NEW FINANCIAL
Rethinking capital markets

THE CRISIS OF CAPITALISM - APPENDIX

Some further reading on why so many people around the world are so angry with capitalism, big business, politicians and the elite and what can we do about it.

December 2019

Part 4 – Further reading: a selection of books and articles on the crisis of capitalism

This section includes some short summaries of interesting books and articles on and around the subject of the the crisis of capitalism for highly motivated readers. You can click on the title of the book to read a review or on the headline of the article to read the original. For book or article we have summarised the salient points that articulate the problem and some of the suggested solutions.

i) Some books on the crisis of capitalism:

- *The great reversal: how America gave up on free markets - Thomas Philippon)*
- *The value of everything (Mariana Mazzuchato)*
- *The future of capitalism (Sir Paul Collier)*
- *Prosperity: better business makes the greater good (Colin Mayer)*
- *Saving capitalism from the capitalists (Luigi Zingales and Raghuram Rajan)*
- *The finance curse: how global finance is making us all poorer (Nicholas Shaxson)*
- *A capitalism for the people (Luigi Zingales)*
- *WTF (Robert Peston)*
- *Reinventing capitalism in the age of big data (Viktor Mayer-Schonberger and Thomas Ramge)*
- *The myth of capitalism: monopolies and the death of competition (Jonathan Tepper)*

The great reversal: how America gave up on free markets (2019) by Thomas Philippon

The problem:

- Many sectors of the US economy at a national and regional have become more concentrated over the past few decades.
- A wave of deregulation that spurred competition in the 1980s and 1990s has given way to a wave of consolidation.
- Many sectors are now dominated by a handful of large firms with the resources to lobby politicians to protect their profit margins. This creates a vicious circle by further raising the barriers to entry.
- This raises prices artificially and reduces investment, innovation, productivity, growth and wages.
- The flow of new entrants in many sectors of the economy has fallen sharply, along with the numbers of listed companies and the number of IPOs. Today's monopolies are yesterday's start-ups.
- Europe has often been dismissed by US as uncompetitive but is now beating the US at its own game with tougher national and regional competition policy.

Some solutions:
Philippon outlines three broad principles to boost competition in the US economy:

- Free entry, always and everywhere: firms have the right to try to beat their competitors, even to try to drive them out of business. Regulators have a duty to ensure they do not impede free markets. Be equally tough on everyone, even the firms we like.
- Governments should make some mistakes too: while we tolerate mistakes and misbehaviour by many companies across the economy, we think it's unacceptable for regulators to make mistakes. New problems require new solutions and regulators will need to take risks, engage in trial and error and make some mistakes.
- Protect transparency, privacy and data ownership: US regulators must take a global lead in increasing transparency of fees, costs and charges. You need to know what you are paying and why you are paying it – and if you do not pay, you need to know which part of your is being sold.

The Value of Everything (2017) by Mariana Mazzucato

The problem:

- The concept of 'value' has shifted from something derived from the cost of production to something defined by its market price. If price defines value, then the concept of value can be easily used and abused. 'Value creation' is increasingly confused with 'value extraction'.
- Mazzucato analyses this shift and its impact in three main areas of the economy: finance, innovation and government.
- Finance has shifted from a sector designed to mobilise resources to support the wider economy to a huge profit centre in its own right. Market participants get rich by capturing and extracting value from other sectors through several ways, such as interest differentials and expensive transaction costs, rather than by creating underlying value.
- Innovation is vital for the economy but can also be captured and distorted: for example, the patent system aims to provide short-term protection, but longer periods of protection and extended coverage of products can prevent innovation.
- Governments are often criticised as productive and for getting in the way of value creation. However, many of the technologies that dominate our daily lives were conceived and developed by the public sector. Far from apologising, governments should play a more active role in value creation.

Some solutions:

- A stronger and more visible commitment to alternative energy can help kickstart investment.
- Bigger tax breaks for R&D.
- Creation of a "mission-oriented" state investment bank and a virtuous circle can be created.
- Active tracking and publicising the value created by government.

