Tim Harford

The Undercover Economist: A trade deficit with a babysitter | *Financial Times Magazine* **|** 10 December 2005

Yes, we have bananas. We just can't ship them | *New York Times* **|** 16 December 2005

How the government can quit an oppressive habit | *Financial Times* **|** 18 February 2006

Photo credit: Fran Monks

TIM HARFORD writes the 'Dear Economist' and 'The Undercover Economist' columns for the *Financial Times*. He presents a TV series for BBC2, called 'Trust me, I'm an economist'. He was the first Peter Martin fellow at the *Financial Times* and rejoined the newspaper as economics leader writer in April 2006. Mr Harford is author of *The Undercover Economist* and 'The Market for Aid' (with Michael Klein). His other experience includes time at the International Finance Corporation, as a scenario expert at Shell, as a tutor at Oxford University, and as a speechwriter for Stanley Fischer, now Governor of Israel's Central Bank. He lives in London with his wife and daughters.

A TRADE DEFICIT WITH A BABYSITTER

10 December 2005

Cheap foreign labour has recently made inroads into the economy of Family Harford. My wife pays a student, "Sally", to look after the imperious Miss Harford for a few hours a week, so that my wife can get on with running her photography business. This is the simplest and most straightforward of transactions. My wife is happy, Sally is happy and even Miss Harford appears to approve of the arrangement.

How strange that if it were judged by the conventional wisdom applied to trade negotiations by newspapers, pub pundits and even our own trade negotiator, this arrangement would be regarded as economic suicide on both sides.

Family Harford runs a substantial bilateral trade deficit with Sally. A bilateral trade deficit is what you spend with a particular trading partner, less what you earn from them. We spend $100 a week on service exports from Sally, and we earn nothing at all from her. That's a yawning bilateral trade deficit, but we're happy enough with it.

If politicians were in charge of Family Harford trade policy they would bully Sally to raise her hourly rates, so that trade would take place on a "fairer" basis. The politicians in charge of Sally's trade policy would refuse.

Boggled already? You should be. But this matches perfectly the state of US-China trade relations: China keeps selling cheap stuff to the US, the US isn't selling so much to China (but plenty to other parts of the world). The Americans are demanding that the Chinese charge more, and the Chinese are refusing.

Judged by the standards of conventional wisdom, Sally should refuse to trade with Family Harford at all because she is uncompetitive. My wife possesses impressive productive capacities in three industries: childcare, tertiary education and photography. That is, she's good at looking after Miss Harford, she's good at passing exams, and she's good at taking photos of people for money.

Sally can also look after Miss Harford, pass exams, and take photos, but she's not as good at babysitting as Miss Harford's own mother, she lacks the discipline and experience to ace all her social science exams the way my wife did, and the market has shown no interest whatsoever in paying Sally to take photographs. The pub philosopher concludes that without some kind of trade protection, my wife will not only look after the baby and run her own business, but muscle in and sit Sally's exams for her, in between taking Sally's family snapshots.

That doesn't make any sense either. First, my wife doesn't have time to do Sally's work for her, even though she would do it quicker and better. Second, even if my wife did have time, why on earth would she offer to do all this stuff for nothing? Contrary to popular belief, it's simply not possible for cheap foreign labour to take all the jobs in Britain, because the British have to work to pay for all the nice stuff the foreigners send us. In the long run, all imports are paid for by exports, and barriers to imports into Britain are also barriers to the exports we send out to pay for them.

Peter Mandelson, the EU trade commissioner, believes that in the run-up to the latest WTO trade negotiations he has offered tariff cuts "even where it hurts us the most" – that is, areas vulnerable to competition.

For Family Harford my wife's childcare activities fall into that category: lacking tariff protection, they have been eroded by cheap competition from Sally. Have we been "hurt" by this? My wife believes she's been liberated to spend more time on her photography business. She has a better grasp of trade policy than Mandelson.

YES, WE HAVE BANANAS – WE JUST CAN'T SHIP THEM

16 December 2005

At this week's ministerial meeting of the World Trade Organization in Hong Kong, negotiators have once again hit an impasse over how and when to open the rich world's agricultural markets to farmers in the poorest countries. What few people have realized, however, is that poor countries don't have to wait for the World Trade Organization. There is plenty that they can and should do to help their own farmers to trade.

Imagine a dream scenario in which the trade ministers emerge from their negotiations this weekend holding hands and proclaiming an end to all agricultural protectionism. What then?

For, say, a banana picker in the Central African Republic, not a lot. The trade barriers at the borders of the rich world may have disappeared, but if our picker wants to sell his bananas abroad he first has to get them onto a ship bound for America or Europe. That takes 116 days, and an incredible 38 signatures – each one an opportunity for some official to collect a bribe. Something is rotten here, and not just the bananas.

Sub-Saharan African exporters face, on average, delays of nearly 50 days for each shipment. They must get roughly 20 signatures on eight or nine separate customs forms. (These figures are all documented in "Doing Business in 2006: Creating Jobs," a report released in September by the World Bank. A disclosure: I was an adviser to the report team.)

Part of the problem, of course, is that landlocked African countries are linked to the outside world by long, decrepit roads and underdeveloped ports in neighboring countries. But determined growers can move bananas along even lousy roads. The real problem is elsewhere: three-quarters of delays are the result of red tape, not port handling or inland transport. These delays, caused by senseless bureaucracy, unnecessary forms and archaic inspection practices, can often be eliminated with a stroke of a pen by a country's chief executive. Even the more sophisticated reforms, like introducing electronic filing, or using software to guide sensible risk-based customs inspections, require only small outlays. What's more, such reforms increase the interception of smuggled goods and discourage corrupt customs officials.

The Group of 20, composed of developing countries like Argentina, Brazil, China and India, has been pushing hardest of all for an end to rich countries' agricultural subsidies and tariffs. Paradoxically, some of the most vocal members of the group impose regulatory barriers that are just as crippling to exporters in their own countries. India's commerce minister, Kamal Nath, has called for rich countries to "eliminate export subsidies as fast as possible." And so they should, but Mr. Nath might take note that an Indian exporter needs to collect 22 signatures on 10 documents – that puts India in the bottom 20 countries in the world for letting its own entrepreneurs trade across borders. Celso Amorim, Brazil's foreign minister, has condemned farming subsidies as "the most harmful single piece of commerce." The subsidies are indeed repugnant, but Brazilian exporters need 39 days to get their produce onto a ship, too long for some agricultural goods.

It doesn't have to be that way. China can get exports moving in 20 days, the United States in nine days. Danish exporters can ship in five days.

We should wish the trade ministers well in their negotiations, because agricultural protectionism hurts consumers in the developed world as well as farmers in the poorest countries. But governments of poor countries must do far more to help their own citizens by reforming the Byzantine obstacles that stand in their way. One day rich countries may finally allow poor farmers to sell them beef, sugar or rice. It would be a disaster if their own governments prevented those poor farmers from taking full advantage of that opportunity.

HOW THE GOVERNMENT CAN QUIT AN OPPRESSIVE HABIT

18 February 2006

Never too eager to lead from the front, this week British parliamentarians followed Ireland, Spain, Italy, New York and California as they voted to introduce a ban on smoking in bars, restaurants and offices – so-called "public spaces". (Those people who really believe offices and restaurants are public spaces might try organising a Boy Scout jamboree in one.)

The decision, of course, owes much to the fact that defending the right to smoke is politically as appealing as defending the right to pick your nose. Whether the new law is sensible is another matter.

It is easy to conjure up justifications for a smoking ban but harder to make them stand up to scrutiny. The most popular argument recently has been that smoking must be banned in public spaces because passive smoking can be dangerous. Bar staff or customers exposed to smoke from other people's cigarettes are running a health risk.

That is true, but customers are well aware of the risks of passive smoking, as well as the stench, and can always take their money to a less smoky environment. Staff are also free to work where they please, at least since Britain outlawed slavery back in 1833. If customers really are clamouring for smoke-free places to relax and chat with friends, we should see an ample supply of them provided by some entrepreneurial company. We do, and the company is called Starbucks.

Many pubs cater profitably to smokers because there are plenty of smokers keen to pay, many non-smokers not concerned enough to look elsewhere, and bar staff who are happy to be paid to take the risks of the job. The government has no more business interfering with the pleasures of these consenting adults than it has imposing a dress code in nightclubs – not even if such a dress code might improve the typical club-goer's experience. Nightclub owners can be the judge of that, and their customers will let them know quickly whether they have made the right call.

An alternative argument is that smokers are a drain on publicly funded or subsidised health systems, and this justifies measures to discourage smoking. Unfortunately, the sums do not add up. Life is, it turns out, 100 per cent fatal and Alzheimer's disease is a lot more expensive than a quick coronary arrest. Anyone misguided enough to believe that individual welfare should be subordinated to the bottom line of the National Health Service should be arguing for a cigarette subsidy.

The final justification for the smoking ban is that it will help smokers to quit. Well, that is also true, but not all smokers wish to quit. Pile on enough humiliation and inconvenience and we can persuade most smokers to give up in disgust, but not all of them will thank us. The next stage in the process will be to make every smoker wear a collar and a cow bell, so that non-smokers can avoid them in the street.

No one can deny that smoking is a dangerous habit and that many smokers are tormented by their addiction and dearly wish to stop. The nannying impulse of the government is therefore understandable. But there is a better way for the government to help those smokers who want to quit, without oppressing those who do not.

It is time for a bit of policy entrepreneurship. Why not try something that has not been attempted elsewhere instead of aping the Californians or the Irish?

Here are the pieces of the puzzle: a government desperate to flex its muscles to restrain wayward nicotine-addled citizens, millions of smokers desperate for someone to be firm with them and a huge public-sector borrowing requirement.

My proposal is simplicity itself. Any smoker who wants to quit can call a government hotline or log on to a website and buy "Quitter's Bonds". They will be available in denominations to suit any budget.

