How to Rethink Capitalism

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Project Syndicate, Oct 1, 2019

The 2008 financial crisis, together with failed efforts to combat climate change and sharply rising inequality, has frayed the neoliberal consensus that has prevailed in the United States and much of the West for more than two generations. Three issues must be considered in weighing what comes next.

WASHINGTON, DC – The United States Business Roundtable, an organization of CEOs of large US companies, recently issued a statement that caused quite a stir in some circles. Rather than focusing primarily or exclusively on maximizing shareholder value, America's corporate titans argued, companies should attach more weight to the wellbeing of their broader stakeholder community, including workers, customers, neighbors, and others.1

As CEOs of large companies are hired and fired mostly on the basis of their contributions to profits, such statements merit a certain amount of cynicism. Unless and until incentives created by financial markets change, we should expect the short-term profit motive to prevail.

The Business Roundtable's views are part of broader attempts to reimagine capitalism – the topic now of high-profile courses at Harvard Business School, Brown University, and elsewhere. In his recent book *The Economists' Hour*, Binyamin Appelbaum, an influential *New York Times* journalist, argues that economists are to blame for tilting too much of the world excessively toward profits. And Democratic presidential candidates are putting forward ideas that range from modest reform to a more substantial overhaul of how markets work.

There are three main issues to consider when thinking about how to adjust the role of markets in the modern American economy in a sensible way.

The first issue is that market incentives are actually positive in some contexts. If you are an entrepreneur and want to raise capital, appealing to a broader social good will get you very little. To transform an industry – and challenge the incumbents represented on the Business Roundtable – you need a business model that promises future profits. For example, private venture capital financed the process of converting research on the human genome into life-saving drugs over the past two decades.

Second, a balance obviously needs to be struck between public and private (profit-seeking) efforts. Appelbaum's strongest argument is that leading economists denigrated public action and, at least since the 1960s, viewed private business through rose-tinted glasses. As James Kwak (my co-author on other matters) correctly points out, powerful interests lay behind the development and dissemination of these ideas (although his own book, *Economism*, also highlights how policymakers distort sensible economic analysis to bolster the naive view that business is infallible).

Third, the private sector typically does not consider positive and negative externalities – actions that affect other people but not the actor. For example, in *Jump-Starting America*, Jonathan Gruber and I argue that the public sector has a robust role to play in investing in basic science, because the general knowledge that results affects many people, in ways that are hard to predict. This was exactly the rationale behind the very successful government backing provided to the human genome project; it also motivates

the broader funding provided to the National Institutes of Health. Almost all modern drugs emerge from a process supported, at its early stages, by the NIH.

The private sector is also not generally good at regulating itself, again mainly because of externalities. For example, financial sector firms lobby hard to relax regulation – allowing them to make higher profits but also to take greater risks. No individual firm cares enough about risks to the entire system. Similarly, energy companies want to extract more natural resources. Their CEOs are not paid to worry about climate change.

The long-prevailing model for the US economy was to allow the market to organize most economic activity and then regulate or redistribute relative to the outcomes. But the 2008 financial crisis, together with failed efforts to combat climate change and disappointing longer-term economic outcomes for most Americans (while some rich people have become much richer), has frayed the consensus underlying this model.

Can we have a more inclusive form of capitalism that yields better outcomes? Yes, according to Senator Elizabeth Warren, who is running for the Democratic presidential nomination on a pro-reform platform. Warren, who made a political name for herself by advocating for stronger consumer protection for financial products, is not at all anti-market. Rather, she argues that designing market structures differently will lead to different (and better) outcomes. Many of her various proposals amount to rethinking what is allowed in terms of market structures and firm behavior, as well as how to limit the influence of money in politics.

The market is not necessarily good or bad. What you get out of capitalism depends on how you shape it. If you rely on wealthy people and already powerful businesses to make the key decisions, you will mostly get what you already have – a highly unequal economy, prone to crises, rushing headlong toward a climate catastrophe.