

## **Free market, not state capitalism, holds the key to growth**

By Maurice Newman, *The Australian*, 2 November 2016

In a book, *No Ordinary Disruption*, McKinsey Global Institute has, according to LinkedIn chairman Reid Hoffman, published “an excellent primer in how to think strategically about the transformational role of technology ... and how to prepare yourself for a future that will be marked by relentless change and massive opportunity”.

Mostly, the book will be read by corporate leaders who are aware the next disrupter may not be a known competitor, but someone working from a garage. The book calls for “an intuition reset” and observes that “major shifts can blindsides even the most circumspect among us — first slowly and then all at once”.

The book outlines how it took Britain 154 years to double economic output per person, while the US achieved it in 53 years and China and India in only 12 and 16 years respectively. “In other words, this economic acceleration is roughly 10 times faster than the one triggered by Britain’s Industrial Revolution and is 300 times the scale” (based on relative populations). It is a similar story for postwar Germany, Japan, and South Korea.

While technology and urbanisation were important growth drivers, the indispensable link common to all was the application of free market principles. They emancipated unprecedented numbers of the world’s impoverished in ways few could have imagined.

Take postwar Germany. Contrary to advice from the occupying authorities, chancellor Ludwig Erhard abandoned most price controls, introduced regressive taxes to stimulate savings, investment and labour overtime, and reduced the money stock to eliminate hyperinflation.

His commitment to market forces transformed a broken-down economy into an economic miracle with limited social welfare and widespread prosperity.

Deng Xiaoping also realised the wealth-creating potential of the market and, by using his authority, reduced the role of central planners. In the process he lifted hundreds of millions of Chinese out of poverty. In 40 years China’s share of global GDP rose from 1.8 per cent to more than 16 per cent. Grain production increased nearly 70 per cent.

But, sadly, Chinese faith in markets has lately been shaken by the meltdown in share prices. It has spooked the ruling class, which now sees market forces as a serious threat to its authority and privileges. Despite promising a more “decisive role” for competition and market pricing, indications are that Beijing has had a change of heart in a number of areas and is using an anti-corruption drive to strengthen political control. This is relevant to Australia’s future.

China’s apparent rethink seems to be the way of the world. In Britain, as Paul Kelly identifies, “so sweeping is (Prime Minister Theresa) May’s language, so specific are her claims, so determined is she to redefine the Tory government, that only one conclusion is permitted: free market deregulation and economic liberalism are in rampant retreat post Brexit”. Indeed, her promise of “a new centre ground in which government steps up — and not back — to act on behalf of all of us”, confirms the state capitalist model she inherits may change emphasis, but not direction.

Even in the land of the free, state intervention is on the rise with Barack Obama introducing a record number of federal regulations estimated to cost the economy \$US1.9 trillion. He has

increased the minimum wage and brought in a healthcare scheme which is destroying private providers and leaving millions of people facing skyrocketing premiums and fewer choices.

We are following a similar trajectory. While neither Malcolm Turnbull nor Bill Shorten enjoys May's coherence, their policies are consistent. Their instincts are to impose more economic and political control from the centre. No intuition reset here. Just blindness to huge opportunities.

So, when we see bankers go cap in hand to Canberra to pay homage to their political masters and when a government agency seeks to silence a cartoonist for depicting the truth, we know capitalism and freedom are no longer what they used to be. Time to realise South Australia's statewide blackout, the politically desperate submarine deal and the failed NBN thought bubble are metaphors for what lies ahead.

State capitalism cannot avoid the inefficiencies of government control, the concentration of risk, lower economic growth rates and greater social inequity. But it strengthens the hand of central planners. It allows, through regulations and subsidies, the direction of private capital without actual ownership. It may stifle innovation, reduce small business competition and be economically hazardous, but the process evolves into a mutually reinforcing establishment of powerful state apparatchiks, big business and organised labour. As the Chinese are realising, free markets may be great for the masses but not for entrenched elites.

Which is why, as wealth gaps widen, Western voters are wondering what, apart from benefiting the establishment and an occasional vote, does the present system offer? They may entertain alternatives, but financial insecurity and growing state dependence make them wary of smaller government. In this way the ruling class perpetuates itself.

According to McKinsey, by 2040, one in four people in advanced economies, including China, will be 65 or older. But productivity is going the wrong way. Technological advancement may partially offset this, depending on how costly legislated rigidities have become. But tomorrow's jobs require science, technology, engineering and mathematics qualifications where Australia ranks only 17th in the world. We can choose between being a disrupter or being disrupted.

Historically, state capitalist societies become increasingly authoritarian and protectionist. They are a threat to global security and prosperity. Without an early return to 20th century economic growth rates this threat will intensify. But, with ageing demographics and an ingrained system more interested in entrenching elites than creating economic miracles, that prospect is dim.

Ultimately, something will have to give.