Nostalgia for the land of opportunity

Book Review
A timely essay on the nature of American capitalism argues for more competition, not less, to prevent creeping cronyism, writes John Plender

Laugi Zingales, a noted economist at the University of Chicago’s Graduate School of Business, knows a thing or two about crony capitalism. The reason he emigrated to the US from his native Italy in 1988 was because he had had enough of living in a country where promotion was based on who you knew, not what you knew. Competition there was suppressed, corruption rife and chintelism rampant. Even emergency-room doctors in Italy were promoted on the basis of political affiliation instead of ability, he says, in a new book to be published shortly.

In the US he found a country that had built a system of capitalism that was the pre-eminent exemplar of the free-market ideal of economic liberty and open competition. He thrived on this meritocratic ethos. Yet now he is beginning to have his doubts, detecting hints in America of the kind of crony capitalism that afflicted Italy in the years of economic stagnation and corruption under Silvio Berlusconi.

A clear case in point is the extent to which the legislative process has become hostage to the lobbyists, while politicians increasingly depend on campaign finance on big business. The land of opportunity is thus turning into a land of rent seekers in which business has acquired excessive power and regulators have been captured by those they regulate.

A further problem is that extreme income inequality is breeding disaffection with capitalism. Boardroom pay has escalated while average earnings have stagnated. The economics of many modern industries work on a “winner takes all” principle, which diminishes hope and leads to the perception, expressed by the young people who camped in Zuccotti Park and elsewhere, that the rules no longer apply equally to everyone. The feeling that the system is rigged is exacerbated by a decline in upward mobility.

Zingales expresses an understandable nostalgia for the values of the American Revolution, which started as much as a protest against the corruption of the East India Company as a battle over taxation. And he produces a wonderful quote from Supreme Court justice Noah Swayne in 1875: “If any of the great corporations of the country were to hire adventurers who make market of themselves in this way, to procure the passage of a general law with a view to the promotion of their private interests, the moral sense of every right-minded man would instinctively denounce the employer and employed as steeped in corruption, and the employment as infamous.” Compare and contrast with the pygmies of today’s Supreme Court, who in 2010 made the landmark decision in Citizens United v Federal Election Commission that gave money unlimited power on the electoral process via super-Pacs. For some, this is fine because it is disclosed. Yet the fact of disclosure does not make the system of political finance any less corrupt.

A Capitalism for the People
Recapturing the Lost Genius of American Prosperity
By Luigi Zingales
Basic Books, $27.99

Zingales’s fundamental diagnosis is right. Lobbying has run riot, capitalism has become pro-business instead of pro-market and cronyism is a real threat. So what are the remedies?

For him, the genius of capitalism lies in competition. So he would like to build a populist political agenda that reflects support for free markets and distrust of government and big business. He wants more competition not just in the markets but in the boardroom, which suffers from too cozy a nomination process. The problem of regulatory capture, he thinks, could be overcome by simpler, more limited regulation, enforced by a whistleblower reward system. The best way to prevent lobbying, he argues, is to introduce a law eliminating subsidies to industry, supported by giving citizens a right to sue to recover the cost of subsidies paid unfairly. Everything that can be done with subsidies can be done better with taxes that modify incentives. The scope for a tax reform that scraps pork-barrel loopholes in exchange for lower headline rates is obvious.

Yet Zingales is no stereotypical Chicago ideologue. He believes that free markets do not work well without rules. And he has read Adam Smith’s The Theory of Moral Sentiments. He consequently places emphasis on the value of trust, of social norms and ethical behaviour in the economy and in markets. Among many recommendations, he proposes, in a scheme devised with Oliver Hart, an interesting form of modified bankruptcy in which the regulator relies on credit default swap prices to trigger action.

Not all the ideas are fully worked out. There is plenty here to disagree with as well as to admire. The political obstacles to many of Zingales’s nostrums are huge, requiring turkeys on Capitol Hill to vote for Christmas. Yet this remains a stimulating essay on the nature of American capitalism and the issues that will determine the pace of America’s relative decline.

The writer is an FT columnist