**Creating an economy of inclusion**

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**Introduction**

Christian religious leaders are not known for their sympathy towards a market economy. They frequently complain about injustices and inequalities that they argue are caused by markets. Sometimes, supporters of a market economy respond by conceding ground. On other occasions, though, supporters of a market economy respond by arguing that we have not got a real market economy and that we need less state intervention and not more. Such a response was common, for example, when critics of markets blamed the banking crisis on a lack of government regulation of banks. The response was to point out that the government regulation of banks that did exist, together with government safety nets for banks that behaved recklessly, were a cause of the crisis. This kind of response often seems inadequate and rather like the responses of die-hard communists after the fall of the Berlin Wall who argued that real communism had not been tried and that they just wanted another go.

Such arguments are difficult to settle. We have theoretical and some empirical evidence, but often the evidence is context specific and hard to interpret unequivocally. A lack of counterfactuals is always a problem in making economic evaluations. However, there are many economic problems – especially those that cause dire poverty - that are demonstrably not the result of markets but of their absence. It is not that markets have been found wanting, it is that injustices have prevented access to markets. Those injustices might be in the form of deliberate policies that lead to the exclusion of people from markets or they might be situations where governments are not undertaking their proper functions of maintaining the rule of law, operating efficient and uncorrupt court systems and properly ensuring that property rights are legally recognised and enforced. In such cases, surely it is not appropriate to criticise markets but, rather, the political forces that perpetuate the exclusion of people from markets.

**Excluded by or excluded from?**

Pope Francis’ statements on economics have often suggested that he believes that people are excluded by markets. For example, in his Apostolic exhortation, *Evangelii Gaudium,* Pope Francis wrote: ‘Just as the commandment “Thou shalt not kill” sets a clear limit in order to safeguard the value of human life, today we also have to say “thou shalt not” to an economy of exclusion…’. In the following paragraphs, 53-60, the Pope seemed to blame market economies for the “economy of exclusion”, listing consumerism, debt, financialisation, ‘trickle-down’ theories and the profit motive amongst other reasons for the desperate poverty and inequality that exists in some places. The question did not seem to be raised as to whether the problem was a somewhat different one. Is it, perhaps, possible that various interests have conspired to ensure that people are not so much excluded by markets but that they are excluded from markets?

This might happen as a result of malfunctional and dysfunctional government, possibly working in collaboration with business interests to promote monopolies, to prevent land rights being established or to collude in perpetuating corrupt processes that lie at the heart of much economic exclusion and the concentration of economic power.

These problems are common in Central and South American, the home continent, of course, of Pope Francis. Indeed, one of the right hand men of Pope Francis, Cardinal Rodriguez of Honduras, illustrates the opposing points of view well. He has made statements that are similar to those of the Pope. For example, he has written: ‘In this time the free market has produced one sector which is booming: social exclusion.’[[1]](#footnote-1) As it happens, in the period 2008-2014, the period to which he was referring, there had been a continuation of the very rapid decline in world poverty and a continued narrowing of the world’s income distribution.  Poverty has fallen because countries have become more open to trade and adopted systems of governance that are somewhat more supportive of the rule of law, private property, the proper administration of justice and so on. Putting that aside, however, this statement again raises the question whether people are excluded by markets or excluded from markets?

The Cardinal’s own home country helps illuminate this particular point.  Those who are ‘excluded’ in Honduras – one of the continent’s poorest countries - do not suffer because of free markets but because of the cronyism, corruption and absence of the basic conditions for markets to function. Indeed, if one were to look for an absence of social exclusion in the continent, then one would probably look to Chile which is the most economically free country in Central and South America and which has a tiny percentage of people living in absolute poverty. Honduras, on the other hand, is the 112th freest country in the world and has a quarter of its people living in absolute poverty. According to the World Bank’s ease of doing business report, Honduras is the 162nd (out of 189) easiest place in the world to start a business. In Honduras, as in many other places in the world, people are most certainly excluded *from* markets and not excluded *by* markets. They may well be excluded by business interest groups and governments working together, but such places are not the type of market economy which Saint Pope John Paul II had in mind when he wrote in *Centesimus annus* (42):

Is this [capitalism] the model which ought to be proposed to the countries of the Third World which are searching for the path to true economic and civil progress?

The answer is obviously complex. If by "capitalism" is meant an economic system which recognizes the fundamental and positive role of business, the market, private property and the resulting responsibility for the means of production, as well as free human creativity in the economic sector, then the answer is certainly in the affirmative, even though it would perhaps be more appropriate to speak of a "business economy", "market economy" or simply "free economy".

