

John Kay

Professor John Kay CBE FBA is an economist. A video of extracts from this interview can be found via www.britishacademy.ac.uk/prosperingwisely/kay



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What was the initial spark that made you want to work and study in economics?

John Kay

I suppose there were two things. One was that I was a person who was good at mathematics at school and interested in politics and current affairs, and economics brought them together. Then, it was a brilliant lecturer at Edinburgh University who excited me about the subject.

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What is economics and why is it important?

John Kay

I don't think it is very difficult to persuade people that economics is important. It is often harder to explain what economists do, and how the academic study of economics contributes to everyday events. What most people recognise as economics is: what is happening in the markets, whether interest rates are going up or down, growth and inflation, and so on. These are the issues that brought me to economics in the first place as well. But actually the part of economics that I found really interesting was the way in which households, firms, businesses and industries operate. That is why it is micro-economics that has been the subject of the work I have done over my career.

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It is obvious from looking at your CV that you are not just a theorist; you get your hands dirty and actually do stuff.

John Kay

That's right. If I had just been interested in theory, I would have stuck with mathematics. It is because I was interested in the practical application of the analysis that I did that I moved to economics.

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Do values play a part in economics? Or do you take the view that, as an economist, you are a kind of scientist, and values do not influence your thought processes as an economist?

John Kay

I think, in this sense, economics is somewhere in-between the hard sciences and the pure arts subjects. In physics, values do not play much role at all. It would be wrong to say that they play no role, but they do not play very much. In most of the social sciences, most theories are associated with some broader ideological views of the world. In economics, there is an element of ideology.

In particular over the last couple of decades ideas from economics have been used as support for a rather aggressive right-wing ideology. However, that is people who have that ideology seizing on the bits of economics that suit their preconceptions. Before the last 20 years, people on the left did the same. It was the Marxist categories and the arguments that were generated from the political left that dominated economic debate, for people on the right as well as the left, in the years up to the collapse of central planning and the end of communism in the 1980s. Since the 1980s, we have had a kind of market fundamentalism in which the political right has seized on a different group of economic ideas as justification for their policies.

Whatever the prevailing political climate of the times is, people will find bits of economic doctrine that suit their beliefs.

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What part did economists play in the financial crisis? Are they to blame, are they the solution, or are they both?

John Kay

If we think of the financial crisis, economists have to take some of the blame, but they are also part of the solution.

The reason they deserve part of the blame is that, certainly, there was a set of economic ideas that had a large influence on policy. These were, roughly speaking, that what was going on in the merry-go-round of circulating paper that happened before 2008 – and which was a great deal to blame for the crisis – was a more efficient way of managing and sharing risk. There were economic theories that provided the intellectual underpinning for what was, from the point of view of the people who thought they were making a lot of money out of it, a rather convenient doctrine. Economists have to take responsibility for that, and there was bad policy made on the basis of that belief.

I think most of the ideas as to how we escape from this kind of crisis come from economics. While the development of global economies in the years since 2008 hasn't been great, we have at least avoided the kind of economic and political collapse that followed the biggest

other economic crisis in modern history, which was the Great Depression that followed the financial crisis of 1929 and afterwards.

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Is there a specific piece of work that you are particularly proud of?

John Kay

I suppose the thing I am most proud of was the Institute for Fiscal Studies, which has become probably the most respected think-tank in the area of economics. Then I went on from that to set up a business that did economic consultancy. The idea we had was that I and the people I was working with were good at taking economic ideas that were firmly rooted in serious research, and making them relevant and communicating them to a wider audience. We thought there was a market for that, both in the public policy area and in dealing with business and everyday affairs as well. That proved to be right.

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What has been the influence of the Institute for Fiscal Studies?

John Kay

The specific influence of the Institute for Fiscal Studies has really been telling truth to power and the public. When people are rightly more and more sceptical about the value and the reliability of the information with which they are presented, in the press or, equally nowadays, by government, then having people out there who are just trying to tell the truth as best they can is terribly important. I think that was the big contribution of the Institute for Fiscal Studies.

Ideas influence behaviour. But it is a gradual influence – it is almost like dripping on a stone.

What we also did there, and what I have tried to do in other parts of my career, has been to put ideas into the public domain. A lot of people think that ‘impact’ means you talk to business people or politicians and they say, ‘Gosh, that is a good idea. I must do that.’ That is not the way the world works at all. The way the world works, as I have discovered, is that ideas influence behaviour. And they do have a huge influence in the long run, but it is a gradual influence – it is almost like dripping on a stone. You put ideas out there into the public domain, and people start talking about them. You know you are winning when people start feeding your own ideas back to you as if they were their own. That has happened many times in the course of my career.

