

The Financial Times, February 2, 2012

Our ignorance will yield more crises in capitalism

By Kenneth Rogoff

Over the past three weeks, contributors to these pages have engaged in a vigorous debate on the merits of contemporary capitalism. Entrepreneurs who have earned billions, world leaders who have spent trillions, journalists, academics, and even “Occupiers” have all weighed in. A few clear themes have emerged, highlighting points of agreement and controversy.

Virtually everyone defends the market system, albeit some with more unvarnished enthusiasm than others. Failures in financial regulation, environmental and consumer protection, and particularly in regulating income distribution, are all emphasised. Bill Clinton, former US President rightly argues that markets can be made to work better for charity as well as production. Economist Jeffrey Sachs points to addictive consumer behaviour as a central flaw in today’s growth dynamic, a point with which I strongly agree. Occupy London argues that regardless of overall income level, higher levels of inequality breed social ills, a very plausible conjecture. But no one is seriously arguing against markets; only for regulating them more effectively and more fairly.

The general enthusiasm for economic markets does not extend to political markets. It is striking that both George Osborne, UK chancellor, and Ed Miliband, leader of the Labour party, highlight short-termism in politics as a key flaw. Although the two politicians highlight problems in financial policies, their arguments could well be extended to a host of other areas, ranging from global warming to world food production. The purchase of influence is hardly unique to the financial industry.

Nor is the problem of excessive political influence by business unique to developed countries. Perhaps China’s greatest challenge in the decades ahead will be to shift away from an investment and export-driven development model to a world in which domestic consumers adjudicate the competition between China’s producers. As China grows it must shift to a domestic-demand driven model where it will be much harder to resist internal political pressures to interfere with competition. The idea that Chinese capitalism, which is evolving and transitional, provides a blueprint for the rest of the world, is an absurd exaggeration. Creating impressive infrastructure eventually runs into diminishing returns, as evidenced by the history of Japan and the Soviet Union.

As Martin Wolf points out, contemporary capitalism, which does such an extraordinary job of generating a cornucopia of private goods, is far less effective at generating public goods, whether it be education, infrastructure, environment or financial stability. Improving political markets – and as a corollary, regulation – is a central challenge facing all countries in the world, not just those in the west.

Europe, along with countries such as Canada, has arguably done a better job balancing public and private goods than either the US or China. Governments at least pay some attention to pollution. For the moment, Europe still has a reasonably strong social safety net. Mass transit systems work, at least when the employees are not on strike. Indeed, many countries around the world look to the Nordic model, which at least according to a variety of surveys produces some of the highest happiness levels in the world. In Europe, of course, the big challenge is dealing with overly generous pension schemes and insufficiently flexible labour markets in the face of the rapid changes emanating from globalisation.

How to strike a balance? One absolutely essential prerequisite is emphasised in Adam Smith's letter to the Financial Times (as imagined by David Rubenstein): educate, educate, educate. It is really hard to see another way out of the growing sustainability problems that capitalism has given us. Mr Rubenstein focuses on the inadequacies of primary and secondary education, as well as the need to re-educate and retrain adults.

I would take the point much further: Societies need to find ways to make adult education, including economic and financial literacy, far more available and far more compelling. If voters are uninformed and easily swayed towards demagogues peddling short-term ill-considered policies, there is little hope for righting the course of capitalist economies.

The idea that the masses are indifferent to education, and that any broader notion of literacy beyond the three R's (reading, writing and arithmetic) is a hopeless cause, is nonsense. As someone who has spoken to all kinds of people in the wake of the financial crisis, my sense is that most citizens are starved of information, and would consume it hungrily if offered in a palatable form.

One must admit that followers of the recent political debate in the United States might feel justified in being supremely cynical. But perhaps today's errant political dialogue is only a symptom of a profound deeper failure of modern societies to pay attention to ongoing adult education and literacy. Without major changes, including attractive web learning platforms, expanded public radio and television, and greater educational choice

for children, it is hard to see a long-term cure for contemporary capitalism's many political problems. Improved education alone will not resolve the flaws inherent in today's capitalism, but it is an essential first step down any path to a solution.

The writer is professor of economics at Harvard University and co-author with Carmen Reinhart of 'This Time is Different'