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“Capitalism: What Has Gone Wrong?”
Who Went Wrong? Capitalism? The Market Economy? Governments? “Neoliberal” Economics?[1]

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Abstract

The paper contributes to a symposium of the *Oxford Review of Economic Policy* on “Capitalism: What has Gone Wrong, What Needs to Change, and How can it be Fixed?”. The analysis starts from the observation that, in the United States, the United Kingdom and continental Europe, widespread discontent has become an important political force. I attribute this discontent to a sense on *unfairness* in developments of the past few decades. I relate this sense of unfairness to: (i) negative effects of structural change, including joblessness and regional decline, (ii) the observation of extraordinary growth in executive remuneration and financial-sector remuneration, coupled with government bailouts in the global financial crisis, and (iii) changes in public policy and public discourse, with a retrenchment of public services and public investment, except for bailouts and a focus on “efficiency”, the meaning of which is driven by the perceptions of corporate executives rather than standard welfare economics. To capture these developments, one needs to think about “capitalism” in the sense of French “capitalism” or German “Kapitalismus”, with a focus on the symbiosis of wealth and power, including the elimination of competition, rather than the English sense of merely another term for the market economy.

Key Words: Capitalism, structural change, executive remuneration, public-sector retrenchment, “efficiency”, symbiosis of economic and political power.

JEL: D30, D60, D70, F60, H10.

[1] I am grateful to Ken Mayhew, the discussant at the symposium, and to an anonymous referee for helpful comments.

1. Introduction

The question of this symposium presumes that something has gone wrong with capitalism. Do we know that the presumption is justified? But what is "capitalism"? In English, the word "capitalism" is mostly synonymous with the market economy. In French and German, the words "capitalism" and "Kapitalismus" refer to something more sinister, even among non-Marxists.

The eminent French historian Fernand Braudel (1979/1986) actually saw a conflict between "capitalism" and the market economy.[2] According to him, capitalism involves a striving for power, economic and political, and a suppression of competition, as well as wealth. His prototype for the combination of wealth and power in "capitalism" was the Dutch Vereenigde Oostindische Compagnie (VOC) of the 17th century, which used its wealth to equip a fleet, make war, conquer the Spice Islands, kill or enslave their population, and establish a highly profitable monopoly.[3]

Whereas Braudel focussed on the dynamics of wealth and power, Schumpeter (1942) emphasized processes of "creative destruction", in which newcomers repeatedly use innovations to take over markets from incumbents and monopolies do not last. While acknowledging that, once successful, innovators try to entrench their positions, he emphasizes that after a while the next generation of innovators will upset these positions again. "Capitalism" is presented as the major factor behind the unprecedented increases in living standards over the past two hundred or so years.[4]

Most accounts of "capitalism" in the continental European sense of the word focus on exploitation and class conflict.[5] Increases in living standards tend to be attributed to the heroism of the labour movement that allowed workers and poor people to share in the benefits.[6] The fact that these improvements occurred in countries with weak labour movements, such as the United States, as well as countries with strong labour movements, such as Sweden, is overlooked.[7]

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[2] Braudel (1979/1986, Vol. 2, Ch. 3) contains an extensive discussion of the different meanings of the terms "capital", "capitalists", "capitalism" in different countries and different times. See also Kocka (2013). Whereas Marx mainly referred to the "capitalist mode of production", the term "capitalism" became prominent with Sombart (1902).

[3] Importantly, the VOC also was a prototype of the modern corporation. On the legal innovation involved, see Dari-Matinacci et al. (2017); on the activities, see Braudel (1979/1986, Vol. 3, Ch. 3). Pistor (2019) discusses the role of the law in creating such institutions for maintaining and managing wealth and power.

[4] In a similar vein, see Mokyr (2002, 2009) on the first industrial revolution and Chandler (1990) on the second industrial revolution. For a modern analysis, see Aghion et al. (2021).

