Capitalism is no longer what it used to be

The system has always proved able to change, that is one of its great strengths. As Zygmunt Bauman, a very critical observer, writes, *"capitalism has an in-built wondrous capacity of resurrection and regeneration."*[1] Somewhat ironically, it is more flexible than many of its rigid and doctrinaire defenders in the books and in reality. With all due respect to Adam Smith, and every economist (liberal or not) owes him a lot, one of the major flaws in a work that remains essential is the metaphor of the invisible hand.[2] This has proved to be an illusion more than once in the history of capitalism, as are the -somewhat related- principles of perfectly informed and rational economic agents (as defined or analyzed by the French Léon Walras and the English William Jevons, among others.)[3] As Joseph Stiglitz puts it: *"the reason that the invisible hand often seems invisible is that it is often not there."*[4] The invisible hand is very often the heavy hand of dominating firms or the hand taken by financiers in markets. Besides, one thing is certain: for all its VIRTUES -and there are still some real and a few unmatched ones- the market no longer has the answers to all the problems. Saying that capitalism is capable of changing and regulating only by itself is like asking the tobacco industry to tell people not to smoke.

The NATURE of capitalism has changed.

- Financial markets' side effects far outweigh their benefits to real economies.
- Corpocrats rule over small entrepreneurs.
- Risk-betting traders make a much quicker buck than risk-taking businesspeople (except for a few rags-to-riches stories for TV shows).
- Bankers have switched to short trading and lost credit (all meanings, bar the cards).
- Greed fuels large parts of the system.
- Individual shareholders have no say.
- Daily share price targets have replaced medium-term strategies.

---

[1] *"On the Nature of Capitalism"* on www.social-europe.eu (October 17, 2011).
[2] Adam Smith: *"The Wealth of Nations"* (1776, republished e.g. by Bantam Classics, 2003). The "invisible hand" is referred to in *"The Theory of Moral Sentiments"* (republished in Penguin Classics, 2010). The Scottish economist may be forgiven, his words must be put in context, and his times were not ours.
[3] Léon Walras: *"Elements of Pure Economics, or the theory of social wealth."* (1874). William Stanley Jevons: *"The Theory of Political Economy"* (1871). A summary of *"The Rationality Principle and Classical Economics"* by the Canadian philosopher Maurice Lagueux goes to the point (go to www.philo.umontreal.ca/textes/).
[4] Joseph E. Stiglitz: *"Making Globalization Work"* (W. W. Norton, 2007).

- Unrelated derivatives can travel buck naked.
- Speculative bubbles burst regularly.
- Too many economists are just conformists.
- Casino finance pays off more than the provision of a good service.
- Many policymakers are subservient to markets and their latest ratings.

Those flaws come on top of other weaknesses –some of them qualifying as original sins: booms and busts, inequities and inequalities, selfishness, the cult of growth, supposed rationality, unfettered globalization, overconsumption, indebtedness, environmental damage… What were once virtues -making profit is not sinful as such- turn into vices -making money with money proves purposeless and value-destructive and can be terribly harmful for the ones who do not have deep pockets.

Markets are unstable by nature. That has its charms –who needs the stability of the Middle Age and communism? Well, some. That comes at a price too, named crisis and recession, and a few other "on"-suffixed words. The latest crises will not be the last, whatever the short- or long-term economic or business cycle school (Juglar, Schumpeter, Kuznets "swings" and Kondratiev "waves"). *"Once we were satisfied that the cycle was ten years in length and since that was smashed,"* said Irving Fisher… in 1946. However, even if upward cycles may occasionally last longer -some even argue that recessions last shorter than in the past- bubbles burst and crises tend to repeat more often and spread much faster than in the past. There were at least six major crises in the last fifty years compared with two in the previous half-century. Now, "thanks to" globalization, each significant crisis has repercussions almost everywhere, at least to some extent, which was not the case even in a relatively recent past.[5] The logical question that arises from this essay's title and content is: if it suffers from "deadly" sins, will capitalism die from this crisis? Well, the system has gone through many crises and has proved extraordinarily resilient: sometimes stronger, sometimes weaker, sometimes stepping backward, sometimes moving forward. One of the great questions of our times is about what forms of economic models will dominate -and are desirable- in the coming years and decades.

The latest crises -some are not over, at least in some parts of the world- are more serious because, in addition to their usual ingredients, they are the result of a conjunction of worrying trends and factors.

[5] To give but one example, a deep Eurozone recession could cut China growth by 50%.

Those are: too large, too powerful and uncontrolled financial institutions; a tyranny of short-termism; pure irrationality (often disguised as "rational markets"); irresponsible public policies (not everywhere, though); and, last but not least, unprecedented greed. *"We have just witnessed a... phenomenon in the financial markets. A crime has been committed. There is a victim (the helpless retirees, taxpayers funding losses, perhaps even capitalism and free society). There were plenty of bystanders. And there was a robbery (overcompensated bankers who got for bonuses hiding risks, overpaid quantitative risk managers selling patently bogus methods)... Most poignantly, the police itself may have participated in the murder."*[6] Those lines were written in the middle of the first great financial crisis of the 21st century. They do not come from a bunch of leftists but from a professor of risk engineering and a derivatives consultant! The Madoff gang, the Lehman brothers, the Greenberg solo, Freddie and Fannie, Merrill marauders and other champions of greed were and are no exceptions, they were and are still part of a system now extremely dependent on it. To make things worse, regulators are often *"captured"* by the institutions they are charged with regulating.[7] The net result of the explosive mix of malpractices and a financial system that had run out of control (mostly, yet not only in the U.S. and other Anglo-Saxon economies), was the late-2000s financial turmoil. Although based on credit, it was paid in cash. Year 2008 losses on major stock markets ranged from 34% to 65%. And the costs and losses, first estimated at $1,000 billion by the IMF in April 2008 (i.e. in the early stages of the crisis), were recalculated by the same IMF at $4,100 billion one year later (with estimated total write-downs on U.S. assets only at $2,700 billion).[8] Over a longer period, an IMF database, which reviews systemic banking crises since 1970, shows that the average fiscal cost of such crises was about 15% of GDP.[9] A hell of a lot of money!

Excerpt from ***"The Seven Deadly Sins of Capitalism"***, by Mike Guillaume (Searching Finance, 2012)

[6] Nassim Nicholas Taleb, professor at New York University; and Pablo Triana, derivatives consultant: *"Bystanders to this financial crime were many"*, in the Financial Times (December 8, 2008).
[7] *"Reckless Endangerment. How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon"* by Gretchen Morgenson and Joshua Rosner (Times Books, 2011), in which the authors focus on Fannie Mae.
[8] See the critical comment by Martin Wolf on *"Why Obama's new Tarp will fail to rescue the banks"*, and *"IMF puts financial losses at $4,100bn"*, in the Financial Times (February 10, April 21, 2009).
[9] In *"The cost of resolving financial crises"* by Luc Laeven, a CEPR Research Fellow, on http://voxeu.org (October 2008).