Quitter's Bonds will be financial assets like Treasury bills or premium bonds, but they will have an unusual feature. They will pay no interest and will not be redeemable except by the original purchaser. In order to cash in her Quitter's Bonds she will have to pass a year of random blood tests to demonstrate that she has stubbed out the habit. Until then, the money is an interest-free loan to a hard-hearted government with unlimited reserves of moral superiority.

Quitter's Bonds have an honourable pedigree, in the Christmas Clubs popular with American families in the 1970s. Customers would give their money, interest free, to banks. In exchange, banks would refuse to allow them to take it out until the beginning of December. Coercive, yes – but the coercion is voluntary. Anyone who preferred to save for Christmas in his own way could open a conventional bank account.

In spite of the sometime popularity of Christmas Clubs, I am not convinced that Quitter's Bonds will have many takers, but that is perhaps the point: it is up to each smoker to decide if he would like the government to help force him to quit.

There is an added bonus. Since smokers tend to die young, there is a good chance that many Quitter's Bonds will never be redeemed for cash. In troubled times, what could be better for the public finances?

Frank Miele

Precedent and wisdom in the Supreme Court | *The Daily Inter Lake* | 5 March 2006

Will Karl Marx have the last laugh? | *The Daily Inter Lake* | 9 April 2006

Health care over easy, with fries on the side | *The Daily Inter Lake* | 16 April 2006

FRANK MIELE has been the managing editor of the *Daily Inter Lake* in Kalispell, Montana, since 2000. He previously worked at the *Inter Lake* since 1984 as editor of the *Flathead Business Journal*, entertainment editor, and wire editor. Mr Miele majored in anthropology at Tulane University in New Orleans, and did graduate studies in creative writing at the University of Montana and University of Arizona. He co-authored two non-fiction books, has published poetry and criticism in various small magazines, and was a co-founder of the Sonora Review literary magazine. In 2005, the Montana Newspaper Association named his column 'Best in Montana'.

PRECEDENT AND WISDOM IN THE SUPREME COURT

5 March 2006

I always like to be able to see both sides of any issue, but it is hard to see anything good in the Supreme Court's famous *Kelo vs. New London* ruling of last year that gave cities permission to take people's private property because other people wanted it for themselves.

Try as you might to find some logic in it, you keep coming back to the plain language of the Fifth Amendment of the Constitution, and nowadays that language has the haggard look of a man with his hands thrown up in abject surrender. It seems the Supreme Court has tortured the language to the point where it had to submit and do whatever the court wanted.

Here is the famous "takings clause" of the Constitution:

"...nor shall private property be taken for public use, without just compensation."

It is so devilishly simple, yet it consists of words, and words have meanings, and meanings have interpretations, and interpretations have nuances, and nuances have penumbras, and by the time the Supreme Court gets ahold of them, the penumbras have emanations.

Thus, the phrase "public use" is not so simple after all. Indeed, based on the Supreme Court's logic, the next time you see a sign on a bathroom door that says "not for public use," you should just point out to the owner of the establishment that you don't intend a public use for the bathroom, but a private one, and walk right in to do your business.

Now, I can hear my distinguished attorney friends clearing their throats as they prepare to explain to me how I don't understand the intricacies of the law or the fine points of constitutional interpretation.

Turns out that "public use" is many things to many people, and according to the principle of *stare decisis*, we have to pay homage to the many rulings on public use that have already found their way into the annals of common and uncommon law.

And so we discovered last June that "public use" now means "public purpose" or – more to the point – "private development."

Thanks to a 5–4 majority decision by the Supreme Court, the city of New London, Conn., has permission to force people out of their homes because private developers want to make heaps of money by building a waterfront hotel or a pharmaceutical research facility or fancy condominiums or high-tone stores or all of the above.

We also discovered that this is to be done not in the name of removing "blight" – as sometimes occurs – but simply because the city was "economically distressed" and was looking for a way to make itself seem more inviting to investment.

This presupposes that the city, as a corporate entity, has rights of its own that surpass the constitutional rights of individuals, and that one of those rights is the right to perpetuate itself into the future by pretty much whatever means are necessary. This gives cities a neat advantage over other corporate entities such as businesses – they don't have to worry about market conditions or remaining competitive through wise policies. Heck no. Instead, when they get on a respirator and start to flat-line, they can just bull-doze everything under and call in some rich developer to build fancy condos and office complexes.

Curiously, Justice John Paul Stevens, who wrote the majority decision in *Kelo*, later announced that he considered the decision "unwise" but necessary. This is akin to a breakfast chef announcing that, because of inventory problems, he found it unwise but necessary to make this morning's scrambled eggs without eggs.

Of course, sometimes – often even – judges are called upon to approve of the carrying out of laws with which they don't personally agree. Thus, a judge who opposes the death penalty might nonetheless approve the execution of someone because the law called for that penalty and because the law had been faithfully and accurately applied.

But in this case, no intervening law can subvert the intent of the Constitution. This was not a matter of interpreting legislative intent or trying to divine whether a particular law had been written correctly to meet constitutional muster. No, there were just two things to consider – the intent of the city of New London and the plain language of the Fifth Amendment.

Judged thus, it would have been an easy thing for Justice Stevens to have made a "wise" decision and say that New London had no "public use" for the property being seized and thus could not take it.

But instead, Stevens and the other four justices who joined him, inserted another principle into the mix – the principle of *stare decisis*, or respect for judicial precedent – and thus concluded that "public use" is really "public purpose" because the Supreme Court had said so for at least 100 years.

That sounds straightforward enough, but it isn't.

First of all, not all the members of the court agree about what those rulings of the last 100 years say. This is important, because it should diminish the luster of infallibility which sometimes attaches to Supreme Court rulings. We should remember that relatively few rulings are unanimous, and that men and women with brilliant minds often disagree about what is right and wrong even on the Supreme Court.

In this case, four members of the court entirely disagreed with the majority that there is no difference between public use and public purpose. Justice Sandra Day O'Connor in her dissent worried that the majority's decision would "effectively ... delete the words 'for public use' from the Takings Clause," and she held that no prior precedent from the court had set the stage for granting the right of a government to take property from one private owner for the benefit of another private owner.

As a result of the *Kelo* decision, she notes, "The spectre of condemnation hangs over all property. Nothing is to prevent the State from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory."

And Justice Stephens' reliance on precedents does not persuade her. She reads the precedents differently, for one thing, but more importantly she returns to the original document – the Constitution – for her underlying argument.

"When interpreting the Constitution," she writes, "we begin with the unremarkable presumption that every word in the document has independent meaning, 'that no word was unnecessarily used, or needlessly added.'"

In other words, she returns to the plain language of the Fifth Amendment and comes up with an entirely different conclusion than the judges who paid deference to earlier rulings and looked for guidance not from our founders but from their fellow judges.

This should raise some concerns about the importance of precedent in constitutional law, in particular. We do not want to risk our constitutional protections being sawed off bit by bit by intervening judicial interpretations. Each ensuing judge should have the temerity to return to the original document – the Constitution of the United States – and wave it in the face of precedent.

Precedent, in other words, is a judicial construct which owes obeisance to the Constitution, not the other way around.

It is perhaps instructive, therefore, that the thin majority of justices who supported the broadening of government powers to take property based on a reading of precedent rather than a reading of the Constitution are known as the liberals on the court. Considering the importance placed on *stare decisis* in the recent confirmation hearings of Chief Justice Roberts and Justice Alito, it is perhaps even more instructive that the liberal wing of the court should have banded together in support of precedent in the *Kelo* case, even though it led to a decision which Justice Stephens acknowledged was "unwise."

The reason it is so interesting is because these days, we usually hear about the importance of precedent or *stare decisis* in regard to one particular case – *Roe vs. Wade*, the case which established as a constitutional principle that a woman has the right to have an abortion.

The argument used by pro-choice advocates is that *Roe vs. Wade* is "settled law" and that the principle of *stare decisis* should be applied to *Roe* so that future justices must all accept that abortion is constitutional no matter how "unwise" they think the ruling is based on their own reading of the Constitution.

It might make sense except for one thing – *Kelo vs. New London*.

That case shows just how silly – and dangerous – precedent can be when it serves to sever the law of the land from the Constitution itself.

Kelo is now the law of the land, and we are stuck with it.

But that doesn't mean we should not be able to do away with it; after all, everyone knows it is "unwise" – even the person who wrote it. It will take time; it will take patience. Yet sooner or later, one can hope that a new majority will step forward and say that Justice Stephens was just plain wrong.

In the meantime, there doesn't seem to be any reason why Justices Scalia and Thomas (the only two remaining members of the court who participated in the minority opinion) should not continue to vote in favor of the Fifth Amendment if similar issues return to them in the future.

Indeed, it would be logical and appropriate for them to hope that, despite the existing precedent of *Kelo*, they could persuade other members of the court to agree with their opinion so that an "unwise" ruling could eventually be replaced by a wise one.

No Supreme Court justice should be held hostage to a legal precedent he or she does not agree with – most especially if it appears that the precedent was accomplished by ignoring the Constitution itself.

Instead, judges must have the latitude to rule according to their best understanding of the law and the Constitution in all cases – even controversial ones such as *Roe* or *Kelo*. That guarantees that the court will sometimes be wrong, but more importantly that it will always have the chance to correct itself later.

WILL KARL MARX HAVE THE LAST LAUGH?

9 April 2006

Karl Marx lost the battle, but he may be winning the war.

We all thought back in the late 1980s when communist governments were collapsing under the weight of their own excesses in Eastern Europe, that the discredited ideas of communism's founder would disappear, too.

But old Karl Marx may have the last laugh.

From each according to their ability; to each according to their need.

That is the simplest statement of Marxist philosophy that exists, and if it doesn't set off alarm bells when you hear it, then you haven't been paying attention to the political debate in our country recently. More and more, it looks like our country and our people are supposed to feel guilty for being successful, and we are supposed to make up for it by throwing money at people who haven't earned it. In the old days, they called that begging; now they call it "entitlement."