Pope John Paul also made a reference to the importance of a free economy being supported by appropriate structures of governance when he said:

But if by ‘capitalism’ is meant a system in which freedom in the economic sector is not circumscribed within a strong juridical framework which places it at the service of human freedom in its totality, and which sees it as a particular aspect of that freedom, the core of which is ethical and religious, then the reply is certainly negative.’

This does not mean that a market economy should be wrapped up in government regulation. But, if an economy is not to be an economy that excludes, then people need to be able to obtain redress in law when contracts are not adhered to, property rights need to be respected, and so on. A free economy should also be reasonably free from corruption. Without that, the strong will dominate the weak and there will, indeed, be an economy of exclusion.

A situation where there is an absence of secure property rights and without a straightforward means for businesses to legally register prevents proper business contracts developing, leads to reduced opportunities for entrepreneurship, prevents capital secured on property from being invested within businesses, leads to corrupt legal and governmental systems and can lead to ‘mafia gangs’ dominating a business economy. New businesses, cannot develop, expand and advertise in case they come to the attention of the authorities. Employment relationships often remain informal because legally enforceable contracts cannot develop, and so on. Such an economy is one in which established and powerful interests and those with connections have an in-built advantage.

As the World Bank puts it in relation to the legal barriers to establishing businesses:

A growing body of empirical research has explored the links between business entry regulation and social and economic outcomes. Where formal entrepreneurship is higher, job creation and economic growth also tend to be higher…Conversely, excessively cumbersome regulation of startup [sic] is associated with higher levels of corruption and informality.[[2]](#footnote-2)

Perhaps unsurprisingly, there is a strong relationship between government institutions and economic growth. Gwartney and Lawson (2004)[[3]](#footnote-3) have studied data relating to the legal systems of 100 countries from 1980 to 2000. They were rated according to the criteria established by the Fraser Institute’s Economic Freedom of the World index. This includes factors such as the rule of law, protection of property rights and the enforcement of contracts. The top 24 countries had an average GDP per capita of $25,716 at the end of the period and average economic growth of 2.5 per cent. The bottom 21 countries had an average income of $3,094 per capita and average economic growth of 0.33 per cent.

An economy of inclusion needs good institutions to allow markets to flourish. Generally, though not in all circumstances, governments have an important role in supporting such institutions. Their very purpose is to protect the weak from the strong. A market cannot be thought of as ‘free’ unless the institutions exist to ensure that agreed contracts are adhered to, property rights are respected, the administration of justice is upheld, and so on.

**Insider-outsider economies of exclusion in the West**

It is easy to point to institutional factors in poor countries which indicate why an “economy of exclusion” may exist. We might assume that such an economy of exclusion would not exist in the West where it is perceived that structures of governance are much more effective. This may be so in general, though there are some Western countries that do have poor institutions.

Whilst the problems discussed below are less likely to be a matter of life and death, in many Western countries the actions of government can create an economy of exclusion. In continental Europe, the most obvious way this arises is from labour market regulation which has a tendency to create what economists call “insider-outsider” labour markets whereby some have secure jobs but others (the long-term unemployed, the young and older workers) are trapped outside with little prospect of obtaining a job.[[4]](#footnote-4) In Spain, for example, only 17 per cent of young people have a permanent, full-time job. Whilst this figure has varied with the strength of Spain’s economy, extremely poor employment levels amongst vulnerable groups has been a permanent feature of an economy where the risks of employment decisions are raised by various forms of regulation.

Whilst there are tangible forms of exclusion in labour markets in the UK and whilst there are many people who may feel insecure in their employment[[5]](#footnote-5), we do not experience anything on the scale of youth unemployment or long-term unemployment that is prevalent in southern Europe. What is common, though, are low income levels amongst households with at least one adult in work[[6]](#footnote-6). There are certainly problems with the way the statistics that are used to illustrate this problem are compiled and exploited, and especially with the way in which in-work poverty and out-of-work poverty are compared[[7]](#footnote-7). However, that there are some groups who have suffered from low income growth and have very little financial resilience at times of misfortune is difficult to deny. This is one of many reasons why the use of food banks has increased in recent years.

Proposals to deal with such problems almost always focus on welfare systems. However, Pope Francis has said that welfare is not a long-term solution to poverty. The question we face is why so many people in a prosperous country struggle to earn sufficient to meet basic needs whilst having enough left over to put money aside to save for retirement and for a rainy day.

Niemietz (2012)[[8]](#footnote-8) suggests a wide-ranging process of economic reform that could address such problems. This would include reform of the Common Agricultural Policy, reform of energy policy and the liberalisation of land-use planning laws. These reforms, together with reform in one or two other areas, could add around £750 a month to the household incomes of the least well off.