The future of capitalism: facing the new anxieties (2018) by Sir Paul Collier

The problem:

- The divide between the well-educated and the less educated has coincided with the geographical divide between big cities and declining provinces.
- Globalisation has benefited the well-educated city-dwellers while devastating industrial cities and towns.
- The western elite have been far too arrogant and incompetent.
- Employers have become much more short-term in their outlook.

Some solutions:

- Collier regularly returns to the central principle of 'reciprocal obligation' as the basis for a co-operative world, civilised society, ethical business and functioning families.
- Building on the ideas of political economist Henry George who argued that the foundation of public revenue should be the taxation of rent on land, Collier argues there is now a need to tax more forms of rent.
- Introduce a crime of 'bankslaughter' for managers who let their banks collapse.
- Proposes taxing educated metropolitan professionals more steeply than their provincial counterparts, justified on the view that former earn more simply by living around others like them.

Prosperity: better business makes the greater good (2018) by Colin Mayer

The problem:

- The singular pursuit of profit has caused great damage to other aspects of society.
- Global tax arbitrage is eroding faith in business.
- The shift toward a dispersed ownership and self-interested listed corporate model has become a dangerous monoculture in modern capitalism, overshadowing other models such as employee ownership, mutual and family companies.
- The millennial generation have higher expectations of chief executive activism than their predecessors.

Some solutions:

- Systems that allow "block" shareholders such as families or trusts anchor long term ambitions.
- Companies such as Tata, Bosch and Carlsberg are overseen in such a way that stable ownership, board. accountability and social purpose are guaranteed.
- Corporations should want to enhance human, social, natural and intellectual capital.
- Corporate ownership should be in the hands of investors with a real interest in long-term sustainability and in corporate governance that holds business leaders accountable.

Saving capitalism from the capitalists (2003) by **Raghuram Rajan and Luigi Zingales**

The problem:

- Behaviour exposed by corporate scandals like Enron solidifies the public conviction that financial markets are simply tools for the rich to get richer at the expense of the general public.
- A big threat to financial markets is from incumbents who already have an established position in the marketplace and would prefer to see it remain exclusive. For example: the 9/11 terrorist attacks affected the whole tourism industry, but the first legislation was not relief for the hundreds of thousands of taxi drivers, hotel workers or restaurant workers but for the airlines which conducted an organised lobbying effort for taxpayer subsidies.
- Technology: the pace of change is affecting the professions such as accountancy and teaching that have been mostly immune for centuries. This will generate huge anxieties and displacements.
- Globalisation: emerging economies such as China and India are finally on the move meaning that never before have so many people become wealthier at such a pace. This will mean stiffer competition for jobs that these countries can do more cheaply and more efficiently.
- Demographics: through decreasing birth-rates and increasing life expectancy the population of developed countries is aging rapidly. This is borne out most acutely in Japan and Italy. The size of transfers each worker has to make to give the elderly their promised retirement benefits will keep increasing. The mismatch between political power and economic power historically threatens property rights.

Some solutions:

- Tougher antitrust law to prevent monopolies and excessive market power.
- Property tax: the current system of income taxation hits the highest producers the hardest, rewards inefficient managers and penalises efficient managers. Property-based tax systems tend to penalise the inefficient and reward the efficient.
- Corporate governance: more legal protection should be guaranteed to facilitate a healthy separation between ownership and control. Appropriate mechanisms such as independent boards, effective auditors and a vibrant market for corporate takeovers are also important.
- Inheritance tax on transfer of control: inefficient and concentrated wealth imposes all manner of social costs. An inheritance tax structured so that the rich are encouraged to transfer passive ownership of productive assets rather than active control to their children would make sense.
- Insure people: often the demand from a group of people who are hit particularly hard by creative destruction gets transformed into a subsidy to existing firms. It is better to insure people directly, not through firms. Offering a lump sum payment to workers who lose their job does not interfere with the competitive process but gives workers the right incentive to find new work as they get to keep the payment regardless of how long it takes them to find a new job while relieving them of the cost of unemployment.