The United States has jobs, and Mexicans need them, so therefore Mexicans are entitled to those jobs.

Hospitals have health services, and poor people need them, so therefore poor people are entitled to those health services.

Bill Gates has billions of dollars, and the government needs billions, so therefore he should fork over as much as the government wants – no questions asked.

(Oh yes, and because he has so much money, the government is going to want more of his than yours. Heck, they're entitled to it, right? From each according to their ability; to each according to their need.)

While we're on the topic, the government has billions of dollars it already got from Bill Gates and other taxpayers, and people with less initiative, intelligence and good fortune than Bill Gates need it, so therefore they are entitled to it in the form of tax credits. It doesn't matter if they paid taxes or not. They "need" the money – so they get it. You can call it an earned-income tax credit or you can call it communism. Either way, it's the same story:

From each according to their ability; to each according to their need.

If you are a hard worker, it ought to make you mad. There you are, putting in extra time and effort to accomplish the best for yourself and your family, but the next guy over is less driven ("I like to enjoy the good things of life!") so he ends up taking it easy. You provide health insurance for your family; he provides nothing. When your family gets sick, you bring them to the hospital, pay the deductible, follow the rules, borrow if necessary, set up a payment plan, but you do the right thing. When his family gets sick, he brings them to the hospital, demands the best care, then complains when he gets the bill. "Why is my family not entitled to the best health care?" he whines. "Are we not people?" So instead of trying to pay the bill, he lets the rest of us pay in the form of higher bills, higher insurance payments and higher taxes.

From each according to their ability; to each according to their need.

Now, before anyone accuses me of locking the hospital doors and letting people die on the street, let me explain myself. I do believe in charity. I do not believe in entitlements. Charity helps to bring us closer together; entitlements drive us further apart.

It is a good thing for the government or a church or an individual to help someone in need, but it is a bad thing to let people expect that every time they get in trouble, there is going to be someone there to bail them out. That is not called charity; it is called enabling.

When you enable an alcoholic to continue drinking by helping him to avoid the consequences of his disease, you are not doing him any favors – you are just speeding him on the way to his death – and you will encourage resentment at the same time.

Likewise, when you enable the chronically unsuccessful to avoid the consequences of their lack of education, resourcefulness or toil, you are just speeding them on the way to a life of dependency and despair, and if you don't think people on welfare resent the hand that feeds them, visit the inner city in a major urban area for a day. You will not discover an attitude of gratitude.

Maybe Karl Marx should have said it this way: "From everyone else because they've got it; to me, because I damn well want it."

HEALTH CARE OVER EASY, WITH FRIES ON THE SIDE

16 April 2006

People sure are funny.

Take the response to last week's column on how Karl Marx's philosophy is slowly but surely taking over the United States. A number of readers wrote to let me know they appreciated my willingness to challenge the "entitlement mentality" that has pervaded our country, but a few others wrote to call me names.

I enjoy nothing more than a well-reasoned argument, but being called an "egotistical, arrogant jerk" has its charms, too.

Almost everyone who wrote to complain about my column focused on the paragraph that talked about health care. I compared the example of two hypothetical families, one which tries to pay its own way and one which feels that "health care" is a right and thus should be available to everyone, with or without the ability to pay.

Put aside the notable lack of reference to "health care" in the Constitution of the United States. Forget about the fact that the Declaration of Independence does not mention the right of the people to commandeer medical services whenever necessary. The Declaration does say that people have an unalienable right to life, and apparently some people think that includes the extended service warranty with full checkups until death and unlimited repairs at no cost.

Except, of course, there is a cost.

When someone gets free medical service, it means someone else paid for it – the doctor, the hospital, the insuror, the taxpayer. Someone, somewhere is shelling out the dollars. You can take that to the bank.

In the old days, before the New Deal, most of the largesse that helped the less fortunate pay their medical bills came in the form of what is now quaintly called "charity." It was the idea of individuals helping each other, or in a grander sense, the idea of institutions such as the Catholic Church helping those in need. Thus, it was common in many communities to have a Charity Hospital, where the poor and indigent could count on service thanks to the kindness of their fellow man.

Somewhere along the way charity got twisted into "welfare" – the difference being extreme. Charity is an act of giving. Welfare is an act of taking – namely the forced taking of money from one set of citizens for the betterment of another.

This is not to condemn people on welfare. They have no choice in the matter. This is the only option society has given them, and that should be the point which you take away from a study of entitlements. Once you create them, it is inevitable that people will take advantage of them. Poor people are no different than rich people when it comes to opportunism. If you create a loophole in the tax code, then rich people are going to take advantage of it. Why shouldn't they?

By the same token, poor people are going to take advantage of anything given to them for free. Why shouldn't they?

So we should not be surprised by the fact that as soon as private charity became institutionalized as public welfare, it also inevitably mutated into an entitlement. Instead of receiving help with gratitude, people with an "entitlement mentality" receive it with certainty that they deserved it all along. And to be honest, once an entitlement is granted in a democracy, it is virtually indestructible. That's because entitlements eventually translate into voting blocs – also known as special interests – and politicians for obvious reasons are beholden to the voters who vote for the politicians who granted the voters the entitlement in the first place. It's called a vicious cycle.

Of course, the issue of public health care is a complicated one, which cannot be reduced simply to a discussion of entitlements. One underlying cause of almost any problem in our society today is the lack of an extended family such as existed for millennia before technology allowed us all to become mobile. When you lived in a small town with your mother and father and five to 10 brothers and sisters and your rich Uncle Allan and your great-grandmother Rose and you all knew each other and got together for holidays, then if you got sick, it wasn't going to be the problem of Uncle Sam; it was going to be the problem of Uncle Allan and whoever else in the family had some money to help.

Today, it is much more likely that you live in a town where you have no relatives other than the immediate nuclear family. That means there is no private support structure – which is why more and more people turn to the government for more and more help.

Then, of course, you have to factor in the wonderful achievements of modern medicine. The average life expectancy increased by 50 percent during the 20th century. Over the course of about 160 years, life expectancy has increased by as much as 40 years. That is quite remarkable, and it means that health care costs for society as a whole have increased exponentially. You also have to kick in the value of all those high-tech gadgets and gizmos that diagnose us and cure us. Or if you want cheaper health care, you can just go to a hospital that doesn't use MRIs, miracle drugs, computer-assisted surgery – you know, the kind of hospital they had 100 years ago.

But that isn't going to happen, is it? Because everyone wants the very best medical care they can get – for obvious reasons. And because we are a caring people, American society tries to give it to them, but let's be realistic about what that means – not just to the individual but also to the society.

It is nice that we live in a society where individual well-being is highly valued, but before we declare "quality" health care a human right, let's remember that every time we "declare" a new right, it costs society money. The way that rights have been piling up lately, we may well be on our way to a bankrupt society. Perhaps that will come when we declare that everyone has a right to free food. After all, you need it to live, so why should you have to pay for it. Just back your truck up to the grocery store and take what you want.

Then we will have to change the old slogan to "There ain't no such thing as a free lunch, but I'll take mine with mustard on it."

Ila Patnaik

This racket about duties | *Indian Express* **|** 17 September 2005

Who killed Manjunath? | *Indian Express* **|** 28 November 2005

The licence permit raj | *Indian Express* **|** 21 May 2006

ILA PATNAIK is the economics editor of *Indian Express*, an Indian daily newspaper. Her columns primarily deal with policy-related issues, with a focus on removing the restrictions that still shackle one of the fastest growing economies in the world. She is an active participant in economic policy debates in India. Patnaik has a PhD in economics from the University of Surrey. She has published research papers on capital flows and monetary and currency policies in India. She previously worked at an economics think tank in New Delhi and was a regular columnist for the *Business Standard*, a financial daily published from New Delhi.

THIS RACKET ABOUT DUTIES

17 September 2005

Chandan Basu is not the only one who may want to avoid paying high customs duties on cars. Anybody who wants to own a car would like to do so. After all, the first principle of economics is that people respond to incentives. In this case, the structure of customs duties in India provides an incentive and a framework to avoid duties. Of course, the higher the duty, the greater the incentive. That is why the car racket operates for makes like Lexus, Mercedes, Jaguar and BMW which cost between Rs 80 lakh [eight million, approximately US $175,000] and Rs 1.5 crore [15 million, approximately US $328,000].

In the spirit of reforms, the "peak rate" of customs duty, which applies for almost all manufactured goods, has dropped from 150 per cent in 1991 to 15 per cent in 2005. But the term "peak rate" is incorrect. There are so many products with an above-"peak" rate, that it might better be called a "median rate" for manufactured goods. In the case of imported cars, the rate is at the shocking level of 105 per cent. The prevalence of such high rates makes India look foolish when we claim that our "peak" rate is 15 per cent. When a customs duty is 105 per cent, there is an incentive to bypass it. If criminals become involved in the trade, no one knows where they will stop.

The first reaction of the government will be to clamp down on customs duty evasion using policemen. But gold smuggling did not go down by the police chasing smugglers. It went away when [Prime Minister] Manmohan Singh and [Finance Minister] Chidambaram reduced customs duties. Lower tax rates change the cost-benefit calculations of evading taxes. If the customs rate on imported cars had been 15 per cent there would have been much greater compliance. However, in the name of protecting domestic industry, which ironically consists primarily of foreign manufacturers such as General Motors, Ford and Honda who are among the biggest in the world, India keeps customs duties rates on cars nearly 7 times the "peak rate". Moreover, India today is an exporter of cars. There is no reason to think the industry needs protection.