[5] This view goes back to the "social question" of the 19th century, with extraordinary misery in the early industrial cities, as described, e.g., in the 1845 classic *The Condition of the Working Classes in England*, by Friedrich Engels. There is an identification problem however in assessing whether this misery was due to capitalism or to population growth. Historical accounts of working-class living standards at the time stress the role of crowding and the lack of alternatives in the countryside.

[6] This has been my experience in public debate about the subject.

[7] Historical accounts suggest that real wage rates and employment in England began to rise significantly after 1845, the very year of Engels's book; see, e.g., Hobsbawm (1975), Mathias (1983).

The Schumpeterian vision is as relevant today as in the nineteenth and twentieth centuries. Over the past three decades, new developments have radically transformed our lives, most visibly through changes in information and communication technologies. Books, films, music, information – all have become available much more widely, at greater ease, and much more cheaply. The iPhone and iPad have eliminated the dependence of internet access on fixed locations and allowed the addition of many useful services. Video conferences have replaced in-person meetings and reduced the need for travel, which was very useful during the pandemic.[8]

Nor is the change abating. Developments in the area of artificial intelligence promise (or threaten?) further profound changes in our lives. Self-driving cars may make a great difference to how we move around. The mRNA technology for vaccines is already being compared to the antibiotics revolution of the 1940s and 1950s; in 2020, the speed of development of vaccines against Covid-19 was breathtaking.[9]

2. Discontent and Its Causes

Despite the ongoing successes of capitalist development, we see a lot of discontent in continental Europe, the United Kingdom, and the United States. Underlying this discontent is a sense of *unfairness*. This has several dimensions. One dimension concerns people's personal experiences of losses – of jobs, incomes, and opportunities – caused by adverse developments outside of their control. Another dimension concerns the observation that, for some other people, the past few decades have provided extraordinary opportunities for personal enrichment. A third dimension concerns the perception that political processes have been distorted so that the concerns of ordinary people have been shoved aside.

Deindustrialization has played a major role. Changes in technology and changes in international environments ("globalization") have shifted comparative advantages of countries, regions and industries. Academic economists are accustomed to the idea that such changes can provide improvements for all, but this idea presumes that people who become worse off receive some compensation, and, in the real world, this does not happen. Moreover because some of the affected industries have been geographically concentrated, these developments have put entire regions into distress, in

[8] All these examples refer to private benefits. I do not address the issue of overexploitation of the environment, in particular of fossil fuels, with catastrophic effects on climate. Given the externalities and public-good aspects involved, any notion that this issue can be handled by "capitalism" on its own would be illusory. It requires government intervention of some sort or other.
[9] Mazzucato (2013) has emphasized the importance of government funding for many of the developments listed. This is certainly true at the initial stages. However, once developments are on the entrepreneurial agenda, private funding tends to dwarf government funding. This is true even for the mRNA technology for the Covid-19 vaccines.

the rust belt of the United States, as well as the old industrial regions of Northern England and Wales, Northern France, or the Ruhr and Saar areas of Germany.[10] The losses involve not only income but also status, as many laid-off workers were unable to find work again and were deprived of the sense of making a productive contribution.[11]

In the United States, the United Kingdom, and France, voters in the affected regions have been particularly susceptible to populist nationalist rhetoric, voting for Trump, for Brexit, and for LePen. In Germany, fiscal federalism dampened the impact of industrial decline on regional economies, so voters in the Ruhr and Saar areas have not followed this route; in the former GDR though, where deindustrialization has been even more radical, voters have been susceptible to radical rhetoric. The policies that such votes enable may actually go against the voters' own interests, but often spite is more important.[12]

Dramatic increases in executive remuneration since around 1990 have contributed to the sense of unfairness and to spite. People cannot believe that any executive is "productive" enough to justify millions of dollars, pounds or euros per year; they see such remuneration as a reflection of power rather than achievement.[13] The increases in corporate profits and stock prices that have been invoked to justify the large increases in executive remuneration are widely perceived as the flipside of downsizing and outsourcing at the expense of employees and local communities. Perhaps they are also the flipside of the weakening of labour institutions – and the stagnation of real wages – that were enabled by the mere threat of moving activities elsewhere.