The finance curse: how global finance is making us all poorer (2018) by **Nicholas Shaxson**

The problem:

- Too many banks and businesses and too many professionals have moved away from creating wealth for the economy towards extracting wealth from the economy. That's good for them but bad for their workers and for consumers and taxpayers.
- With the help of various lawyers and accountants as well as government, individual company leaders have structured their businesses to increase their share of economic spoils in the good times while offloading risk and costs onto staff, customers and the public during the bad, for example, the 2008 financial crisis and Carillion.
- The growth of the City of London has impoverished the country by sucking up talent that would have otherwise gone elsewhere.
- "Britain owes its pre-eminence as a financial centre to the combination of a strong legal system, which stops people stealing your money, with a weak regulatory one, which allows you to steal other people's".

Some solutions:

- Establish new pressure groups to curb tax havens.
- Control dirty money flowing into Britain.
- Reform the cosy cartel of the big four accountancy firms.

A capitalism for the people: recapturing the lost genius of American prosperity (2012) by **Luigi Zingales**

The problem:

- The idea of a meritocratic economy where increasing wealth benefits all has been eroded.
- Government is too often 'pro-business' rather than 'pro-market' meaning that individual institutions are given advantages at the expense of the institutional corporate framework .

Some solutions:

- Protected sectors such as education and healthcare should be opened up to competition.
- Tax policy should be updated. It should make the subsidies and their costs more transparent: the deduction on mortgages should be termed a rent tax, benefits for ethanol production should be regarded as a petrol tax. Tax should also be used as a substitute for complicated regulation and applied against social costs such as pollution and the use of short-term debt by banks.
- A more explicit bond between capitalism and morality through public shaming of corporate crooks.
- Better collaboration between government and business schools, who are ideally placed to analyse the costs and benefits.

WTF? (2017) by **Robert Peston**

The problem:

- The UK's much-vaunted labour flexibility is more of a weakness than a strength since it has squeezed pay for employees and legitimised large profits "and sky-rocketing executive rewards".
- Financial liberalisation poured money into the south-east but neglected the rest of the country.
- Government never had enough money to help industrial companies when they were in trouble, but still found billions to bail out the banking industry.
- High immigration allowed the rich to hire cheaper labour while avoiding the competition through private healthcare and private education but increasing labour and public service competition for the rest.
- A disproportionate share of Britain's wealth goes into feeding the housing industry rather into starting businesses.
- A third of British firms have seen no growth in productivity since 2000.

Some solutions:

- Establishing regional banks that can adapt their interest rates for local circumstances.
- Reducing the power of the Treasury.
- A wealth tax: an annual levy of 1% on all net assets greater than £500,000.
- Online collectivism: digital trade union platforms and the creation of a new ombudsman to regulate the labour market along the lines of the financial services' Financial Conduct Authority.
- Universal basic income as inevitable: reinvention of the welfare state would see the government pay every single citizen irrespective of their wealth or employment status a regular cash sum calculated to cover all their basic needs.

Reinventing capitalism in the age of big data (2018) by Viktor Mayer-Schönberger and Thomas Ramge

The problem:

- The modern economy is best described as data-rich with the potential to put people out of work and to concentrate corporate power among a small number of firms.
- Early winners in the market can use their strength to beat back competition and ultimately harm the public interest.
- What happened with the railroad trusts, Standard Oil and AT&T is beginning to happen with the big winners in today's data-rich, market-orientated economy. Amazon, Apple, Facebook and Google make huge amounts with relatively small workforces.
- These firms are adept at avoiding taxes. They continue to amass data about human behaviour that will them grow stronger.
- Much of the data being gathered by these large markets and providers is kept internally, which may result in the misappropriation of the information or fuel the planned economy that the authors see.

Some solutions:

- Robo taxes could potentially replace payroll tax.
- Mandated data sharing echoing the patent system to allow new entrants a fair chance to compete.
- European data laws to be adopted by the US so larger organisations can share data with others.

