The Pudong financial district of Shanghai. While it is true that the Chinese economy has a higher degree of state intervention than many developed economies, its fast growth can hardly be used as a case against free market capitalism, says the writer. PHOTO: REUTERS

In defence of free market capitalism

It has its flaws but it imparts dynamism to economy that gives rise to innovation

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For The Straits Times

In a recent article in The Straits Times, Professor Ngaire Woods, dean of the Blavatnik School of Government at Oxford University, argued the case against free market capitalism and in favour of "more active and effective government" to boost growth and expand opportunity.

I differ from her conclusions about the relevance of free market capitalism for a number of reasons.

In "The case against free market capitalism", published on Oct 20, Prof Woods cited the example of China's faster growth than many developed countries as an argument against free market capitalism. While it is indeed true that the Chinese economy has a higher degree of state intervention than many developed economies, its fast growth can hardly be used as a case against free market capitalism. The most dynamic parts of the Chinese economy are private enterprises that have flourished in a globalised world.

In fact, even though world-leading companies such as Haier, Lenovo and Huawei started as enterprises with some connection to the Chinese government, they are now managed like private enterprises and much of their success has come from outside China. Other success stories from China such as Alibaba and Tencent are excellent examples of free market capitalism.

Indeed, China's state-owned enterprises are believed to be holding the country back from achieving even higher growth and a possible source of social disruption – for example, such as widespread unemployment – when they are eventually reformed.

Prof Woods' examples of other countries such as India, Laos, Myanmar are even more questionable. Many of these countries had centrally-planned economies that resulted in decades of economic stagnation. It is the embrace of some elements of free market capitalism that eventually spurred growth. She also forgot to account for the fact that fast growth is easier to achieve for developing countries because the base on which growth is calculated is smaller.

Prof Woods' argument committed the usual error of polarising the situation as a binary one – presence or absence of free market capitalism. In reality, no country in the world has the purest form of free market capitalism and governments in almost all countries intervene selectively in their economies.

At early stages of development, in which institutions such as banks and capital markets are underdeveloped, government intervention tends to be high. As they become more established, government intervention typically becomes lower. Even in Singapore, many of the former government-linked companies have now been privatised.

In India, which Prof Woods cites as a classic case of state-led development, the divestment of state-owned enterprises has not happened because no political party has shown the will to administer much needed bitter medicine to the economy. The state-owned banks in India are in a poor shape because they are not managed like free market enterprises.

Also far-fetched is Prof Woods connecting free market capitalism with outcomes such as illiteracy and worsening health. I can't imagine a single country, free market capitalist or otherwise, that has a purely private system of education without government involvement. She also committed a similar error in overlooking the fact that countries that historically had poor health services, such as Albania and China, are better able to bring about a rapid improvement.

While it is true that free market capitalism has led to many excesses and there is a need for regulating the behaviour of firms and individuals, that does not mean that the system is broken, only that the system needs to evolve with changing times. For instance, as industrial development has gathered pace, issues such as pollution have become more salient and so has the need for devising new regulations. In addition, new or improved regulations are needed in areas such as corporate governance to protect investors' interests and to prevent, or at least reduce, tax avoidance.

Even the strongest proponent of free market capitalism would not suggest that economies should be free of all government involvement.

Free market capitalism imparts an element of dynamism to the economy where adjustments are not painless or effortless, but they are likely to be timely and successful.

The United States economy, which is often held up as an exemplar of a free market capitalist economy, is a dynamic one and despite drawbacks such as income inequality, the US economy has been remarkably resilient. It has also been the source of many innovations and is routinely ranked near the top of competitiveness rankings.

Many analysts question whether the Chinese economy will prove itself to be as resilient, not because the Chinese people are not ingenious but because of the heavy hand of the Chinese government.

Like democracy or any other system, free market capitalism is not without its flaws. As tycoon Richard Branson said: "Capitalism is the only system that works, but the problem with it is that extreme wealth ends up in the hands of few people. I would rather live in this system, even with its shortcomings, than any other system which is probably even more flawed."

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