The financial crisis of 2007-09 has further darkened the picture. Even before 2008, the displacement of goods production by "financial transactions … as the source of private fortunes" had widely been regarded as a symptom of distortions.[14] Reckless behavior, infringements of supervisory and legal rules, fraud, and even embezzlement, from the 1994 mini-crisis to the Enron and Madoff scandals, did not help.[15] The picture was completed in the financial crisis when government money was used to bail out the banks, but despite the many reports of recklessness and fraud, hardly any banker was prosecuted, but homeowners who had been misled by aggressive lenders received no

[10] These are only the most prominent examples. In the case of Germany or Italy, one might also mention the Palatinate or the Veneto, where leather-based industries have been hard hit by international competition.
[11] On the importance of the distinction, see Sandel (2020) and Goodhart (2020).
[12] See, e.g. Davies (2016), Éribon (2009).
[13] For an elaboration of this theme, see Bebchuk and Fried (2004). The point here is not that they are right, but that their perception is shared by many and contributes to public discontent.
[14] Judt (2010), p. 11. In his chapter on money, Craig (1982) gives historical evidence for the difference in popular attitudes to wealth from activities in production and in finance. He also draws a link between negative attitudes to finance and antisemitism.
[15] Partnoy (2009).

relief.[16] The experience made a mockery of any argument about incentives and efficiency justifying the increases in managerial remuneration.[17]

The developments that I have sketched have caused significant increases in inequality of income and wealth in developed economies. At the same time, intergenerational social mobility went down.[18] People do not observe Gini coefficients, nor do they care about them. They care about what happens to people, themselves and their neighbours. They see adverse labour market experiences as well as the lack of affordable medical care from which Case and Deaton (2020) draw a straight line to declines in life-expectancy, with "deaths of despair" playing a key role. They also see reports about the super-rich and draw a line from the effects of downsizing in their neighbourhoods to the incomes that translate into such wealth.

3. Analysis

The developments sketched in the preceding section, regional deindustrialization, expansion of executive pay, expansion of pay and recklessness in the financial sector have one theme in common: In OECD countries, benefits mostly accrued to people who were very well off, costs were borne by people who were not so well off, or by the public at large. Is this correlation enough to assert that they are actually related?

The **developments in real economies**, including regional deindustrialization and the weakening of labour institutions, may be attributed to changes in market conditions. Some of these changes were caused by technical change, some by international developments ("globalization"), and some by austerity policies. Skill biases in technical change worked against manual labour. Changes in communication technologies facilitated the outsourcing of supplies to other countries, exposing domestic labour to foreign competition. First, the rise of the "Asian tigers", then the disappearance of the Iron Curtain and the admission of former Comecon countries into the EU and, finally, the admission of China into the WTO and subsequent massive expansion of Chinese exports all played a role.[19]

To some extent, these are the normal operations of a market economy. As circumstances change, so do the opportunities that people have for earning money. One of the scandals of the market economy is that one can never be sure of the income one

[16] See, for example, Admati and Hellwig (2013), Financial Crisis Inquiry Commission (2011), Eisinger (2017), Tooze (2018).
[17] Tooze (2018) describes the same effects for the "euro crisis". He sees the different crises as parts of a single story, with the same hybris and the same asymmetries in official reactions, with no serious consequences for people in banks and governments that had contributed to the crisis and the austerity policies causing significant hardship for people at large, through deindustrialization, erosion of public services, and poverty.
[18] See Scheidel (2017), Judt (2010).
[19] See for example Marin (2006), Marin and Verdier (2008).

will be able to earn a few years hence. And “creative destruction” à la Schumpeter always involves people who suffer from the destruction. Even if income losses are compensated, people may miss the sense of doing something useful.[20]

If developments had been more gradual, perhaps the adjustments would have taken place without too much trouble, as had happened in the past.[21] But the scale and the speed of market adjustments in the past two decades caught many by surprise and left little time for smooth adjustments.