The Myth of Capitalism: monopolies and the death of competition (2018) by Jonathan Tepper with Denise Hearn

The problem:

- Most workers are simply asking that their basic needs be met, and for far too many in our economy they are not.
- Much of the stock market growth and the increase in corporate profits we've seen have come through industry consolidation and economic concentration, and an increasing lack of competition in American business.
- The evidence is overwhelming that higher economic concentration has created a toxic cocktail of higher prices, less economic dynamism, fewer startups, lower productivity, lower wages, greater economic inequality, and damage to smaller communities.
- Worker productivity has been steadily rising for decades, while wages remain stagnant. Meanwhile, chief executive pay has skyrocketed.
- In many industries, like big tech, the business model of startups is no longer to compete with existing industry leader, but to be bought out by them.

Some solutions:

- Much tougher antitrust enforcement is necessary to bring more competition to modern capitalist economies.

ii) Some articles on the crisis of capitalism:

- *Jamie Dimon's annual letter to shareholders (JP Morgan Chase)*
- *Why and how capitalism needs to be reformed (Ray Dalio, founder of Bridgewater Associates)*
- *Ten guidelines for inclusive capitalism (Nigel Wilson, chief executive of Legal & General)*
- *Populism will change corporate purpose for good (Fidelity)*
- *Ctrl + Alt + Del. Conservatives must reboot capitalism (Ruth Davidson)*

Jamie Dimon's annual letter to shareholders
Jamie Dimon, chief executive, JP Morgan Chase - 2018 Annual Report

The problem:

- Middle class incomes have been stagnant for years. Income inequality has gotten worse. Forty percent of American workers earn less than $15 an hour, and about 5% of full-time American workers earn the minimum wage or less, which is certainly not a living wage.
- Financial insecurity: 40% of Americans don't have $400 to deal with unexpected expenses, such as medical bills or car repairs. More than 28 million Americans don't have medical insurance at all. And, surprisingly, 25% of those eligible for various types of federal assistance programs don't get any help. The social needs of far too many of citizens are not being met.
- Failing education system: many schools and colleges do not properly prepare today's younger generation for available professional-level jobs, many of which pay a multiple of the minimum wage. In some inner-city schools, fewer than 60% of students graduate.
- Excessive regulation has reduced growth and business formation without making the economic system safer or better. The ease of starting a business in the US has worsened, and both small business formation and employment growth have dropped to the lowest rates in 30 years. By some estimates, approximately $2 trillion is spent on federal regulations annually, which is about $15,000 per household.

Some solutions:

- Mortgage reform: reducing onerous and unnecessary origination and servicing requirements (there are 3,000 federal and state requirements today) and opening up the securitization markets for safe loans would dramatically improve the cost and availability of mortgages to consumers - particularly the young, self-employed and those with prior defaults. In the early 2000s, bad mortgage laws helped create the Great Recession of 2008. Today, bad mortgage rules are hindering the healthy growth of the US economy
- Data laws: new laws in Europe stipulate that consumers should be able to see what data companies have on file about them and to correct or delete this information if they choose. It is imperative that the US government thoughtfully designs policies to protect its consumers and that these policies be national versus state-specific.
- Infrastructure investment: the US is falling behind on airports, bridges, water, highways, aviation and more. One study examined the effect of poor infrastructure on efficiency and concluded this could all be costing us more than $200bn a year. Philip K Howard, who does some of the best academic work on America's infrastructure, estimates it would cost $4 trillion to fix our aging infrastructure. A recent study by Business Roundtable found that every dollar spent restoring our infrastructure system to good repair and expanding its capacity would produce nearly four dollars in economic benefits.
- Education: with seven million job openings and six million unemployed workers in the US, high schools and community colleges should work with local businesses to create specific skills training programs, internships and apprenticeships that prepare graduating students to be job-ready. Business must be involved in this process, and on a local level where the actual jobs are. Germany has one of the strongest education and training systems - about 1.5 million young people annually participate in apprenticeship programs - and has one of the lowest youth unemployment rates in the world. Proper training and retraining would also help in our rapidly changing technological world.

- A Marshall Plan for America: throwing money at problems does not always work but if we can demonstrate that we are spending money wisely, we should spend more - think infrastructure and education funding. That may very well mean taxing the wealthy more. The wealthy should remember that if we improve our society and our economy, then they, in effect, are among the main winners.
- Some countries are now implementing mandatory preschool for children at three years of age. This is a wonderful policy. It makes childcare less expensive and has proved to be extraordinarily good for student education short and long term. Parents like it too.