Of course, all governments use policies that reduce household real incomes in the pursuit of other goals. For example, the regulation of energy markets could be justified on the ground that it reduces carbon emissions and that such reduction brings about long-term benefits that more than justify the costs. However, one area where the costs of policy are almost certainly overwhelmingly greater than any benefits is in the area of land-use planning controls. By a big margin these are the most significant cause of additional costs on households that arise from government regulation in the UK. Also, such controls have the characteristic of specifically excluding people from markets. They are part of the “economy of exclusion” in many parts of the developed world, but especially the UK.

There are many statistics that illustrate the impact of the problem. For example, according to Countrywide, the average 20-29 year old will spend about half their post-tax income on rent for a one-bedroomed property[[9]](#footnote-9). According to UK government (ONS) figures, published in 2015, the ratio of median monthly rent to median monthly salaries in Westminster (the most expensive area of the country) was over 78 per cent. Also, 18 London boroughs were amongst 25 areas where the rent to income ratio was over 50 per cent[[10]](#footnote-10). The ratio of house prices to average earnings in the UK is 5.89[[11]](#footnote-11). This does, of course, disguise huge regional variations with much higher figures in the south east of England and London. The UK also has amongst the smallest dwellings in Europe (see Morgan and Cruikshank, 2014[[12]](#footnote-12)). Furthermore, the housing stock is of poor quality with many people living in accommodation that is inadequate by modern standards.

The UK is an outlier when it comes to the problem of housing costs, and it is a problem driven entirely by a policy that prevents the building of houses. The problem is not lack of social housing (the UK has the third highest level of social housing in Europe). In other words the problem is not lack of government activity. Rather, the government has created an ‘economy of exclusion’ by adopting a policy that prevents houses from being built and which therefore raises the cost of housing dramatically. This situation, it should be noted, is not a natural consequence of the UK’s relatively high population density. If the regions of Switzerland, Belgium, Germany, Holland and the UK are ranked by their density (excluding single conurbations), no UK region appears in the top ten. Indeed, less than 5 per cent of the south east of England comprises buildings or transport infrastructure[[13]](#footnote-13).

People are literally excluded from the housing market by prohibitions on building; they are prevented by the cost of housing from moving from areas of high unemployment to areas of low unemployment or from areas of low wages to areas of high wages; high land prices lead to higher business costs and less business competition thus raising other household costs; and the least well off are prevented from having dignified housing and attaining a level of disposable income after housing costs which allows them to buy other necessities and have some money left over to save for times of greater need.

The effect of land-use planning policies on the least well off has been enormous. Between 1971 and 2011, median house prices rose more than three-fold relative to inflation. During this time, the ratio of house prices at the bottom end of the market (i.e. house prices in the lowest quartile) to incomes in the lowest quartile has risen from 3.2 to 5.7 in the East Midlands; 3.9 to 9.0 in London; and 4.2 to 8.2 in the South East. Bottom quartile house prices relative to bottom quartile incomes in the region with the lowest ratio today (the North East) are higher than bottom quartile house prices relative to bottom quartile incomes in the region with the highest ratio (the South East) in 1997. In other words, it was easier for somebody on a low income to buy a house in London in 1997 than it is for somebody on a low income to buy a house in the North East today. Of course, house prices directly affect rents charged to those who choose not to or who are unable to own their own house.

The effect of high house prices on the disposable incomes of the poor is dramatic. Real incomes before housing costs for those at the tenth percentile of the income distribution grew by 80 per cent between 1965 and 2009. However, incomes after housing costs grew by only 45 per cent over the same period. In other words, had housing costs grown only at the same rate as incomes between 1965 and 2009, low income families would now have a level of real income 26 per cent higher. It is not only the least well off, of course, who have suffered from this rise in housing costs, but they feel the problem most acutely.

An economy of inclusion that allowed more housing to be built would not involve “paving over the countryside”. As has been noted above, only a relatively small proportion of the country is used for housing or infrastructure. Housebuilding is at very low levels in the UK because of the difficulty of obtaining planning permissions. It is at especially low levels in places where demand is greatest. In the UK, new dwelling starts have ranged from 331,000 in 1970 to 119,000 in 2008, with a strong secular decline – that is peaks generally being lower than earlier peaks and troughs being lower than earlier troughs. In Germany, new housing starts have ranged from 810,000 to 179,000 in the same period. Only 8 per cent of all housing finance in Germany comes from government sources: the grant of planning permission for a piece of land raises its value to such an extent that government funding is not necessary.