Is there a relation between these developments in real economies and the **explosion of executive pay**? One puzzle of recent history is to explain the changes in corporate rhetoric and in executive compensation that occurred in the 1990s. As of 1985, it was politically incorrect to use the term “shareholder value” in corporate boardrooms.[22] By 1995, shareholder value had become an accepted norm. According to Jensen and Murphy (1990), profit- and stock-price related components of executive remuneration in the United States were surprisingly small. By 1995, bonuses and stock options had become very prominent; their expansion provided the means for increasing executive pay. In Europe, the change came a bit later, in the late 1990s.[23]

Why did this change occur? And why did it occur at this time? In addressing these questions, it is instructive to go back to the takeover wave of the 1980s. In this period, maverick raiders tried to use stock markets to acquire control of corporations that they deemed to be wasting resources. Even where the raiders failed, they often induced significant changes in corporate policies, which benefited shareholders.

This wave ended with the interest rate hike of 1989. Subsequently, incumbents installed effective anti-takeover defenses, such as poison pill provisions in corporate charters, with substantial help from legal and political institutions.[24] One might have expected successful entrenchment to eliminate the need to preempt outside raids by

[20] The unpopularity of the German Hartz Reforms of 2004/5 was not just a matter of money. By putting laid-off workers after a year of unemployment “on welfare”, the reforms destroyed the illusion that long-term unemployment support was a kind of compensation for past contributions and devalued the recipients’ perceptions of their own status. On the role of status, see Goodhart (2020) and Sandel (2020).

[21] With significant differences across countries. Davies (2016) refers to discontent in parts of England and Wales as going back to the decline of coal and steel industries in the 1970s and 1980s. In contrast, in Germany, the decline of coal, steel, and textile industries was slowed down by subsidies and to some extent compensated by the growth of other industries, in particular, automobiles.

[22] For a lively account, see Pickens (1987). In the early and middle 1990s, Union Bank of Switzerland tried to justify the disenfranchisement of a large shareholder with the argument that the bank had a responsibility to other stakeholders and the overall economy, as well as shareholders; see Hellwig (2000).

[23] In Germany, the crystallizing events were the acquisitions of Chrysler by Daimler-Benz and of Bankers Trust by Deutsche Bank, following which the German executives “needed” to have remunerations that would match their American managers.

[24] For details, see Useem (1993), Roe (1994).

accepting "shareholder value". It is therefore paradoxical that the acceptance of shareholder value rhetoric by corporate incumbents proceeded at the very same time when these incumbents reinforced their entrenchment against hostile takeovers. Why did it happen anyway?

References to shareholder value diverted attention away from management's own enrichment. The argument that bonuses and stock options would better align corporate strategies with the interests of the corporations' "owners" provided a smoke screen. Despite the rhetoric, the actual arrangements had little to do with efficiency-enhancing incentive provision.[25] Corporate remuneration included not only rewards for shareholder value increases from managerial actions but also rewards for shareholder value increases from extraneous developments outside the managers' sphere of influence, for example stock price increases due to decreases in rates of interest.[26] Moreover, contrary to what contract theory would suggest, there was no neutralization of distributive effects through reductions in the fixed elements of executive pay.

This is not to deny that there were incentive effects. With large amounts of money at stake, executives did pay more attention to stock prices than before. As a result, the influence of investors increased, even out of proportion to their voting powers, as management would pay attention to the recommendations of hedge funds owning four percent of the company's stock, an order of magnitude that would have been considered risible twenty years earlier. A fund manager's threat of shedding the stock could be effective because, even at that order of magnitude, the effect on the stock price would harm the managers' wealth. For managers, submission to such pressures and to the tyranny of quarterly earnings reports was the price to be paid for high stock-price-related remuneration.