How and why capitalism needs to be reformed
Ray Dalio, founder of Bridgewater Associates - April 2019

The problem:
- There has been little or no real income growth for most people for decades. Prime-age workers in the bottom 60% have had no real income growth since 1980, while incomes for the top 10% have doubled and those of the top 1% have tripled.
- Generational expectations: the percentage of children who grow up to earn more than their parents has fallen from 90% in 1970 to 50% today. That's for the population as a whole. For most of those in the lower 60%, the prospects are worse. The economic mobility rate in the US is now one of the worst in the developed world.
- Inequality: the income gap is about as high as ever and the wealth gap is the highest since the late 1930s. Today, the wealth of the top 1% of the population is more than that of the bottom 90% of the population combined, which is the same sort of wealth gap that existed from 1935 to1940.
- Financial insecurity: most people in the bottom 60% are poor - and they are increasingly stuck being poor. Only about a third of the bottom 60% save any of their income in cash or financial assets. A recent Federal Reserve study found that 40% of all Americans would struggle to raise $400 in the event of an emergency.
- Child poverty: the childhood poverty rate in the US is now 17.5% and has not meaningfully improved for decades. In the US in 2017, around 17% of children lived in food-insecure homes where at least one family member was unable to acquire adequate food due to insufficient money or other resources. Unicef reports that the US is worse than average in the percentage of children living in a food-insecure household (worse than Poland, Greece, and Chile).
- Globalisation: the pursuit of greater profits and greater company efficiencies has led companies to produce in other countries and to replace American workers with cost-effective foreign workers. This is good for companies' profits and efficiencies but bad for American workers' incomes.

Some solutions:
- Accountability culture: clear metrics that can be used to judge success and hold those in charge accountable for achieving it. These would produce the accountability and feedback loops that are required to achieve success. To the extent possible, I'd bring that sort of accountability down to the individual level to encourage an accountability culture in which individuals are aware of whether they are net contributors or net detractors to society.
- Taxing harmful practices: raise money in ways that both improve conditions and improve the economy's productivity by taking into consideration the all-in costs for society, ie. pollution tax.
- Taxing the rich: raise more from the top via taxes that would be engineered to not have disruptive effects on productivity and that would be earmarked to help those in the middle and the bottom primarily in ways that also improve the economy's overall level of productivity.
- Coordination of monetary and fiscal policies: money is clogged at the top and the capacity of central banks to ease enough to reverse the next economic downturn is limited. Fiscal policy will have to be more coordinated with monetary policy while maintaining central bank independence to stimulate growth and reduce the effects quantitative easing has had on the wealth gap.
- Childhood education programs that lead to better school performance, higher future earnings and lower odds of committing crimes.
- Infrastructure investment: smart infrastructure programmes have a 10% to 20% rate of return in terms of increased economic activity.
- Public health and preventative healthcare interventions such as vaccines, home blood pressure monitoring, smoking cessation create $14 of benefit for every $1 of cost.

Ten guidelines for inclusive capitalism

Nigel Wilson, chief executive of Legal & General - March 2019

The problem:

- Only 33% of UK millennials enjoy the benefits of home ownership. However, 60% of UK baby boomers were home-owners at the same age.
- Studies have shown that younger generations lack sufficient assets and access to capital to get a start in life.
- The short-term focus on quarterly earnings announcements and giving share buybacks comes at the expense of R&D investment and other patient capital investments.
- A cycle of combined educational, financial and digital exclusion is creating social and economic problems.

