their citizens from becoming victims of macroeconomic imbalances, how can we continue to call for less state and more privatisation of public goods and commons?
- If hybrid economies are able to integrate several contradistinctive rules and principles, why do we insist upon theoretical and political coherence?

Our market economies will have to face these questions if they want to learn why they are descending in the rankings of enduring competitiveness.