**Conclusion**

When Pope Francis and others criticise a market economy, there is little doubt about the power of the points that they are making in the eyes of opinion formers. However, it is possible that, in analysing these problems, we are holding the telescope to our eyes the wrong way round. In the last 20-30 years the ‘economy that kills’ (to use Pope Francis’ words) marked by the increasing globalisation of trade, of which he is critical, has led, more or less directly, to the most rapid reduction in poverty in the history of the planet. But, there is a problem. Still many hundreds of millions are desperately poor. In the West, many people are poor relative to the level of prosperity to which they might aspire. But, what is the problem? Are they excluded by markets or from markets? Of course, it is true that some people have to be – and should be – supported because they cannot meet their own needs by working in a market economy alone. Such people need support, whether from family, civil society, charity or government. They should be treated with compassion and justice. However, there are also huge numbers of people who are excluded from the market economy as a result of the failure of government to provide its basic functions in an uncorrupt way. In the West, there are many more people who experience less prosperity than they should because governments place obstacles in their way.

We can argue about the appropriate role for government in the lives of such people and whether government needs to provide healthcare, education, training, basic health and safety regulation, welfare and so on. However, the most rapid way to successfully lift many more people out of absolute poverty in poor countries and relative poverty in rich countries would be to remove the obstacles to their participation in markets.

It should not be thought that business – or the private sector in other respects - is necessarily a benign actor here. The crony capitalism that Pope Francis knows so well from South America is often responsible for problems in poorer countries. Businesses can use the levers of government to pursue their own interests, acting alongside governments, to create an ‘economy of exclusion’. But, nevertheless, the problem is exclusion *from* markets and not exclusion *by* markets. In the West, it is often private sector trades union interests that favour the labour market regulation that causes problems for “outsiders” in labour markets, and often large firms accept such regulation because it reduces competition. Certainly, it is private interests in the UK – normally well-off householders – who support strict land-use planning regulation.

This exclusion from markets does not help promote the common good and it leaves many people struggling on the margins of society. Governments should, through rooting out corruption and performing their basic functions properly, as well as by removing impediments to economic development, promote a climate which leads to a more inclusive economy. However, this also relies on private interests that operate through the political process (whether by lobbying or choosing which factors motivate their voting) putting their own interests aside and supporting policies that nurture an economy that promotes human dignity and the common good.

1. See: <http://www.caritas.org/2014/09/family-time-economic-crisis/> [↑](#footnote-ref-1)
2. See: <http://www.doingbusiness.org/data/exploretopics/starting-a-business/why-matters> [↑](#footnote-ref-2)
3. Gwartney, J. and R. Lawson (2004), ‘What have we learned from the measurement of economic freedom?’, in M. A. Wynne, H. Rosenblum and R. L. Formaini (eds), *The Legacy of Milton and Rose Friedman’s ‘Free to Choose’: Economic liberalism at the turn of the 21st century*, Dallas, TX: Federal Reserve Bank of Dallas. [↑](#footnote-ref-3)
4. Indeed, it is interesting that economists use similar language (‘outsider’ labour markets) to Pope Francis’ (‘economy of exclusion’). However, they conclude differently. Most economists argue that labour market regulation is a major cause of the problem whereas Pope Francis has blamed unemployment – in Italy at least – on globalisation and people putting “money” at the centre of economic activity. [↑](#footnote-ref-4)
5. This is often equated with zero-hours contracts, but, in fact, those on zero hours contracts on average are as happy with their situation as those who are not. [↑](#footnote-ref-5)
6. See, for example: <http://www.jrf.org.uk/data/work-poverty-levels> [↑](#footnote-ref-6)
7. See, for example: <https://iea.org.uk/blog/how-the-poverty-figures-stack> [↑](#footnote-ref-7)
8. *Redefining the Poverty Debate Why a War on Markets is No Substitute for a War on Poverty*, Research Monograph 67, Niemietz K. (2012), Institute of Economic Affairs, London, UK. [↑](#footnote-ref-8)
9. See: <http://www.countrywide.co.uk/news/countrywide-lettings-index-june-2016/> [↑](#footnote-ref-9)
10. See: <https://www.ons.gov.uk/peoplepopulationandcommunity/housing/articles/housingsummarymeasuresanalysis/2015-08-05> [↑](#footnote-ref-10)
11. <http://www.nationwide.co.uk/~/media/MainSite/documents/about/house-price-index/2016/Nov_2016.pdf> [↑](#footnote-ref-11)
12. See Morgan M and Cruickshank H (2014), Quantifying the extent of space shortages: English dwellings, Building Research & Information, 42:6, 710-724. [↑](#footnote-ref-12)
13. The problem of housing costs is greatest in the south east. However, the south east is less densely built on than the West Midlands and, as has been noted, in Surrey (one of the most expensive areas for housing) more land is used for golf courses than housing. [↑](#footnote-ref-13)