¹ J.A. Kay & M.A. King, *The British Tax System* (1978; 5th edition 1990); *The Structure and Reform of Direct Taxation*, Report of a Committee chaired by Professor J.E. Meade (1978).

² John Kay, ‘Taxpayers will fund another run on the casino’, *Financial*

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Can you give us some examples of how, over time, your thinking has affected conventional wisdom?

John Kay

I will give two examples.

At the Institute for Fiscal Studies, we talked a great deal about fiscal neutrality: the idea that the tax system wasn’t designed to make people do good things and stop them doing bad things.¹ The most that we could actually hope for was that they wouldn’t make worse decisions as a result of the way the tax system operated. Now, that’s something that is almost taken for granted in public debate today; but when we first started talking about it, it was a new idea. Politicians and the public took for granted that the tax system was there to be a form of social engineering.

A more recent example, which I feel startled and excited by, is that when I wrote in 2007 and 2008, as the crisis in the financial system emerged, that what we needed to do was separate out the risky investment banking from the boring payment system and ordinary lending operations of banks – to separate, as I called it, the utility from the casino in the financial system – that was regarded as a way-out idea, impossible to do and undesirable in any case.² It has gradually moved from being on the fringes of public debate to being at the centre of the proposals the Government is actually implementing. That is how things have changed after only five years. I described earlier how people feed your own ideas back to you, and I quite often now have people asking me, ‘What do you think about this idea of splitting utility from casino banking?’ It is not just my idea that is reported back: it is my words.

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The fact that the work of economists and other social scientists can be subversive and critical of existing structures of thought and institutions can be quite difficult for policymakers.

John Kay

Yes, that’s right. If you analyse how the financial crisis and reactions to it have evolved, you have a quite interesting story.

What you got in 2008 was a pragmatic reaction by policymakers, who said that the priority is to keep the system afloat – and it *was* the priority. That is how we got into the business of providing loads of public money to keep the banking system operating and make sure that, when we put our cards in the holes in the wall, there was still money coming out. But that kind of pragmatism is quite hopeless as a framework for deciding how in the long run you prevent that kind of crisis happening again.

Now, if we move a year or two after the crisis, what we get in 2010 onwards is people in the financial sector thinking, ‘It’s back to business as usual. We can just get on making money in the ways in which we have before.’ But we have moved on from there. If one looks at the way public and political opinion started to evolve last year,

Times (17 September 2008) www.johnkay.com/2008/09/17/taxpayers-will-fund-another-run-on-the-casino; John Kay, *Narrow Banking: The Reform of Banking Regulation* (2009) www.johnkay.com/2009/09/15/narrow-banking

people in Britain started to understand that what had gone wrong in the financial sector was not that some terrible accident of events that was beyond anyone's understanding or control had happened. Actually, the problems that had emerged were the product of forces that were the result of deficiencies in the culture and behaviour of the financial services sector itself. It is at that sort of moment that you start getting the influence of more fundamental thinking and ideas coming into policy. I hope – I am still not sure, but I hope – that the ways in which policies evolve over the next three or four years will reflect this more thoughtful, long-term analysis of what it is that went wrong.

One of the lessons of the 2008 crisis is the way in which the financial sector has become enormously self-referential. One needs an underlying theoretical framework in order to ask basic questions about what these activities are for in the first place.

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You chaired the Kay Review of UK Equity Markets and Long-Term Decision Making.³ Was it inevitable that an economist would chair that, or could it have been someone from another discipline?

John Kay
I doubt if it could have been someone from another discipline. Most often that kind of exercise would be given to someone who had no particular disciplinary background, but simply practical experience of equity markets. One of the lessons of the 2008 crisis is the way in which the financial sector has become enormously self-referential. People have generated – to my mind – largely unnecessary complexity. There is a dialogue in which people talk to each other, and one needs an underlying theoretical framework in order to try and penetrate that, and ask basic questions about what these activities are for in the first place.

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If the crash had not happened, who do you think would have chaired a similar review?

John Kay
I think, at a different stage, you would have had someone from the Stock Exchange chairing a review of equity markets. It is when events raise fundamental questions about how well these institutions are working that you have to ask someone who is not directly connected with these institutions to take a dispassionate, outside view.