Even if the customs duties on all imported cars had been 105 per cent, it would have been one matter. Here, the issue is further complicated by the fact that when two identical cars are imported into India, they encounter very different tariffs. This is because there are a large number of exemptions. These exemptions are based on who is importing, or why he is importing. Under the Export Promotion Capital Goods (EPCG) Scheme, import of motor cars, sports utility vehicles and all-purpose vehicles by hotels, travel agents, tour operators or transport tour operators whose total foreign exchange earnings in the current and preceding three years is Rs 1.5 crore [15 million, approximately US $328,000], are exempted from paying the normal 105 per cent customs duty, and have to pay only 5 per cent.

Rules allow items to be imported for defence, police, training, education, oil exploration, exhibitions, expeditions, for export purposes such as packaging materials, durable containers, by charitable institutions, for handicapped persons or for sports related activities – exemptions from customs duty after due paper work. The list of items where such exemptions exist runs to nearly 2,000. The importer gives the appraising officer the relevant literature and a certificate from one of the 33 approved certifying agencies such as the Director General of Foreign Trade; the Director of Vanaspati [hydrogenated vegetable fat], Vegetable Oil and Fat; the Council for Leather Exports or the Sports Authority of India.

The importer has to get a Bill of Entry from the appraising officer. These steps involve multiple contact points with the government, and huge costs of compliance, since appraising officers have to get engaged in questions of valuation and end-use. This means that even when the importer does not have a genuine business, as is alleged in the case of Sanjay Bhandari, the man Chandan Basu is reported to have bought (or leased) his car from, it is possible for him to bribe his way to the required exemptions.

What is really required is not the police going after those who find loop-holes in the structure of customs duties, but to change this structure. As long as the law is unchanged, the practice will continue, as did gold smuggling until the duties were changed. The minimal agenda in reforms is the elimination of exemptions, which should ensure that no two consignments of a given product encounter different taxation rules or procedures. This would also serve to remove the involvement of agencies such that those which certify end-use. It will remove the involvement of customs officers who can today choose who qualifies for the exemption and who does not.

The second issue in reforms is identifying all goods with a rate above the peak rate and bringing them down to the peak rate. This will reduce the incentive for evading or avoiding duties, especially since we are progressively moving towards reducing tariffs every year. India should be able to truthfully say that the peak rate is 15 per cent.

The third issue is the removal of rate dispersion. The structure of tariffs is presently biased against consumer goods. The duties on raw materials, intermediate inputs and capital goods are generally lower than that on final products. It is on this basis that cars imported under the EPCG scheme face a lower tariff rate when classified as capital goods, and a higher rate when classified as consumer goods. Since modest differences in apparent tariffs can imply very big differences in the effective rates of protection for manufacturers, this results in immense lobbying by firms, in this case the car manufacturers. A uniform rate is the best way to avoid this lobbying.

Deficiencies of domestic taxation, however, pose an impediment against the move to a uniform rate. As a compromise between the first best solution of one rate and what exists at present, the Kelkar Task Force Report suggested that duty rates should be 5, 8 and 10 per cent for "raw materials", "intermediates" and "finished goods" respectively. Once a proper GST [Goods & Services Tax] is in place, the next phase of tariff reform can commence, of moving to a uniform rate, and of going down to a uniform rate such as 2 per cent.

So even though the Directorate of Revenue Intelligence may presently be on the job, the one who really needs to act to avoid such cases is Chidambaram himself. He did it for gold, now he should do it for cars.

WHO KILLED MANJUNATH?

28 November 2005

The responsibility for the murder of IOC [Indian Oil Corporation] officer S. Manjunath lies with economic policy. The murder is a wake-up call for the government to change policies in the petroleum sector. The government's decision to continue with the policy of subsidising kerosene, despite knowing fully well that kerosene is being used for widespread adulteration of diesel, is irresponsible and callous.

It is well understood that the structure of economic incentives is a far stronger force than policing. It is easy to blame the law and order situation for the murder. But the real blame lies with the petroleum price policy that created incentives for adulteration. When diesel costs Rs 35 [approximately US $0.75] per litre and kerosene is available in PDS [Public Distribution System] shops for Rs 11 [approximately US $0.24] per litre, there is a very powerful incentive for petrol pump owners to adulterate diesel with kerosene. If a mafia has arisen, it is a creation of government policy. In the same way that the smuggler gangs of the 70s were the inevitable consequence of restrictions on imports, the mafia that murdered S. Manjunath is the by-product of the pricing distortions in the petroleum sector.

The policy of providing subsidy to kerosene is supposed to be about helping poor people. But for a long time, there has been ample evidence that a tiny percentage of the subsidy on kerosene reaches the poor.

When the Administered Price Mechanism (APM) for petroleum product prices was dismantled in April 2002, it was hoped that these prices would move freely as they do all over the world. They would stop being determined by political considerations. More importantly, it was hoped that free imports and distribution would lead to competition, so that helpless consumers would not be in the clutches of the ministry of petroleum. Instead of moving forward with the agenda of competition and decontrol, we have stayed with the monopoly of the government and continued political interference.

The problem is not limited to kerosene. The bad economic policy of the oil sector has hit LPG [liquefied petroleum gas] as well. LPG prices are subsidised, again in the name of the poor, though poor people definitely do not use LPG. The subsidised LPG gets diverted to commercial use. People respond to incentives, so the larger is the subsidy, the larger is LPG demand.

The government does not have the grace to place the subsidy cost on budget. Oil companies are being forced to absorb losses arising from the low price of LPG that's set by the government. So they have an incentive to cut production of the subsidised product. If need be, oil companies will make all kinds of excuses about factories that have stopped working, in order to avoid selling goods at a loss.

So, we have a shortage of LPG cylinders. For the last two months, gas companies are not giving new connections. A visit to a HPCL [Hindustani Petroleum Corp. Ltd.] outlet is like deja vu, all over again, where an Indian consumer is a supplicant at a store and is told that the monopoly will refuse to sell to him.

True to the 1970s India, Mani Shankar Aiyar [Minister of Petroleum and Natural Gas] is very engaged with the LPG shortage. He promised that the LPG shortage would be sorted out in time for [the Hindu festival] Diwali. He is trying to send the police after black marketeers. He should learn a lesson or two from [Prime Minister] Manmohan Singh and [Finance Minister] P. Chidambaram, who conquered gold smugglers by removing controls, not by sending in the police.

Meddling in the market by trying to control the quantities demanded and supplied, instead of relying on the price mechanism to clear the market, has been tried in the 70s and failed abysmally. The economic illiteracy of policy that set out with the dubious goal of giving LPG and kerosene consumers a subsidy has instead given shortages, criminal activities, and the murder of one ethical citizen. The dismantling of the APM failed in the NDA's [National Democratic Alliance] term, when on the eve of the Allahabad elections, the then petroleum minister Ram Naik resumed interfering in petrol prices.

The core rot of the petroleum sector is that of violating the principle of competition. If the private sector could freely import petroleum products and sell directly to consumers – if this economic freedom was unquestioned – then the shenanigans of the ministry of oil would be greatly curtailed. But the oil ministry continues with its monopolistic control over import and distribution of oil. That sets the stage for unethical or ignorant ministers for misusing the system. Whether it's Ram Naik's attempt at manipulating elections, or the petrol pump allocation scam unearthed by *The Indian Express*, or Manjunath's murder – these are all the consequence of the control-raj.

What is the solution?

Oil policy in India requires to shift away from the interests of socialists, the interests of oil PSUs [Public Sector Undertaking, government-owned company] and the interests of oil companies like Reliance. Instead, we need to apply the first principles of a market economy. Better health of oil companies requires the sector must be exposed to competition. At present, a host of barriers make it difficult for the private sector to import and sell petroleum products in the country.

In the 1990s, India found its way out of a mess in the industrial sector – where there were thousands of incompetent companies – by cutting customs duties and opening up to imports. The same story applies in the petroleum sector. We should focus on opening up the Indian market for petroleum products to global competition. Anyone should be allowed to open petrol pumps, buy petrol from anywhere in the world and sell to customers. Each of these steps should be jealously protected from the meddling of the ministry of oil and its cronies in the oil sector. This will help destroy the monopoly of oil companies and force them to work in a competitive framework.

One concern is this will lead to a rise in oil prices when world oil prices go up as the government will no longer be able to "protect" consumers. But should scarce public resources be wasted in shielding the rich Indian consumer from the ups and downs of world prices? While all agree that low inflation is a desirable objective, is it desirable to achieve low inflation by artificially keeping the price of oil products low? If world oil prices rise, the economy needs to adjust itself to higher prices. A policy of having subsidies requires taking public resources away from producing public goods. It also reduces the adaptations of the private sector such as increased energy efficiency, and shifting to non-oil sources including renewables.

The short-run price elasticity of oil, the amount by which consumption of oil changes in the short run when its price changes, has usually been observed to be low. Given technology in use, consumers can reduce the consumption of oil by making some behavioural changes. However, the long run price elasticity of oil is high. Over the long run, a higher price of oil creates incentives for adoption and development of technology which is not intensive in its use of oil. Either the use of alternative sources of energy becomes more profitable, or companies invest in fuel efficient technologies. This has been seen in the automobile industry in which significant R&D went into the development of small fuel-efficient cars and when consumers all over the world were seen preferring more efficient cars.

Policy in the oil sector has been mismanaged over the years. Manjunath may have been the first to be murdered, but if the government does not sort out the mess it has created, it will be signing the death warrants of many more young and honest officers in the public sector.

THE LICENSE-PERMIT RAJ

21 May 2006

Education, unlike most other sectors, has not been touched by liberalisation. The removal of the license-permit raj released industry from the shackles that had prevented its growth. Telecom blossomed after entry into the sector was liberalised. The aviation sector gave consumers access and low prices. But education has been left mostly untouched.

Consider this. To open a school an association or group of individuals first has to register as a society with a non-profit motive. Next, the society needs to apply for a license called the "Essentiality Certificate" (EC). The EC is like the industrial license of the old days and is issued if the government decides that there is a need for another school in the area.

The number of ECs the Department of Education of a state decides to issue each year for each zone and each kind of school – primary, upper primary and secondary – are decided by the department in an arbitrary manner, without any objective criterion. It is supposed to depend on its estimate of demand and supply made by the department.

