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Luigi Zingales, *A capitalism for the people: Recapturing the lost genius of American prosperity*

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In 1971 the federal government guaranteed a $250 million loan to Lockheed Aircraft. It was the first time in history that the federal government had come to the rescue of a single failing firm (or, more precisely, its creditors).[1] By the end of the 1970s, Penn Central Railroad and Chrysler would also receive bailouts. In 1984, it was Continental Illinois. And on the eve of the '90s it was the creditors of hundreds of savings and loan associations. Nothing, however, would compare to 2008. In a single year, the federal government bought stake in or bailed out hundreds of private financial and automotive firms. The rules of the bailout game, if there were any, were not always clear. Having come to the aid of Bear Stearns (via J.P. Morgan) and Fannie Mae and Freddie Mac, the federal government stunned creditors when it let Lehman Brothers fall in mid-September 2008. But just 2 days later, bailouts resumed when the Federal Reserve made an $85 billion emergency loan to insurer American International Group.

The experience left a lot of people reexamining their beliefs about American capitalism. From then on, were all large firms assumed to have the full faith and credit of the federal government behind them? Was there any way to credibly commit not to bail out systemically significant financial institutions? What cultural and political norms and taboos had the bailouts shattered? And how did these changes affect the public's perception of government and "free market" capitalism? We are fortunate that one of the people thinking about these questions was Luigi Zingales. He recorded his first observations on the crisis in a must-read piece in *National Affairs* titled "Capitalism After the Crisis" (2009). Now he has expanded those observations to book-length in *A Capitalism for the People.*

Zingales is as qualified as anyone to address these questions, and that's not just because he is an extraordinarily creative and productive financial economist of the University of Chicago's Booth School of Business. He's also an Italian émigré who is refreshingly unafraid to draw on his personal biography to make his case.

[1] For details, see Ritholtz (2009).

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1 Complex relationships

"Raised as I am in Italy," he tells us, "I know a few things about nepotism" (40). He knows, for example, that the way to get ahead in Italy is to "carry the bag" ("*fare il portaborse*") for powerful people. He also knows that crony capitalism has grievously undermined Italian social capital, leaving the population distrustful of markets, of the government, and of one another. When he came to the U.S. in the late 1980s to study economics at MIT, Zingales found that his adopted nation was fabulously rich in social capital. His first American hurricane showed him that Americans (or at least Bostonians) faithfully take the advice of local authorities to "stay at home, tape the windows, and so on." If an Italian mayor had told him to tape his windows, he says, "I would assume that his brother sold tape" (172).

Like his *National Affairs* piece, some of the best passages of *A Capitalism* explore the messy relationship between culture, markets, and government. "In order to survive in a democratic country," he avers, "a free-market meritocracy must offer large, widespread benefits to citizens and possess a welcoming culture" (20). But "when voters lose confidence in the economic system because they perceive it as corrupt, then the sanctity of private property becomes threatened as well. And when property rights are not protected, the survival of the free-market system itself is in doubt" (xxii). The problem can become self-reinforcing. As the public turns against markets and property rights, companies—aware that at any moment the mob might turn on them—demand more privileges from the state (xxii).[2]

2 Overcoming the power of special interests

Zingales is desperate to save competitive, meritocratic capitalism from the clutches of crony capitalism. And in this desperation, he suggests dozens of policy proposals. This makes the book fun, but also frustrating. Just as I was hoping to give his latest idea a test drive—to consider its downsides, and the secondary and tertiary consequences—he was on to the next idea.

For example, he'd like antitrust authorities to take account of "the enhanced political power" that a combination might confer: "Mergers that lead to excessively powerful political entities could be subject to limitations on the amount of lobbying they engage in." In full understatement mode, he acknowledges, without elaboration, that "this would be a radical departure from the status quo" (157). Might this power be abused? Perhaps even by the politically-connected crony capitalists it is intended to thwart? If he has any of these concerns, Zingales doesn't express them.

3 New rules of the game

Some of Zingales's solutions suggest a Hayekian appreciation for spontaneous order and the evolutionary process of institutional development. Thus, his preferred method of restraining rent-seekers is to regulate them through social norms: "The biggest

[2] On the various forms that government-granted privilege might take, see Mitchell (2012).

advantage of social norms is that they are generated from the bottom up—from the institutions of civil society—rather than from the top down" (190). To that effect, he calls on his fellow business school teachers to instill in students "a market-based ethic" that shuns rent-seeking.

Some of his other proposals are closer to the James Buchanan mold of constitutional political economy: forget about evolutionary change and reason through the optimal set of rules as if you were a constitution-maker. One particularly clever rule would combine a ban on government subsidies with an enforcement mechanism based on class-action lawsuits. "Such a mechanism would grant any citizen the right to sue the subsidized industry in the name of the state and obtain restitution of the unfair subsidy, retaining a finder's fee—say, 15 or 20 %—for himself" (214). Thus armed, diffused and unorganized interests would have an incentive to overcome the collective action problem and oppose concentrated and well-organized interest groups.

4 Limiting the political use of economic power

Like many economists, Zingales worries about monopoly power and recognizes that the state is often its source. Channeling (but not citing) Max Weber, he writes:

> The most debilitating barriers to entry…are those that the law creates. The state has the ultimate monopoly: the monopoly on the legitimate use of violence. Accordingly, any other monopolies that the state protects are the most difficult to overcome (32).

Importantly, however, Zingales also contends that causation can run the other way. In his view, a firm doesn't just become a monopolist because it has political power; it may gain political power because it is a monopolist. This twist compels him to endorse a number of government interventions in the marketplace that—though inefficient in a strict economic sense—might be worthwhile if they limit the *political* power of firms. In this vein, unit banking laws, limits on intrastate and interstate banking, Glass-Steagal, and the Sherman Anti-trust Act were all beneficial. Despite their economic costs, these policies splintered the political power of the financial industry, making it more difficult for these firms to obtain privileges, and helping to "preserve the long-term health of America's democratic capitalism" (50). This same logic leads him to endorse new interventions such as a Pigouvian tax on corporate lobbying (223).

Zingales clearly recognizes a limit to this line of thinking:

> If we believe in the danger of regulatory, political, and intellectual capture, it is difficult to see how we can use the state's might to limit the political use of economic power. The cure might be worse than the disease (255).

In the end, he endorses a "zero tolerance" approach to subsidies and tax loopholes while he is more comfortable with regulatory interventions. This is curious. The regulatory process is opaque and complex, arguably making the code of federal regulations an easier place to hide a targeted privilege than the federal budget or the tax code.

But Zingales hasn't enough time to dwell on such considerations; he has too many other interesting and creative ideas to consider.

References

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