The question is why in the United States attitudes to the tradeoff between power and money changed in the early 1990s.[27] Something must have happened to change this tradeoff in favour of more money.

I conjecture that the shift has to do with the developments in real economies that I discussed above. New technologies related to the development of the internet as well as the integration of Asian and Eastern European countries into the global economic system provided much scope for reorganizing economic activities. There also was a Stolper-Samuelson effect that put pressure on domestic employment and employment conditions in the United States and Western Europe. These developments worked in favour of capital. Present values of claims to returns from capital were bound to rise.

[25] For extensive discussions, see Bebchuk and Fried (2004), Hellwig (2005).

[26] For a comprehensive and detailed analysis of optimal incentive contracting for corporate executives, see Holmström and Tirole (1993).

[27] The question encompasses attitudes to hostile takeovers. The entrenchment measures of the years after 1989 did not prevent the resurgence of takeover activities in the second half of the 1990s. In that new takeover wave, large payoffs to incumbent managers stifled their resistance. See Bebchuk and Fried (2004).

Attributing the resulting increases in stock prices to managerial performance and increasing managerial pay accordingly must have been very attractive even if it meant reduced lengths or diluted powers of incumbency.

Increases in stock prices since the early 1990s have indeed been substantial, despite the burst of the bubble in 2000, the financial crisis of 2007-2009, and the euro crisis since 2010. Most of these increases however were caused by macro developments beyond the powers of corporate managers.

As for the **financial sector**, according to Philippon and Reshef (2012), skill premia in the financial sector and qualified employment increased dramatically from the 1980s to the 2000s, becoming “excessively high” by the mid1990s. They attribute the increases to deregulation and to IPO activities. I suspect that the takeover waves of the 1980s and of the 1990s and the growth of organized markets, in particular markets for derivatives, also played a role. High demand for IPO activities, as well as mergers and acquisitions, would fit in with the picture of changes in real economies driving changes in stock markets and in attitudes of corporate executives to the tradeoff between power and money.

The growth of markets had three sources, the profitability of bond market activity in the 1980s, the creation and growth of new firms in the 1990s, and the development of derivatives in the 1980s. Whereas the creation and growth of new firms are related to developments in the real economy mentioned above, bond market activity in the 1980s was triggered by the change in the stance of US monetary policy and Volcker, and derivatives were a genuine innovation.

In terms of governance, increases in remuneration of investment bankers also involved a lot of self-enrichment. The traders who initiated derivatives contracts of their own making had significant leeway in what estimates to put in for the underlying variances, which determined the book values of these contracts. Arranging the numbers to make the contracts look good and frontloading the gains was a way to increase remuneration, especially if contracts contained no serious clawback provisions for subsequent losses.[28]

There is a deeper problem here: In well-functioning markets, trading only earns profits by luck; high average profits require risk-taking. Traders, however, have incentives to claim that profits are due to their competence? Who is to tell a “successful” trader that his merit is smaller than he claims? How do we distinguish “alphas” from “betas”?

The problem is particularly acute for derivatives. Derivative contracts involve transfers of risks between parties. Such transfers are useful if risk attitudes differ, which may happen if one party employs dynamic hedge strategies that make the risk smaller than

[28] Partnoy (2009).

it initially appears. Depending on how good the hedge strategies are, the contracts involve a mixture of risk acceptance and arbitrage. The arbitrage part is extremely profitable as long as nobody else is doing it. Once others become wise to the opportunity however, one cannot earn more than the requisite premium for the residual risks (if that much). This is why, after a while, plain-vanilla derivatives ceased to be a major source of profits. When that happened, investment bankers and traders began to develop ever fancier new products whose social benefits were not always obvious.[29]

