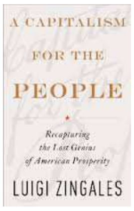

Zingales L. A Capitalism for the People

The American capitalism is so special because of the mobility at the top of income distribution. The wealthiest self-made billionaires have made their fortune in competitive business. In Europe wealth tends to be seen as a privilege, not a reward for effort. In U.S. government involvement in economy was weak. Powerful government confound politics and economics. American capitalism was untouched by foreign influence and by the need to protect domestic companies that encourage collusion and corruption. North America attracted people in search for freedom. In the fight for independence the power was arising from people; federal nature of government limited his size and promoted competition among states. The outcome was a system of capitalism that comes closer to the free-market ideal of economic liberty and open competition.

The American Revolution was a revolt against aristocracy. But unlike French Revolution, emphasized freedom of pursue happiness, not equality, equality of opportunities instead of equality of outcomes, in the belief in assigning rewards and responsibilities according to merit. Americans want the government to provide a level playing field. Meritocracy in capitalism needs to confer sizable benefit and reward effort through clear competition.

Capitalism brings inequality with it. As long as it is not excessive, is seen as part of a system that benefits everyone. Competition limits large income inequality and press toward efficiency an meritocracy. A system like this is considered fair. If there is excessive economic power (monopoly) customer seek protection through political process (antitrust), but when a business obtain both market and political power, escape became impossible; the system resembles a social economy: deprive consumer of innovation and of less costs. Firms are small command-and-control economies. When they acquire market power, they lobby for rent seeking and resemble small socialist economies. The smaller they are the more the system conforms to Adam Smith's ideal.

Finance is an essential ingredient in injecting competition into a economic system. Talented people can compete with anyone. Recently, rising political hegemony, finance has been more like sand in its gears. Deregulation increased efficiency but it brought concentration. In 1999 the Gramm-Leach-Bliley Act removed Glass-Steagall Act's separation between commercial and investment banks. The interest of the major players aligned giving them disproportionate lobbying power. Bankruptcy Law shifted in favor of creditors; the "too big to fail" doctrine had perverse influence on the bank's willingness to take risks (sharing the upside and not the downside consequences); moral hazard problem caused bank bailout and hampered small banks' ability to compete. Some financial institutions have grown beyond the point where they can efficiently monitor themselves against frauds ("too big to manage").

Crony capitalism has corrupted American society: a subsidy-driven market selects non the firms most efficient in production but the most efficient in sucking up public resources. The reward for lobbying is growing. Industrial policy rises spending and encourages private sector to ask favors; regulation increases the profits of incumbents; private-public partnership avoids transparency and create moral hazard, avoiding individual the consequences of their mistakes. Bail-out is a kind of drug and financial system grew addicted to. bail-out distorted incentives and undermined Americans' faith in the financial system and in the government.

Regulators become biased in favor of the industries they regulated. They are captured, interested in the success of the industry. The same is true for all the experts and for the economists too. They search consensus in their groupthink, in the incumbents and avoid public mistrust.

The term "populism" is often used pejoratively. But when big business's interests influence the political process and render the government corrupt, oppressive and unrepresentative of the people, populism can be positive (Occupy Wall Street, Los indignados). Today in the United States there is the possibility of a fully pro-market populism, the best way to protect the interests of ordinary American people.

Some inequality gives the right incentives that assure the benefits of the free market are widely shared and maintain efficiency and fairness of the system. New technologies increase the fixed costs of production and lower near zero the marginal ones. In this situation whoever produces the best application will conquer the whole market, the winner take-all. In companies with diffuse ownership it is easy for the CEO to capture the large part of compensation beyond the productivity. The economy of superstars change incentives and is self-propelling: distortions tend to compound over time; the hope diminish; discourage to improve the knowledge and to invest in human capital. The major cost Is political: the winner is not necessarily the best, the resulting equilibrium is dangerous because the incumbent large firms are the most powerful but not necessarily the most efficient. There is a strong incentive to manipulate the political power to preserve the market power through political means. The response cannot be protectionism or to stop technological change. The solution is to enhance the competition and meritocracy in education, through a voucher system.

Government subsidies have unintended consequences; supply does not respond much to its price, there is a small effect on the quantity and a big effect on its price (ex. education, health care). All this translate in high profits. Remove the subsidies and regulation and the benefits of competition will flow.

Trust is fundamental for transactions. Not only personal trust, but generalized trust in a group, somebody you don't know and don't necessarily expect to run into again. This is rooted in the history and is an example of civic capital, values and beliefs that foster cooperation. It is hard to build up and easy to depreciate. The idea that people act in their own self-interest is a useful methodological assumption, but doesn't mean that they should pursue their own interest. This is non empirically true. There are sustainable social norms that can nudge people to act in a way that benefits society when narrow self-interest fail to deliver a desirable outcome.

Even ruthless competition can be balanced if the resources invested are relatively balanced. That truth applies to lobbying too. Lobbying is tilted against dispersed taxpayers and create a wedge between social incentives and individual incentives. Regulatory process can be captured by vested interests. Social norms are generated from bottom up, emerge from a population's social awareness and the mechanism of enforcement id decentralized and makes it less subject to capture.

If regulation is too complex, people have no way to understand it and cannot participate properly in democracy. Simplify regulation reduce its costs and make it more transparent making it easier for the public to monitor it reducing the amount of capture. Enforcement is easier: whistleblower-based system is resistant to capture.

Redistribution of wealth through taxation reduces incentive to work, to invest, to excel. The role of fiscal policy in a pro-market agenda isn't to raise revenue but to correct distorted economic incentives (Pigou tax) factoring the social costs into decision making (ex. pollution). It can be used to penalize excessive lobbying.

The functional approach to financial regulation (regulator oversee entities according to the kind of functions they perform) maximizes the risk of capture, doesn't eliminate the trade-off among different objectives, overlap responsibilities. We need to rethink regulatory architecture along clear lines of responsibilities by measurable goals: price stability, investors protection and systemic stability. The main challenge of such a design would be communicating crucial information. Separating investment and commercial banking is essential to develop liquid security markets; reform corporate governance empowering institutional investors and making corporate governance more accountable; introducing disclosure standard into the private markets. The solution of the "too big to fail" problem is to protect the systematically relevant obligations (not all the transactions are relevant) by two layers of capital: the junior long term debt could be paid back only after systematically relevant obligations had been repaid. The regulatory intervention should be closely linked whether an institution's long-term debt is at risk. The price of this debt is the better place to took at, reducing regulator's discretion.

The genius of free-enterprise system is competition, the famous invisible hand that align individual incentives with social ones. It's assumed the existence of well-functioning institutions: markets are human constructs that depend on a functional legal framework. Government intervention in the economy should be so limited that voters can understand it, monitor it, oppose to it (Government by the people). We need data, subjected to rigorous crosschecking by people to make more difficult to support unfounded arguments. There are plenty of data that can shed light on mistakes, inefficiencies, corruption and unethical behavior. They are useless if researchers fail to analyze them thoroughly. We need investigative journalism, competitive newspaper, educated voters and academic muckrakers in a competitive academic market.

When there is no competition and few exercise total power, we have socialism. Few big companies will prefer to collude against the public. There is an intellectual confusion between pro-market system and a pro-business one, who encourage crony capitalism. We need competition, reducing government intervention in the economy, simple regulation and scrutiny of voters on simple issues.