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This is a good example of how the social sciences have value.

John Kay
That's right. This goes back to the ways in which economics, or any other social science or humanities discipline, influences policy and generates economic value in the long run. It is through the way in which it influences the climate of ideas. People who make practical decisions – which can range from the design and technology of an iPod to big policy decisions about how the financial system should be organised – make these decisions in a framework of ideas that is, in the end, framed by a series of academic disciplines.

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One of your books has the subtitle *Finance and investment for normally intelligent people who are not in the industry*. Why did you write that?

John Kay
The motivation for writing my little book, *The Long and the Short of It*, which has the subtitle of *Finance and investment for normally intelligent people who are not in the industry*, was this. People know I am an economist – and not just an economist, but an economist who has been interested in investment and financial markets over my lifetime. Lots of intelligent people, such as academic colleagues, friends who are professional lawyers and doctors or something like that, who have a little bit of money to set aside for their retirement or whatever, have asked, 'What should we do with it?' They have discovered that they are not very

**THE KAY REVIEW OF UK EQUITY
MARKETS AND LONG-TERM
DECISION MAKING**

FINAL REPORT

JULY 2012

In February 2013 John Kay gave evidence to the Commons Business, Innovation and Skills Committee about his 'Review of UK Equity Markets'.



³ *The Kay Review of UK Equity Markets and Long-term Decision Making: Final Report* (July 2012) <http://bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf>; Professor Kay's oral evidence to the House of Commons Business, Innovation and Skills Committee on 5 February 2013 may be seen at www.parliamentlive.tv/Main/Player.aspx?meetingId=12506

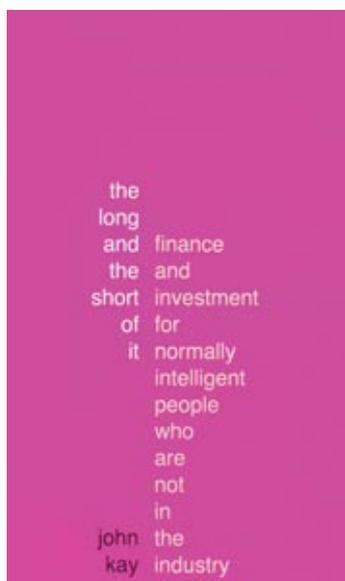
sure that they can trust financial advisers – and they are right to think that, as events have shown. I said, ‘I ought to write a book that actually answers that question, so that next time people ask me, I can say, “Read this”.’ That is how we got to *Finance and investment for normally intelligent people who are not in the industry*, which is designed to capture exactly these kinds of people. They are whom the book is aimed at.

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So it’s about empowerment.

John Kay

That’s right. In that little book I said to the reader that, even if at the end of this, you still don’t feel confident enough to manage your financial affairs yourself, at the very least you will be able to ask some pretty penetrating questions of the people you do hire to manage your investments for you.



most of all about the telly don who is presenting ideas on television. Of course, some of what people are doing there is, in fact, very superficial. But in the end, if we are only communicating our ideas to each other, we are not going to have the effect that I have described of putting ideas into the climate of opinion in which economic development and the development of a whole set of ideas of a democratic society are formed.

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Do you sometimes feel that you now have to react instantly, and say something when you have got nothing to say yet?

John Kay

Personally, I don’t blog, for exactly the reasons that you are describing. I don’t think I want to put every wild idea that comes into my head into the public domain. I do a lot of popular writing. I write a weekly column in the *Financial Times*, but not everything I put in there is necessarily something that I definitely agree with myself. It is an idea

that I think is considered and worth putting into public debate. I don’t think that people in any academic subject should be wanting to make an impact just for the sake of it.

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As a popular writer as well, what is the most peculiar piece of feedback that you have had?

John Kay

I remember, quite a long time ago, getting a publisher’s comment card back on a book I had written. It was from a professor of physics somewhere, and he said, ‘I don’t know how I got this book – I must have filled in a form by mistake. But I enjoyed reading it so much that I want to keep it.’ I thought, ‘I have succeeded with that particular piece of communication.’

Q

What are the opportunities and challenges in economics that lie ahead for you and that you would like to work on in the future?

