In Practice It’s Scarce

If there was really a surplus of capital in the late 20th and early 21st centuries, someone forgot to tell those running the world’s banks and non-financial businesses. They continued to behave as if capital were scarce and expensive, and needed to be carefully conserved. Economic problems since the early 1990s can be linked to a shortage of capital more plausibly than to any surplus.

Capital shortage is a familiar concept in relation to lower-income ‘developing’ countries. There, the tragic shackling of people’s initiative and drive for betterment, for want of additional capital, is obvious to any sympathetic observer. ‘The major stumbling block that keeps the rest of the world from benefiting from capitalism is its inability to produce capital,’ says the Peruvian economist and social activist Hernando de Soto (2000: 5). MIT economists Abhijit Banerjee and Esther Duflo got the chance to test this proposition when the microlender Spandana agreed to offer its services in a randomly chosen half of the 104 neighbourhoods of Hyderabad, while withholding them from the others. ‘People in the Spandana neighbourhoods were more likely to have started a business and more likely to have purchased large durable goods, such as bicycles, refrigerators and televisions’ (Banerjee & Duflo 2011: 171). Few deny that capital is a limiting factor in the early stages of development, disputes arising only on where it is best deployed and whether individuals, big companies or the state are best placed to make good use of it.

Richer economies are deemed to have reduced or resolved their capital-supply problems – through decades of accumulation which create a large, long-lasting ‘stock’ of capital and the development
of capital markets to conserve and reallocate that stock. Incentives
to accumulate and to allocate efficiently are assumed to have been
raised by strengthening shareholder and creditor rights, and mak-
ing property rights easily defensible and tradable. The attraction of
sophisticated financial systems to other countries’ savers and inves-
tors could even mean that a rich-world capital surplus is the comple-
ment to a poorer-world capital shortage, because of ‘perverse’ flows of
capital from regions of scarcity to regions of abundance, once inter-
national capital controls are removed.

But as with productivity growth during the first wave of computeri-
zation, the rich world’s surfeit of capital is visible everywhere except
in the economy. Businesses, banks and economies as a whole are run
as if to minimize any capital requirement. This behaviour hardly
changed when stock markets boomed during the ‘great moderation’
of 1992–2007, driving down the cost of equity for firms that issued it.
Nor did it change when interest rates, the cost of borrowing for
investment, fell to record lows during the booms’ deflationary after-
math. At a time when the world was supposedly awash with capital,
first because of savers providing too much and then because of cen-
tral banks disgorging too much, financial and business enterprises
were acting as if capital were their main constraint, a limiting factor
requiring minimal use.

**Banking without capital**

Perhaps the most extreme and consequential form of capitalism-
without-capital was practised by many of the world’s banks, in the
two decades before 2008. Their widespread need that year for res-
cue by capital injection, followed by international regulators’ impo-
sition of higher minimum capital ratios, highlights the extent to
which banks had made loans ‘secured’ against assets that had been
severely overvalued – and, in some cases, lent with no security at all.
A small fall in the value of the assets acquired through this lending
was enough to drop them below liabilities, threatening a large-scale
insolvency until governments stepped in to swap good public bonds
for bad private debt.

The missing capital in this case was more specifically ‘core Tier 1
capital’, subscribed by shareholders and central to the capital ratios
prescribed by central banks under Bank for International Settlements