This restriction on supply often creates a situation where there are more children in the school-going ages than the number of seats available in schools. Students then have to queue up for school admissions, little children have to take entrance interviews and parents have to pay capitation fee. The well connected always have recourse to political and social networks.

This is reminiscent of telephone connections in the days before telecom liberalisation. The story does not end there. After obtaining an EC, the school gets land, then applies for recognition, then affiliation with a board, and if it wants to become an aided school, for aid to the government who then pays teachers' salaries. After this the school management pays bribes to school inspectors every year. It often takes more than Rs 1 crore [ten million, approximately US $219,000] and between 3 to 17 years to achieve all these.

It is hardly surprising that managements of existing schools today do not want the license raj to be removed. They have already paid the costs. After all, when did the incumbents in any closed club want entry to be freed up for all? Through restrictions on entry, private schools have acquired monopoly status.

The policymakers – politicians and bureaucrats – whose children get to study in private schools, thanks to their connections and money, are not too keen to take away the exclusivity of such education.

The situation with higher education is no different. Both Indians and foreigners are prevented from opening universities and offering education regardless of how large the demand might be. The rich can always put money in and send their children to universities abroad. If the government allowed universities like Harvard, MIT and Stanford, which are reported to be interested in opening campuses in India, with lakhs [hundreds of thousands] of seats at a cost much lower than what it takes to send a child abroad, higher education would be accessible for lakhs of middle class children who cannot afford to go abroad today.

It is again not surprising that our policymakers, who can afford to send their children abroad and get them degrees from universities like Harvard and MIT, are not keen to have such campuses in the country.

Until the netas [politicians] and the babus [senior civil servants] have the will to crush entrenched interests in the sector, take away the clear advantages their children have, and liberalise this sector, good education in India will remain the exclusive domain of the rich and privileged.

Gabriel Rozenberg

Why I am a greenbelt heretic | *The Times* **|** 8 August 2005

Water torture: why is there a hosepipe ban when it is pouring with rain? | *The Times* **|** 31 March 2006

Music to the ears of a tax-happy Chancellor | *The Times* **|** 20 May 2006

GABRIEL ROZENBERG became economics reporter for *The Times* in 2004 and is a contributor to the paper's Comment pages. He previously worked for *The Times* as a political reporter in its Westminster office, as a domestic news reporter and on the foreign news desk. He has also worked for *The Economist* and BBC News. He graduated from Lincoln College, Oxford in 2001 with a BA in Philosophy, Politics and Economics. A fan of globalisation, Mr Rozenberg was born in West London and now lives in North London.

WHY I AM A GREENBELT HERETIC

8 August 2005

There's nothing wrong with Tescotown. Sclerotic planning laws are blighting the countryside

Apparently, 84 per cent of people want to save the green belt and keep if safe from urban sprawl. Can it be true? Can 16 per cent of the country really believe that it's right to pave over our pleasant land? I thought it was just me who reckoned the green belt was a colossally misguided scheme to inflate house prices, cripple the economy and do absolutely nil for the environment.

Try telling people that you think the green belt should be scrapped – worse still, that you think the entire system of Government planning should be done away with – and you won't win many friends. To argue against the belt, which surrounds London, Birmingham and other big cities and which celebrates its 50th anniversary this month, is to most people like calling for clean drinking water to be abolished, or campaigning to bring back witch-ducking.

Never mind that nobody seems to know what it looks like, or whether any of it is very nice. I've lived in London all my life and I've never heard anyone saying that they're off to spend a weekend in the green belt, what with it being so close by and everything. Maybe the BBC's new hit series 'Coast' only narrowly beat a rival show called 'Disused Gravel Pits in Tilbury', but I doubt it.

The point is, for every Chiltern hill or slope of the North Downs that the scheme protects, massive chunks of land that are downright foul are kept at bay from the potentially cheering extension of the suburbs.

Green belts do not create parkland within easy reach. Their real point is to prevent sprawl – although why London or Newcastle should be equally stopped from sprawling is hard to explain: they can't both be the ideal size, surely. Green belts increase pollution by encouraging development farther from the city, so adding to the number of miles commuters have to drive. Mark Pennington, an economics lecturer at Queen Mary College, points out that the new towns will often end up being built on much more environmentally valuable land than the belt itself. All that green belts do is to halt city growth, regardless of the economic benefits of new construction.

Ah. That word – economic – gets you in trouble. The complaint comes that letting the market run loose would cause havoc, because "land is a finite resource": once we've paved over Britain, we can never get it back. But economics is all about managing scarce resources – oil, labour or anything else. And economists will tell you that to manage resources effectively, you need information about their relative values. There is a word for such information: prices. Some of the green belt is lovely, some of it is awful – but greenbelt policy sucks because by shutting down the system of prices it fails to distinguish one from the other. If green belt land were traded freely, and could be developed without constraint, the magic of the price mechanism would get to work. Beautiful land would come at a higher price than ugly land, and developers would be guided to build in cheaper areas.

But alarm has been the sole response to Government plans, unveiled last month, to make planning more responsive to housing demand. Frankly, it would be hard to dream up a system less responsive to housing demand than the current planning laws.

Anyone who has tried to get a building project approved will know how slow, expensive and often corrupt the set-up is.

Planning is the legacy of the postwar Town and Country Planning Act, which tried to do to home building what the Attlee Government was also trying with coal, steel and other industries: control them from above. But, unlike those dinosaurs, planning has never been reformed, and it remains more like a vast, sclerotic, nationalised industry than anything else. Even John Prescott has been unable to break the logjam. Despite his threatening year after year to swamp the Thames Gateway and Bedfordshire with Barratt homes, the big build remains stubbornly unbuilt.

People think that if you got rid of government planning you would have anarchy. But that's not how things work in other parts of the economy. Prices allow a much more sophisticated level of co-ordination, in which demand for houses, offices and open spaces are all stirred into the mix. Do you live in an area with lots of attractive Victorian homes, where buildings that are out of character would damage the appeal? So club together with your neighbours, sign a restrictive covenant that bans everyone in the group from making changes, and watch the market response. Everyone in the group should see their house price rise, because each house becomes more valuable in an area guaranteed to stay attractive.

Having said all of that, I'm not against planning. Planning a town, working out how to mix homes, infrastructure and open spaces, is difficult, but not impossible. The problem is that there is only ever one planner – the Government. To scrap state planning would bring about a renaissance in a forgotten world from a century ago, when private corporations bought land speculatively and created garden cities and suburbs, many with restrictive covenants to keep them from decline. Competition between planners – something the current system lacks – drove up standards of design.

Thanks to the efforts of private planners, we now have picturesque suburbs and towns such as Highgate, Summertown and Letchworth. It could happen again. Tesco towns? They'd certainly beat a weekend for two in a gravel pit.

WATER TORTURE: WHY IS THERE A HOSEPIPE BAN WHEN IT IS POURING WITH RAIN?

31 March 2006

You've got to admire their timing. Tomorrow water companies are putting up their prices, taking the average household's bill to £294, the highest it has reached since 1989. Over the following two days, they're turning off the taps. Hosepipes will be banned – you'll be fined £1,000 if they catch you – for the rest of the summer across a third of England and Wales. At least we'll know that spring has arrived.

In general, there are two reactions to this sorry set-up: people either blame the weather, or they have a go at the likes of Thames Water for failing to staunch their leaky pipes. But I'm reluctant to use global warming as a catch-all excuse for preventable problems, and it's not enough just to attack the companies, lethargic though they are. The blame lies elsewhere. To err is human, but to screw things up this royally needs the Government.

But before getting to that, I want to have a go at you. Do you have a hippo at home? And if not, why not? I only ask because my hippo arrived in the post last week, and it's already proving useful. A hippo, outside of London Zoo, is a plastic bag installed in one's cistern which stops you flushing so much water away. My reason for acquiring one is self-interest, not altruism. We're getting a water meter put in, and every drop, from now on, will cost money.

Water meters make people save water. Don't take my word for it; the Environment Agency has been saying so for years. Look at the stats: on average, metered households used 10 per cent less water than unmetered households in 2004–05, according to [the watchdog] Ofwat. Other countries in northern Europe, who pay for their water by the litre, use less than we do. The companies that have slapped a ban on hosepipes – a ban that, incidentally, seems pretty much unenforceable – would be better off just reminding those with meters that if they wash their car with a bucket it'll cost them 6p, but if they use a hose it's a quid.

Use more, pay more; it's hardly an alien concept. And yet only a quarter of families have them – and the Government is oddly reluctant to boost their numbers. For everyone else, payment is fixed according to the rateable value of your home, a figure calculated in (I kid you not) 1973. Newly built homes, however, get a meter installed. You can also have a meter put in for free, should you request it. Any notion that this system is somehow fair is ridiculous. If the traditional resistance to install water meters was to stop poor people paying too much, why doesn't the same logic apply for poor people who happen to live in new houses? And why shouldn't water-wolfers who leave the tap running pay extra?

One patronising argument used against a water meter policy is that those on low incomes would make "inappropriate savings" – not washing their hands enough, flushing the toilet less, that sort of thing. Even if that were true, it would be an argument for banning meters altogether, which the Government has no intention of doing. Another response is that in northern England, at least, there are no droughts and rainwater is plentiful. But it still costs to clean the rain and get it into people's homes, and that should be paid for in a sensible way.

The real reason we don't have compulsory water meters is that, at heart, Labour still believes that you can't put a price tag on H_2O. "Nobody believes that the rain belongs to any particular private individual," said Helen Jackson, a Labour MP, in 1995, and on that basis the party pledged not to introduce water metering. Frank Dobson raged that metering was expensive, unjust and dangerous to health. *Private Eye* notes that Elliot Morley, now Minister for Water, then argued that water was "a public resource, not a commodity to be bought and sold by the pint". Labour politicians instinctively feel that because water is all around us, it somehow should be free. But no one owns the air either, and yet companies that invest in wind farms can charge a market price for the energy it generates without causing pangs of guilt.