John Kay

At the moment, I am working on the issues that we have talked about in terms of the reform of the financial services system. I am asking, in a basic way, the question, ‘Suppose we had a blank sheet of paper and we could design a financial system to meet the needs of the nonfinancial economy, what would it look like?’ In a way, that illustrates some of the themes we have been talking about, because of course we do not have a blank sheet of paper – we have a history and a culture and a whole variety of established institutions. However, if we are to think about the ways we actually want to change the reality of what we have had, thinking about it in this kind of bluesky way seems to be an essential contribution to that.

There is a broader aspect to this, which is that financial economics has gone quite badly wrong over the last 50 years. In some ways, it is one of the great achievements of economics and social sciences that we have been able to develop some theories that are, at the one level, intellectually rigorous, and at the other have very obvious practical applications. People have been able to go away and earn very large salaries in the City of London and Wall Street by knowing about these theories. The trouble is that I am not sure these theories are true; or perhaps I am just not sure what I think about them. This is difficult, especially for people who come to a subject like economics from the hard sciences, or people who are in economics and want to make economics like a hard science. It is difficult for them to accept that we can have theories that are useful and relevant without actually being true.

For example, the efficient market hypothesis – which is one of the cornerstones of modern financial economics – is a theory that is 90 per cent true. That means, if you don’t know this theory, you are going to make a lot of mistakes in dealing with financial markets; but if you believe it is true, you will also make a lot of mistakes in dealing with financial markets. If you come from a physics background, that is quite hard.

Q
What did election to the Fellowship of the British Academy mean to you?

John Kay

Election to the Fellowship of the British Academy meant that the Academy really valued the kind of work that I had been doing for the last 15 years, which was – as I described – taking serious, academically rigorous ideas, communicating them to the public, and applying them in a business context and a public policy context. That is what I have tried to achieve. I was also rather proud, actually, that I was the first person to be elected as a Fellow of the Academy who was an occupant of a Chair of Management at a business school. We were saying, in effect, that you can do this kind of activity in a way that scholars in the most rigorous of disciplines actually take seriously.

The real economic contribution of the humanities is about defining the ideas that make our society function and operate.

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What do you think the British Academy should be doing more of?

John Kay

I think what we are doing in this exercise is one of the most important things that the British Academy should be doing. That is, to make the case for the humanities; not in the kind of pathetic, narrow economic terms that people want – like how many jobs it creates or something like that. That is not what the real economic contribution of the humanities is about. It is about defining the ideas that make our society function and operate, and that is what people studying the humanities for the last 2,000 years have enabled us to do. That is the argument that needs to be understood by people who have a narrow and limited concept of economic value and the ways in which economic value is created.

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What is your message to the people who publicly fund the humanities and social sciences?

John Kay

My message to them is that they ought to look at the impact of research not just in terms of narrow, short-term

criteria. If you had asked Plato, ‘What have you contributed to improving manufacturing productivity?’, or ‘How many mentions have you received in the *Daily Mail*?’, the answer would be rather few. And yet his ideas are influencing what we do and how we think 2,000 years later. That is the way that the humanities operate.

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Does it matter that the impact of the humanities and social sciences is often not measurable?

John Kay

The world wants things that are measurable rather too much at the moment. There is this quote from Lord Kelvin, which astonishingly was engraved on the University of Chicago’s Social Science Research building, which says, ‘If you cannot measure something, your knowledge is of a rather meagre kind.’ I think that is a terribly stupid remark. There is a great deal of human knowledge that is not of a measurable kind. If I look back on my career in economics, for most of it, I was too inclined to take that Kelvinish view.

I recently wrote about the amazing activity that involved building the embankments in London, which was done in the 1860s.⁴ The embankments have London’s main sewers in them and the Tube lines, and so on. The scale of the project and the vision of the people who built them are extraordinary. What I wrote in the article was that now we would evaluate that project with a huge model in which we estimated how much time people would save by not having to have their sedan chairs carried through congested Fleet Street, and so on. We would come up with a spreadsheet full of thousands of numbers of this kind. And it would all be rubbish, because it would miss the essential point that if you felt sick every time you went out of doors – which, in the late 1850s, people did in London – London could never have become a great business and commercial centre. We would have made the same mistake about medicine, actually, because people believed quite wrongly that the smell gave people diseases. Bad sewerage gave people diseases alright, but that was not the way it worked.

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The humanities and social sciences remind us that our lives are not all about crude economics.

John Kay

Yes. The good life is what it is worth having an economy for!

⁴ John Kay, ‘London’s rise from sewer to spectacle’, *Financial Times* (16 January 2013) www.johnkay.com/2013/01/16/london%E2%80%99s-rise-from-sewer-to-spectacle