Financial Deregulation is more difficult to fit in. Most deregulation, from the 1980 Depository Institutions Deregulation and Monetary Control Act to the 1999 repeal of the Glass-Steagall Act, was a *response* to disintermediation that threatened incumbent depository institutions.[30] With competition from non-banks such as money market funds, the constraints from traditional regulation had become dysfunctional. Deregulation improved competitiveness without relieving solvency and margin problems. One facet of this development, the fate of US savings institutions in the 1980s, is well known. Another facet concerns commercial banks: With lower asset maturities, they had fewer solvency problems but were also subject to squeezes of their margins and tried to escape by moving into other activities, from derivatives (not mentioned in Glass-Steagall!) to the full scale of investment banking activities after 1999. The competitive pressures that this development in turn put on investment banks probably contributed to their eagerness to move into mortgage securitization after 2000.

4. Public-Policy and Public Discourse

Because there is no obvious culprit for the developments that I have sketched, much of the discontent focusses on governments and public policies. Globalization, deregulation, tax breaks for the rich, retrenchment of government (social policies and public services), deterioration of infrastructures, weakening of trade unions – these are buzz words for the view that public policy has become dominated by "neoliberal ideology". Importantly, this view is not just an assessment of the "conservative revolution" of Reagan, Thatcher, and Kohl.[31] It also concerns the centre-left governments of Mitterrand post 1983 and of Clinton, Blair, and Schröder. The policies of these governments have given many on the left a sense of betrayal.

Some of the disaffection has to do with the abandonment of infeasible policies, for example, policies of maintaining industries such as coal and steel through government support. Although Mrs. Thatcher was probably not displeased to see trade unions

[29] According to Partnoy (2009), who documents these developments for the runup to the mini-crisis of 1994, the consequences for unwitting counterparties were often disastrous.
[30] Hellwig (1995, 2005), Admati and Hellwig (2013).
[31] In 1987, the journal *Economic Policy* devoted a full issue to this "conservative revolution". The parallel analyses of different countries, however, exhibited a great deal of heterogeneity. The "conservative revolution" was not a monolith. This observation should serve as a caveat against an excessively "monolithic" interpretation of this paper.

weakened, I suspect that, as in other countries, the main reason for closing down the coal mines was the burden they imposed on government budgets.

Since the early 1980s, budgetary pressures have been a major factor for public policy. Following the dramatic expansion of government activities in the 1960s and early 1970s, some retrenchment became unavoidable when economic growth faltered and government budget constraints made themselves felt. This retrenchment concerned not only social spending, on which the expansion of the 1960s and 1970s had focussed, but also public services and public investments.[32] Given the high levels of earlier investments, the effects of the erosion of public investments were not immediately visible, but, by now, in many countries, the deterioration of public infrastructures and public services are very noticeable. This deterioration tends to hit poor people more than rich because rich people can find substitutes and pay for them.
Some of the budget pressures were due to tax reductions. For example, in Germany, the Schröder government's tax reform of 2000, had dramatic effects on local government finances and forced municipalities to reduce investments, causing net investment to be negative for many years. Investment planning capacities were also much reduced so that in recent years municipalities have been unable even to develop projects to take advantage of federal subsidies. Meanwhile, school roofs are leaking and bridges are crumbling.

This tax reform was a result of deliberate choice, intended to promote efficiency and economic growth. So were the rapid admission of the former Comecon countries into the EU[33] and the admission of China into the WTO, with a view to a further opening up of trade, assisting these countries in raising their living standards by joining the global economy, perhaps also with a view to creating new outlets for one's own export industries. The negative consequences of these choices on domestic industries that would have to deal with more intense competition, and on the people and the region that depended on these industries, were not given much thought. Nor were the policies that might be needed remedy these negative consequences, e.g., educational policies that would improve people's ability to keep finding their places even as the economic environment was changing.