The comparison with energy works in another way. Privatisation has been good for water consumers in England and Wales: for proof, consider Scotland, where a state-run water service charges higher rates than those south of the border, despite year-round drizzle. However, privatisation was incomplete. Log on to uSwitch.com and you can change your gas and electricity suppliers at a mouse-click. As for water suppliers, you have to stick with what you've got. Water companies may be privately owned, but they are also "vertically integrated monopolies": they control both the pipes and the water pumping through them.

As a result, there is no competition to provide a decent service, which is why the companies can, at the first hint of sunshine, heavy-handedly slap a ban on anyone trying to water their garden. Competitive providers of water, faced with an entirely predictable rain shortage, would have been planning for years: building reservoirs, desalination plants, whatever it took. Thames Water does a bit of this, but it doesn't really seem to care one way or the other. Last winter it drained a reservoir in Hertfordshire so it could build some homes on the site instead -the seventh such facility it has drained in the past five years. And then there are all those leaks.

Is a real water market feasible? Colin Robinson, of the University of Surrey, argues that the key lies in splitting companies that treat and store water from those that own the pipes, allowing a National Grid in water to be set up. Water companies, like the vested interests they are, will tell you that this is impossible because water is hard to transport over long distances. But we certainly could have some competition between providers in local areas. Indeed, the Government's Water Act in 2003 allowed businesses to switch providers: they just have to get through an awful lot of the stuff. Even those of us who regularly spend too long in the shower would probably struggle to use up the 50 million litres a year required.

If the Government had set a lower threshold, we could now be putting the pressure on the water companies, rather than them reducing the water pressure on us. Had it seen through its blinkered hydro-ideology on meters, we'd all be keeping tabs on the taps. Instead, a country whose proudest boast was her rule over the earth's waters is reduced to filling its hanging-baskets with cactuses. Drip, drip.

MUSIC TO THE EARS OF A TAX-HAPPY CHANCELLOR

20 May 2006

Give up now. Struggling to choose the ideal investment portfolio to manage your savings? Don't bother. Anxiously scanning the headlines as the FTSE sinks? Waste of time. Refurbishing your house to add value? Pointless. It probably won't make you happier, and if it does, the effect will soon wear off. You may as well pack it in while the going's good.

This was the message of a programme on BBC Two last Wednesday, 'The Happiness Formula'. A succession of academics and psychologists lined up to assure us that, despite massive improvements in health, education, prosperity and so on over the past 50 years, our national level of happiness has not risen at all. The Government should therefore end its obsession with raising economic growth and concentrate instead on increasing levels of happiness.

Even by the BBC's standards, this show had it in for the aspirational classes. Accumulating wealth was portrayed as a Neanderthal instinct: "Struggling with our shopping bags, we get the same thrill cavemen felt, returning from the hunt," the voiceover intoned as primitives ran wild.

Lord Layard, a professor at the London School of Economics, argued that because relative wealth made poorer people unhappy, rich people should be taxed more. "The heavy hand of the State should be brought to bear," he said. Professor Andrew Oswald, of Warwick University, called for Wednesdays to be abolished so that we could all have more free time – which would doubtless be ample compensation for a 20 per cent pay cut.

These arguments are either banal or sinister. Can money buy you happiness? Of course not – and no one suggests that it will. Family and friends are more valuable than anything we can purchase. Moreover, personal tragedies can befall anybody, rich or poor.

Yet despite all this, money is useful. It lets us provide better healthcare or education for our families and helps us to hold down homes near our friends and support our parents as they grow old. By saving wisely we take responsibility for ourselves. Money can also buy insurance against life's pitfalls. Virtuous spending like this should not be belittled.

Also banal is the idea that we should aim for gross national happiness, rather than gross national product (GNP). In his book, *Happiness: Lessons from a New Science*, Layard writes: "We need a revolution in government. Happiness should become the goal of policy."

Well, maybe I've missed something, but I thought that happiness was the aim; that would be what all those government departments are for.

If the Government really did use GNP as its only yardstick, it would end all taxes, benefits and public services overnight. Millions would suffer, but there is no doubt that it would boost the economy. Does it really need to be pointed out that our Government, which grabs more than 40 per cent of our income to use as it sees fit, bears no resemblance to this ultra-libertarian picture? Raising the growth rate is certainly an aim of the Government (one which it is currently failing to achieve), but it is only a part of the picture.

Layard, who is much in vogue in Whitehall, turns sinister when he lauds high taxes for "holding us back from an even more fevered way of life". In other words, if our taxes were cut, we might, heaven forbid, be so short-sighted as actually to work harder.

And why do we all have such a screwed-up set of priorities? Well, it's all the fault of the economists. Perhaps because he is one himself, Layard believes that economists have vast, mystical powers to direct society: economists "have great public influence and have thus inevitably helped to promote the public esteem in which money is held".

This is an injustice. People do not desire money because of some neo-Marxist false consciousness. Instead, they struggle constantly to provide the best standard of living they can for their families. Sometimes that encourages them to spend long hours at work; other times it leads them to give up work, or work part time. But no psychiatrist can make those decisions better than they can themselves. The Government should not try to outguess their choices.

So be wary of these arguments. Their only merit is to give Gordon Brown a fresh-sounding excuse to raise taxes. When academics and politicians lecture us on raising our level of happiness, we should all watch our wallets.

Rakesh Wadhwa

Do foreigners exploit us? | *The Himalayan Times* **|** 10 October 2005

Profits Generate Capital | *The Himalayan Times* **|** 21 November 2005

Steel & Mobile Mittals | *The Himalayan Times* **|** 26 December 2005

RAKESH WADHWA writes every Monday for the business page of *The Himalayan Times*, Nepal's leading English-language daily. He also writes for and advises *The Boss*, a business and management monthly in Nepal. He has been a passionate believer in capitalism and free markets since his school days. Mr Wadhwa is the author of 'Going Abroad' and 'India: the 3rd World, Why?' and co-wrote 'The Joy of Gambling'. He is executive director of Nepal Recreation Centre and manages Casino Everest and Casino Royale in Kathmandu, Nepal. He received an honourable mention in IPN's 2003 Bastiat Prize for Journalism.

DO FOREIGNERS EXPLOIT US?

10 October 2005

Whenever there is talk of opening Nepal's market, whether it be for trade or investment, there is always the fear – sometimes spoken, sometimes unspoken, but never rational – of exploitation by foreigners. In India, this fear, though equally irrational, was understandable since the British ruled it for 200 years, but in Nepal this fear is unfounded.

After the end of colonialism in most countries by 1950s, there has not been a single case of a former colonial power usurping power by either taking over an old colony, or finding itself a new one.

Exploitation is possible only if one country takes over another one and enslaves its people. Exploitation is not possible when people trade with each other, buy and sell property, or make investments with mutual consent.

Consider a foreigner coming to Nepal to buy goods, how is he going to do it if no one sells to him? We will sell only if we are better off by selling to him than by not doing so. Similar is the case if a foreign company sells to us. There is no application of force, no one can compel us to buy if we don't want to. How then does the question of exploitation arise?

In fact, the very principle of trade rests on the assumption that both parties gain, otherwise trade just does not take place. Try selling a product to your neighbour, he will buy and you will sell only if both of you feel that you will be in a superior position after the trade than you were before it. The same principle applies when you buy vegetables from a street vendor. You would rather have his vegetables than your money, and he would rather have your money than his vegetables. Both he and you gain. Can there be any doubt about it?

This principle does not change when it comes to international trade. People in both trading countries are better off and that is why trade is good. And that is why policies which promote trade affect the people and the economic growth of a country positively. And that is why policies which hinder trade are bad. And that is why most economists and I advocate lifting of all barriers to trade including but not limited to tariffs, quotas, import and export controls, licensing, and foreign exchange regulations.

What about foreigners coming in and establishing businesses and buying land, property, and other assets in Nepal? We must understand that foreigners can have no dealings and buy nothing without someone who is willing to deal with them or sell to them. It, therefore, stands to reason that these transactions too are of a nature similar to what has been earlier detailed in respect to trade, insofar as the free consent of all dealing parties is required.

Problems arise only if we consider our own countrymen foolish and naïve subjects to be exploited by cunning, all knowing foreigners. Not so. Not so at all.

Do not Nepalese, when they go abroad, thrive? Nepalese do well when they are in the US, UK, Malaysia, Hong Kong, and Korea. In fact the only place where they do not do well is right over here in Nepal. If Nepalese can prosper in other lands where they are surrounded by foreigners, why does anyone think that foreigners can come here to an alien land, to a different culture, and deal with people who look different, speak a different language, and still be able to exploit them?

If any exploitation, cheating, or mistakes are to be made, chances are overwhelmingly against the foreigners who come here. Odds are stacked against them. They are going to pay higher prices in all their buying activities, otherwise we locals will find no advantage in dealing with them and would end up trading amongst ourselves only.

It is time to shed our paranoia of foreigners. It is time to open our markets for trade, investment, and tourism. It is time to globalize and be freed from restrictions in our dealings with people of other nations.

PROFITS GENERATE CAPITAL

21 November 2005

One of the persons I do business with is fond of attributing profits entirely to capital investment. He is more wrong than right. It is frequently the other way around: profits generate the capital.

Consider Bill Gates and Microsoft. Gates started small, incredibly small. He had no family wealth and virtually no capital. Today, he is the world's richest man and his company Microsoft has turned thousands of its shareholders – which includes many of its workers – into millionaires and some into billionaires.

What was the source of this wealth? Was it capital? No. When Bill Gates first went into business, many were wealthier than him. Almost all companies had more resources than Microsoft's. He and his company created the capital – the wealth – which ultimately put him ahead of every person on this planet.