Some solutions:

- Companies investing in affordable housing, small business finance or start-ups to help younger generations get a foot onto the economic ladder.
- Companies investing heavily and tangibly in making 'second-tier' cities better and more technologically appealing places to live.
- Companies investing to make the wider healthcare system more efficient and effective, including partnering with organisations and individuals regionally and locally to tackle issues such as obesity.
- Companies financing local or regional growth by partnering with leaders of all political shades, even those sceptical of capitalism. Local or regional prosperity is a powerful socio-political unifier, especially in areas that have long been economically downtrodden.
- Leading on financial inclusion: companies practicing inclusive capitalism might employ technology to expand the use of auto-enrolment to get employees to save for a rainy day. A quarter of the world doesn't have a bank account, meaning financial exclusion is a very real problem. So far, technology seems to offer one of the best solutions.
- Companies leading by example as socially and environmentally conscious businesses - not only how they invest but also keeping tracking of their own behaviour, on issues such as diversity, governance and remuneration.

Populism will change corporate purpose for good

Fidelity - January 2019

The problem:

- The singular pursuit of profitability could be criticised from the writings of seminal 'free-market' thinkers such as Adam Smith.
- A number of social contracts have been broken. Increases in executive remuneration without much justification, aggressive tax avoidance schemes and corporate greed have all driven a wedge between management and accountability.

Some solutions:

- Higher wages would go some way to address the populist agenda, reversing the growing share of excess value that has flown into shareholders' pockets at the expense of customers and employees.
- Leading UK economics professor John Kay has made the argument that a company is a social and not just a financial organisation, and by necessity a cooperative venture. Its social legitimacy must be earned and cannot just be asserted.
- Corporate behaviour is starting to change as companies recognise trends that will strengthen the pressure on them to report and act more sustainably, with a bigger focus on human, social and environmental capital.
- South African lawyer and academic Mervyn King has developed a framework of corporate reporting that takes all sources of capital into account - financial, manufactured, intellectual, human, social and natural. It is now mandatory in a few countries including South Africa and Brazil, and supported by regulators in China and India. In 2017, an EU directive urged 6,000 large listed companies to adopt it. Worldwide, about 1,600 companies are adopting integrated reporting. These include Tata, Unilever, Nestlé and Novo Nordisk, a trailblazer which made it part of its 'triple bottom line' balancing act of financial, social and environmental considerations as early as 2004.

- Streamlining reporting: it doesn't help that there are some 230 different corporate sustainability standards of which the Global Reporting Initiative is only one. But there is now a push to streamline them, which will renew the impetus for comprehensive reporting in the next decade. Large investors - including Norway's oil fund, for example - are increasingly looking for those hidden long-term risks with a view to reducing their exposure.

Conservatives must reboot capitalism
Ruth Davidson, former leader of the Scottish Conservative Party
Unherd - July 2017

The problem:

- In the UK, just 19% of people agree that "the next generation will probably be richer, safer and healthier than the last". That figure falls to 15% of Germans and 14% of Americans. Markets might work but they aren't seen to be working for everyone.
- We are living at the tail end of a transition which started roughly 35 years ago and has seen Britain gradually migrate from a manufacturing economy to a service-led one.
- Many technically-skilled men from declining or now uncompetitive industries are among the chief losers, and school leavers no longer have manual and routine occupations offering stable secure employment with career progression and pay. Whole communities have been hollowed out from the inside and lost their identities.
- Beyond London, many regions and regularly forgotten rural communities lack adequate physical and digital infrastructure.
- It is not inequality that bites deepest, but injustice. People expect the chief executive of a corporation to be the highest paid person on the payroll. What they don't accept is that FTSE 100 bosses are paid 174 times the average worker's wage in this decade, compared to 13 to 44 times in 1980.

Some solutions:

- Adam Smith advocated intervention, market restraints, decisions made at a macro-level by governments to ensure basic fairness for the little guy. It doesn't sound like the buccaneering, laissez-faire hero that is lionised by so many on the right.
- Longer-term initiatives like George Osborne's Northern Powerhouse and Greg Clark's devolution agreements for city regions.
- Clamping down on restrictive practices: too much profit comes from tax avoidance, land speculation, financialisation and other unproductive economic activity, rather than through innovation and high performance.
- Targeted investment: policy should also be realigned to reward firms that do the right thing - recognising investment in research and development, in workplace training, in productivity gains.
- Skills and education: policies such as a huge investment and expansion of technical education will do much more for long term wage growth.