"Efficiency" and "growth" were the buzz words behind many policy measures, income tax reductions, deregulation, privatizations and other forms of government retrenchment. However, whatever growth effects they might have had were counteracted by the downturns that followed the burst of the tech bubble in 2000 and the financial crisis

[32] For Germany, Wissenschaftlicher Beirat (2020) provides details.
[33] The speed of integration of these countries into the EU stands in marked contrast to the long transition periods that the Treaty of Rome envisioned for the European Economic Community. In the case of the UK, the Blair government's decision to allow full mobility of people without awaiting the seven-year transition period accelerated the immigration that subsequently became an issue in the Brexit vote.

of 2008, both with accompanying austerity measures. Moreover, a closer look suggests that, for at least some of the measures, redistribution in favour of influential parties may have been a major concern.

For example, besides lowering personal and corporate tax rates,[34] the Schröder tax reform of 2000 created an exemption from the corporate income tax for capital gains on shares of other corporations. This exemption provided a multi-billion euro boon for German banks, which proceeded to sell their large holdings in non-financial companies. Whereas the tax cuts at the top might perhaps be justified with some appeal to incentive effects, I know of no argument and no evidence for efficiency gains from this measure that merely rewarded bygone acquisition decisions.[35] The inclusion of the measure in the 2000 tax reform was the result of lobbying by corporate leaders. The gains went in large part to these leaders as they provided a basis for paying themselves higher bonuses.[36]

Two aspects of the episode are noteworthy. One is the chumminess of leading politicians and leading corporate executives, which contributes to the sense of betrayal on the side of those who do not share in it.[37] The other is the extent to which these executives had acquired dominance over political discourse, in particular the meaning of the word "efficiency". Many media and many politicians had come to treat corporate executives as experts rather than interested parties. Complaints about costs due to government interventions were (and still are) treated as evidence of inefficiency. However, if regulation aims to make firms take account of external effects of their activities, firms must perceive it as costly because its very purpose is to make firms do something they would not otherwise do.[38] The disappearance of this truism from public consciousness shows to what extent public discourse has been hijacked by corporate leaders.

This hijacking of public discourse has been most striking in the area of banking. Elsewhere, I have described the changes in banking regulation from 1990 to 2005 as a case of regulatory capture by sophistication, as banks used their expertise in model-based risk management to influence regulators to allow them to use their own risk models for determining risk-adjusted equity requirements.[39] This scheme was one reason why banks had so little equity funding and were so vulnerable when the financial crisis struck. One might have thought that, after the disaster and the bailouts of 2008, bankers might be shamed into shutting up. However, by 2009, they were again opposing

[34] The top personal rate went from 53% to 42%, the corporate tax rate on retentions from 40% to 25%.
[35] In the United Kingdom, the privatizations under Thatcher seem to have been designed so as to provide her voters with the opportunity to earn significant capital gains, e.g., Vickers and Yarrow (1985).
[36] Given the poor performance of German banks and bank shares since then, these executives were probably the main beneficiaries. The example of Deutsche Bank is discussed in detail in fn. 15, p.282, in Admati and Hellwig (2013).
[37] Schröder was called "Genosse der Bosse" – comrade of bosses, only half-jokingly.
[38] For a systematic discussion of the change in public discourse, see Hellwig (2008).
[39] Hellwig (2010).

regulatory reform, posing as experts as if the crisis had never happened.[40] The only thing that was more remarkable than this shamelessness was the post-crisis acceptance of their "expertise" by politicians and bureaucrats, important media, and, not least, academic economists.[41]

In this debate, the stance taken by academics specializing in banking is particularly interesting. Whereas most other observers thought that the financial crisis was a result of excessive borrowing, in particular, short-term borrowing, by banks, academics specializing in banking maintained that such borrowing is beneficial and that regulation to limit such borrowing would deprive society of benefits from liquidity provision, managerial discipline, and cheap loans to non-financial firms.[42] Some of the arguments had a whiff of industrial policy *dirigisme* as they focused on outcomes without proper welfare assessments of social versus private costs of bank borrowing and the systemic risks it may entail, or of time inconsistency problems in relations between banks and their financiers.[43]