Does his increasing wealth mean that the rest of us have become poorer? Do the billions of dollars with Microsoft mean that everyone else in the world is short by these billions?

No.

We made Bill Gates rich by voluntarily paying for his Window' and other products. We did not give him the money to make him rich, we gave it to him because our benefit from his products exceeded what we paid for them.

Gates became rich because his products increased productivity of every user of his products.

The world rewarded him because by doing so they rewarded themselves. He gave us a language, which made our computers talk to each other and to us. We gained and we only gave a portion of these gains to Gates.

The source of Gates' wealth was not capital – he had practically none when he started – it was the result of his benefiting each one of us by increasing our productivity. We are all a little richer and the world a lot richer because of Microsoft. Even those who don't use his products are better off because of the world's increased productivity.

What we need to do is to create conditions for many more Bills in this world to work their magic and make all of us richer. Today's tragedy is that there are only a handful of countries where conditions exist for people to succeed as spectacularly as Gates did. He could do it because he was in America. If he was in Nepal, there would have been nothing. No Bill Gates, no Windows, no Microsoft.

The success of the recently concluded "NRN" [Non-Resident Nepali] conference shows how well Nepalese have done outside of their own country. The reason is that Nepal makes earning profits far more difficult than most other countries. Entrepreneurial activity is practically non-existent, such are the disincentives for people who want to do something.

America had the environment for Bill Gates to do what he did. He could work with companies like IBM and offer his products. A rich country with many businesses offers a lot more opportunity for success – the road for a newcomer is that much easier.

When Gates succeeded with his Windows, his contracts ensured that he would get his due share. IBM and others could not renege on their commitments even if they wanted to. The US gave a clean and corruption free justice system to Gates. Nepal couldn't have.

Gates could expand his empire without bureaucrats breathing down his neck. His company could hire the best brains from around the world. He was free to buy the best of what the world offered with his dollars. His company could make investments wherever it wanted to.

America protected Gates' wealth and his title to Microsoft shares. He could keep, sell or bequeath his shares to his heirs or to his charitable foundations. No one extorted money from him by threatening to close his businesses. Nepal could not have offered any of this to Gates.

If Nepal wants to have entrepreneurs, it must let its businessmen function without fear and onerous restrictions. Give them the ability to buy, sell, invest, transact, or enter into legally enforceable contracts with anyone anywhere in the world.

Untie the hands of citizens of this country. Let them be free in this globalised world. Their profits will create the capital necessary to transform this nation.

STEEL AND MOBILE MITTALS

26 December 2005

He is the richest Indian. He resides in London and is the richest European. He is also the world's third richest after Bill Gates and Warren Buffett. No prize for guessing who he is. Lakshmi Narayan Mittal (LM) has earned his billions because his company, Mittal Steel, is the world's lowest cost producer of steel.

LM retains his Indian passport. He had to, however, shift out of India to make his fortune. A part of his clan also in steel business remained in India. Their operations went nowhere and are perhaps worth rupees 200 crores [two billion, approximately US $43.7 million]. LM's wealth is estimated at 24 billion euros, or 2,000 billion rupees [approximately US $30.2 billion].

This was not supposed to happen. Indians were not expected to compete against global producers. Indian market was, therefore, protected by the government in India. Imports were banned. The government-owned Steel Authority of India Ltd. (SAIL) operated plants behind this protected wall. Tata Steel too functioned in this cocoon. They were dinosaurs of modern age and symbolized the inefficiency and incompetence of India's manufacturing companies.

LM gave up this citadel of protection and ventured out where he had to compete globally and he did. There is nothing like competition to bring out the best in you. He breezed past his clan in India. He overtook Tata and SAIL. He rocketed past the world's biggest companies. He is now being welcomed back in India with the state governments vying for his billions and wooing him with offers. LM plans to invest heavily in the State of Jharkand in a deal which may involve the biggest inflow of foreign investment by any company into India.

LM would not have succeeded if he had remained in India. No one did. Residence in London offered him freedom from bureaucratic rules. He had to compete, yes, but he could move his capital around without the foreign exchange regulators threatening to put him in jail. He didn't have to seek licences, permits and quotas to increase production.

From India's independence in 1947 to the end of the 80's were India's wasted years. Only those who left, prospered. Those who didn't had nothing to show for their toil. A handful of businessmen did become rich, not by working hard or smart, but by having the government severely restrict issue of licenses, thereby shutting out domestic competition. Competition from abroad was eliminated by import prohibitions. Mercifully, the situation has changed, and though India still remains ensnared in red tape, the licensing era is over. Even LM is now investing in India.

That brings us to the other Mittal clan headed by Sunil Bharti Mittal (SM) or "mobile" Mittal. He became rich and so have his workers and shareholders. He created wealth seemingly out of thin air. Vodafone, the British telecom giant, recently acquired a 10% stake in Mittal's Bharti Tele-ventures for US$1.5 billion thus valuing SM's company at US$15 billion (Rs. 1,100 billion).

How did this happen? India never had the resources for providing telephones. During the dark days of the license quota raj, when a member of India's Parliament complained to the telecommunication Minister about his non-functioning telephone, the reply was: "India is poor. You are lucky to have a telephone. We don't have resources. Cancel your telephone connection if you are not satisfied with it."

It is in this same India that SM has made his fortune. He made it because India opened up telecom for private companies. SM immediately jumped in to fulfill India's pent up demand to be "in touch", and made his billions. Telephones, for which there were "no resources", now contributes billions of rupees in license fees and taxes to India's government. It was discovered that India did not, after all, need "resources" for telephones, rather telephones generate resources.

Apparently words like "resource crunch" appear only in the government's lexicon. If there is a demand, private companies will gather the resources they need. That is why capital markets and stock exchanges exist. It is not for the government to provide or allocate resources.

Will the government of Nepal ever get out of the way and unlock the potential of its people?

Jamie Whyte

Genetics is a risky business | *The Times* **|** 17 February 2006

I'll take the cash not the "free" gift | *The Times* **|** 23 March 2006

A criminal absence of logic | *The Times* **|** 13 April 2006

JAMIE WHYTE is a freelance writer. He contributes regular opinion pieces to *The Times* and is the author of *Crimes Against Logic* and *A Load of Blair*. He has previously worked as a management consultant, as a philosophy lecturer and as a foreign currency trader. Mr Whyte was born and raised in New Zealand. He holds a BA from the University of Auckland and a PhD in philosophy from Cambridge University.

GENETICS IS A RISKY BUSINESS

17 February 2006

It is perfectly fair for insurance companies to charge higher premiums to those prone to illness

This week Sir John Sulston, vice-chairman of the Human Genetics Commission, called for a law to prevent insurance companies from using genetic information to discriminate between policyholders. Genetic analysis may indicate that Mary is twice as likely as Jane to suffer a premature death. Nevertheless, according to Sir John, insurers should be legally obliged to charge Mary and Jane the same life insurance premiums.

This proposal will appeal to many people's sense of justice. Discriminating between policyholders on the basis of their genes, which they cannot help, would be unfair. Or, as Sir John put it: "Everybody should be treated equitably regardless of their genetic inheritance."

Despite its initial appeal, this sentiment gets things exactly the wrong way around. It is Sir John's antidiscrimination law that would be unfair. What is more, it would be impossible to enforce. In other words, it would be as bad as a law can be: wrong in principle and unworkable in practice.

To see why, consider the debate about telecoms pricing in Australia (trust me, it's the same issue). When deregulation of the Australian telecoms market began, some Australians, especially the management of telecoms companies, suggested that rural customers should pay more for phone calls than urban customers, since it costs more to provide them with the service. However, other Australians, especially rural Australians, did not like the idea. They claimed that justice required telecoms companies to charge everyone the same price, regardless of where they lived. These Australians were making the same mistake as Sir John.

To keep the matter simple, suppose that, including a profit margin, it cost 10 cents to provide a one-minute call to an urban customer and 20 cents for a rural customer. Then, supposing also that there were an equal number of rural and urban customers, the one-price-for-all policy would result in all customers, urban and rural alike, paying 15 cents per minute.

The policy would thus provide rural phone users with a subsidy of 5 cents per minute. That is not necessarily unjust in itself. "User pays" has many virtues but it is not a principle of justice. No, what is unjust is that the cost of this subsidy is borne entirely by urban phone users, who must pay a premium of 5 cents per minute.

You may agree that rural phone users should receive a subsidy. Perhaps it will promote the rural economy or have some other benefit. But what on earth could make you think that the subsidy should be paid for by a tax on urban phone use? What special debt do urban phone users owe rural phone users?

The iniquity of Sir John's proposal should now be clear. You may think that the life insurance costs of people with a genetic disposition towards fatal illnesses should be subsidised. But why should they be subsidised by life insurance customers without the disposition?

If Sir John is right in seeking such a subsidy, let it be funded from general tax revenues. Arbitrarily allocating the cost of social policies to some specific group of people – be it urban phone users or low-risk life policyholders – is, obviously, crassly unfair. For all the justice in it, you might as well fund the subsidy from a tax on the tall.

That policy would at least have some chance of working. Taxes on qualities you cannot change, such as being tall, can be avoided only by death. The tall community would surely be unhappy about funding a life insurance subsidy, but not so unhappy as to kill themselves en masse. Low-risk insurance customers, however, could easily avoid Sir John's suggested tax on them.

Indeed, I plan to get rich by helping. If the Government takes Sir John's advice and bans discounts for genetically low-risk customers, I will start an insurance company serving British customers but based offshore, perhaps in the Cayman Islands. I will call it Genetic Life. (If you doubt that I have the wherewithal to start an insurance company, you are probably right. But there are people who do, and they will not miss the opportunity presented by Sir John's proposed law.)