For someone trained in traditional welfare economics, neglect of these concerns amounts to a departure from professional routine. Such neglect is perhaps explained by a research tradition that goes back to the 1970s and that proposes to "explain" the phenomena we observe as solutions to information and incentive problems. This research program has been very fruitful but it exposes researchers to a risk of intellectual capture. If you are used to "explaining" things on the presumption that we see what we see because it is efficient, you are not well equipped to assess bankers' claims of "efficiency".

Most of the people at large cannot distinguish whether arguments about "efficiency" are valid or not. They do however have a sense of the distributive effects of public policies, especially when these effects harm them or when they benefit others whom they consider undeserving, such as failing bankers. Being told to acquiesce without being given understandable and convincing arguments is a source of annoyance. The annoyance is most acute when people get the impression that different elites are aligned with each other and are talking down to them.

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[40] An interview of Josef Ackermann in Süddeutsche Zeitung, November 20, 2009, gives a blatant example. The 2010 contributions of the British Bankers' Association and of the Institute of International Finance to the debate about "Basel III" also fit the pattern. The arguments given are some of what Admati and Hellwig (2013) call "The Bankers' New Clothes".
[41] See Admati (2017), as well as Barth et al. (2012) and Johnson and Kwak (2010).
[42] French et al. (2010), Gorton (2010), Rajan (2012).
[43] For a detailed welfare analysis, see Admati and Hellwig (2019).

5. “Capitalism”?

What does all this have to do with capitalism? If one identifies “capitalism” with the market economy, one can simply point to the developments of the real economy that I have sketched. From a Schumpeterian perspective, these developments reflect the normal workings of a market economy, with globalization and technical innovation as drivers of creative destruction and managerial remuneration reflecting the scarcity of competence in the coordination, organization, and reorganization of activities, or the application of new techniques in finance. An aficionado of *laissez faire* would argue that this is simply the way a market economy works, with some people winning and some people losing, and with significant progress overall as time goes on, the more so, the less anyone interferes.

I find it hard to see this shift as a mere reaction of the market economy to changes in the relative scarcity of talents. After all, the decisions were taken by people in positions of power for their own benefit with few effective checks on the use of this power.[44] And too-big-to-fail policies of the government provided support when outcomes became catastrophically bad.

It is important to keep in mind the power of corporations and the power of executives inside corporations. Corporate choices affect many, inside and outside the corporation.[45] Without complete contracts, most of these effects are not governed by the competitive markets of our models. In the past, many of them were taken into account through the participation of stakeholders, such as workers, in corporate decisions, as well as statutory regulation and political pressures.[46] These countervailing powers have been eroded. Stakeholders have become weak, and political leaders, even those whose party alignments would suggest the opposite, have aligned themselves with corporate management.

Schumpeter (1942) famously predicted that, despite its successes, capitalism would eventually disappear because intellectual and political environments were hostile and would become ever more so. This prediction, which probably reflected the Great Depression and its aftermath, has been thoroughly refuted. Today’s symbiosis of corporate, political and communicative leaders is the opposite of what Schumpeter envisaged. This symbiosis is much closer to Scheidel’s (2017) and Pistor’s (2019) description of the centuries-old tendency of the powerful and rich to further increase their power and wealth at the expense of others. We need a much more complete analysis of this symbiosis, in particular with a view to understanding the respective roles of economic power and political power and the corruption of public discourse.[47]

[44] Bebchuk and Fried (2004), Hellwig (2000, 2005).
[45] Shleifer and Summers (1988).
[46] Hellwig (2000).
[47] I have not made any mention of social media here. Social media have reinforced flaws in public discourse that make room for “fake news”, but the phenomenon of “fake news” itself is much older.

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