Genetic Life will serve only those who can produce documentary evidence that they are genetically low risk. This will allow it to charge much lower premiums than its British competitors, who will be legally obliged to serve both high-risk and low-risk customers at the same price. As low-risk customers begin switching to Genetic Life, onshore British insurers will be left with an increasing proportion of high-risk customers. Which means that they will have to increase their premiums, which will make Genetic Life's prices even more attractive to low-risk customers, which will mean even more will switch to Genetic Life, which will mean British insurers have to increase their premiums yet again. This process will continue until British insurers are left with nothing but high-risk customers, who will therefore have to pay the full cost of their insurance. Sir John's tax and subsidy will have disappeared.

Sir John will, of course, want regulators to block Genetic Life's activities in Britain. Let them try! Genetic Life will advertise on the internet and in foreign airports. It will do deals with financial advisers to direct business to our office in George Town. We will use every trick in the global economy. Eventually, Genetic Life will find a way through to genetically blessed Brits.

Being both unworkable and unfair should be enough to sink Sir John's proposal. But, in case it isn't, consider one further fact. We already accept genetic discrimination in insurance. Being male is part of my genetic inheritance, yet no one seriously complains about insurance firms charging women lower car insurance premiums than men. Does Sir John really want to outlaw Sheilas' Wheels?

I'LL TAKE THE CASH NOT THE "FREE" GIFT

23 March 2006

Do we think politicians are so vastly superior that they know best how to spend our money?

When last employed, I sold my employer five of my 28 days' holiday. The price was one week's pay. It was a perfect deal for me because my work habits made it difficult to distinguish the days I was working from those I was taking off. My salary increased but my efforts did not.

So I was not surprised to read that the European Court of Justice has declared such transactions illegal. Employers must somehow be protected from this kind of exploitation.

Nevertheless, I am sure some will find the ruling outrageous. If employer and employee are both sane adults, why should they be prevented from freely entering into such a transaction? Our entitlement to 28 days' holiday is surely not an obligation to take 28 days' holiday. If you have thoughts along these lines, I sympathise. But our holiday entitlement is only the tip of an iceberg of entitlement-driven compulsion.

In this case it has taken a court decision to turn an entitlement into an obligation. But judges are rarely required; money is usually enough on its own. The entitlements that politicians delightedly announce, as if they were gifts of some kind – free childcare, free education, free medical treatment and all the rest – are nothing but compulsory purchases.

Take a simple example. How much are you willing to set aside to cover the cost of medical care in your old age? Personally, not much. I would rather spend the money now to enjoy life while still deluded that I am young and healthy. I will save only enough to cover my basic medical needs when old and clapped out: enough for false teeth and a few months' supply of morphine should suffice.

But wait. Like everyone else, I am entitled to comprehensive medical care when old, whether I can pay for it or not. So here is what I will do. I won't save anything and then I will take all I can get free from the National Health Service, as will everyone else. How will the Government pay for all this "free" medical care? By taxing me, of course, along with my fellow entitlement holders. In the end, my "entitlement" simply obliges me to buy medical treatment that I do not think worth the cost. It is a compulsory purchase.

Those politicians who make it their business to extend our entitlements are not billionaire benefactors. The burden of funding our entitlements falls back on us. That is why increasing them simultaneously decreases our ability to consume anything else.

Suppose Gordon Brown were to make a legal reality out of the rights he proclaims at Labour Party conferences. Suppose he guaranteed everyone "the highest standard of free healthcare", "the best start in life" and all the rest. To ears reddened by Mr Brown's rhetorical style, this may sound like Utopia. In fact, it would be serfdom. The highest standard of medical care would alone cost so much that funding it would require taxes to be 100 per cent of GDP.

Of course, Mr Brown will not lift taxes to 100 per cent, if only because the policy would result in the disappearance of any income to tax. But, to pay for our present entitlements, tax is already 40 per cent of GDP. Only the rich can afford to pay for items such as education and healthcare from their post-tax incomes. Most British citizens have no choice but to accept what they are allocated by the State.

The entitlement-based policies of all the main parties muddle up two quite different goals: one worthy, the other disgraceful. The worthy goal is redistributing wealth. Since a pound is worth more to a pauper than to a millionaire, transfers from the rich to the poor increase aggregate wealth (at least, until the size of the transfer undermines incentives to work). It also helps to avoid civil unrest, which benefits everyone, including the rich.

The disgraceful goal is to compel people to live in ways that they would not choose for themselves, or to buy things they do not think worth the cost. This is precisely the effect of confiscating a large portion of someone's income and then providing him with services to which he can no longer afford an alternative.

To avoid this oppression, there should be no state services and no specific entitlements, except to a minimum income. All redistribution of wealth should be in cash. There are today no state supermarkets or state tailors. The unemployed are given cash with which to buy food and clothes. They may choose how to allocate their wealth between food and clothes, and they may also decide what they will eat and wear. Why not give them, and everyone else, the same autonomy with respect to education and healthcare.

Left-wing friends always object to my "all cash" suggestion on the ground that people would spend the money unwisely. They would blow it all on booze and fags or something similarly frivolous. This displays an absurdly dim view of the population. My guess is that spending on health and education would increase under such a system.

The objection also reveals an extraordinary admiration of politicians. Is Mr Brown so vastly superior to you in morality and intellect that, sitting in his office in Westminster, knowing nothing of your circumstances or preferences, he can decide better than you how to allocate your spending? It is a great historical irony that politicians who genuinely aim to help the poor have pursued policies that exempt only the rich from being vassals of the ruling class. And funny to the point of making you weep that such policies are commonly described as "generous".

A CRIMINAL ABSENCE OF LOGIC

13 April 2006

The anti-prison arguments may be fashionable but they fail lamentably under close strutiny

How should crime be punished? For many crimes, my wife's answer is torture. In her view it has all the virtues to be sought in a punishment: it would be an effective deterrent, proportionate (because similar) to the crime, and cheap. This is an unpopular view, at least in our social circles. The dinner parties are usually saved only by the refusal of other guests to believe she means it.

My wife is not concerned with seeming nice, or much with being nice.

But most modern Brits are, and few more so than the New Conservatives. For the nice, punishing crime is a tricky business because all punishments are, by necessity, nasty. Torture is very nasty, of course, but imprisonment is quite nasty too. So it was not surprising to learn that Tory thinking is turning against prisons. Mary Ann Sieghart wrote on the comment pages last week that Edward Garnier, the Shadow Minister for Home Affairs, thinks imprisoning criminals "is hugely expensive and not working".

This anti-prison position is certainly fashionable. But is it also true? Mr Garnier claims that prisons are failing because recidivism rates are high. Seventy per cent of prisoners are convicted of another crime within two years of being released from prison.

This is a peculiar objection to imprisonment – rather like complaining that your TV isn't working because it does not defrost chickens. Reducing reoffending is not the purpose of prison. Its purpose is to reduce offending. It does this by deterring people from committing crimes and by positively preventing them from doing so while they are inside.

But doesn't the high recidivism rate show that prison is not an effective deterrent after all? It does not. Testing the deterrence value of prison by observing the portion of ex-prisoners who commit crimes is ludicrous. It is a bad case of the statistical error of "sample bias". Prisoners are, by hypothesis, people for whom the threat of prison is an insufficient deterrent to crime. That prison does not deter those who end up as prisoners tells us nothing about how much it deters the rest of the population, nor therefore by how much it reduces crime.

Effective deterrents are consistent with a high recidivism rate. Imagine a punishment so dreadful that only the most desperate psychopath would risk it by committing a crime. No better deterrent could be devised. Yet it may lead to 100 per cent recidivism. After his punishment the desperate psychopath is still a desperate psychopath.

Indeed, he will probably be more desperate. Once convicted of a crime, it becomes harder to "go straight", if only because employers are reluctant to hire people with criminal records. Being convicted of a crime can increase the chance of committing further crimes and suffering further convictions. This well-known fact helps to deter many from committing crimes in the first place. Far from being counter-evidence to the deterrence value of prison, recidivism is part of the deterrence mechanism.

Recidivism is a red herring. Nevertheless, Mr Garnier may be right that prison is too expensive a way of reducing crime. Alas, Mr Garnier offers no argument beyond pointing to the cost to taxpayers: £37,000 per prisoner per year. He seems to think that upon hearing this figure we will all leap to the conclusion that prison is too expensive. But it would be a leap of faith, because you cannot tell from its price alone whether or not something is good value. Is £15,000 good value for a car? It depends, of course, on what the car is worth. The same goes for prison. If keeping someone in prison for a year is worth more than £37,000 then it is money well spent.

So, is it worth more than £37,000? Imagine a town of 500 adults that has nabbed its local criminal. They convene a town meeting to decide whether to spend the £75 each required to send him to prison for a year. What do you guess they would decide? It would depend on the kind of crimes he commits, of course. But if he were a typical British criminal – if he would willingly smash a pint glass in your face, kick your head in and break into your house at night – then I am sure most people would consider £75 a bargain.

When imprisoning criminals is such good value, we should be doing much more of it. Especially when, contrary to popular belief, Britain has such a low rate of imprisonment. Admittedly Britain imprisons a higher percentage of its population than any other Western European country. But this is a misleading measure, since it takes no account of the portion of the population who commit crimes. Allow for the extraordinary criminality of the British, and Britain has a low imprisonment rate. Whereas Britain imprisons 12 people per 1,000 crimes, Spain imprisons 48 and Ireland 33.

Measured properly, high imprisonment rates correlate with low crime rates: Spain and Ireland, for example, have lower crime rates than Britain. And when Britain began increasing its prison population 13 years ago, the number of crimes began falling. In 1993 the prison population was 49,000 and the number of recorded offences was 19 million. By 2005 the prison population was 75,000 and the number of crimes 11 million. The same story can be told for the US, where the crime rate has fallen steadily as the prison population has climbed.

Someone who knows these facts, as Mr Garnier must, may still favour reducing the percentage of criminals sent to prison. But it cannot really be because he thinks prison doesn't work. It can only be because he is very, very nice.

ARTICLES WHICH APPEAR IN THIS BOOKLET ARE REPRINTED WITH PERMISSION