ESADE
Ramon Llull University

ESADEgeo-CENTER
FOR GLOBAL ECONOMY
AND GEOPOLITICS

E

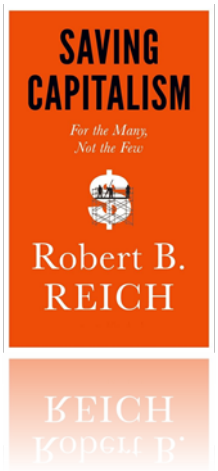
67 Book reviews on global economy and geopolitical readings

Fundación REPSOL

Obra Social "la Caixa"

E

Saving Capitalism:
For the Many, Not the Few



Reich, R. (2015), Icon Books Ltd., London.

"Stagnant or declining wages for most, coupled with declining job security and widening inequality. Corporations, giant banks, and billionaires in control of a growing share of the economy and government. Rising populist agitation in the form of fierce xenophobia and anti-immigrant fervor. Sound familiar? It´s becoming the new political-economic normal in the United States, Britain, and elsewhere around the world."

Summary

When seeking to explain the economic strain endured by workers in the US in recent decades, the blame is often placed on globalisation and technological progress. Although it is true that machines or lower-paid workers abroad can now do many jobs more cheaply, these two factors by no means account for all that has happened. In Robert Reich's opinion, above all else this argument ignores the increasing concentration of political power that the corporate and financial elite have obtained, particularly through their influence over the rules that govern the economy. The current debate between the right and left on the merits of the so-called "free market" has diverted attention from the fact that the markets are now organised very differently compared with half a century ago. According to the author, the way they are currently organised makes it impossible for them to deliver the shared security and prosperity they used to. This concentration of power is the main reason why the compensation packages of the top executives of big companies have soared, wages and job prospects have declined, and job security for the US middle classes is lower than it was a decade ago.

In *Saving Capitalism,* Reich argues very clearly that markets do not exist without rules. When large corporations, major banks and the very rich hold the most sway over those rules, market outcomes favour them, and their wealth and political influence increase in an endless vicious cycle. However, this trend is neither economically nor politically sustainable. Today, we are witnessing the frustration and growing anger of a large percentage of the American electorate who have worked hard for many years without seeing any wage gains. In the course of this book, Robert Reich outlines the reasons why the market has produced such outcomes, and offers some initial

recommendations to turn the situation around and establish a market that functions and is able to guarantee prosperity for the majority of the population again. Although the author focuses on the US, his analysis resonates strongly with what is happening in other countries around the world, starting, as Reich himself suggests, with the UK.

The author

Robert Reich is a professor of public policy at the University of California's Goldman School at Berkeley. He was formerly a professor at Harvard University's John F. Kennedy School of Government and professor of social and economic policy at the Heller School for Social Policy and Management at Brandeis University. In 2008, he was a member of President-elect Barack Obama's transition team for economic policy, and he was Secretary of Labour under President Bill Clinton from 1993 to 1997. Reich is also a leading columnist for *The New Republic*, *Harvard Business Review*, *The Atlantic*, *The New York Times*, *Huffington Post*, *The American Prospect* and *The Wall Street Journal*.

Key ideas and opinion

Do you recall a time when the single salary of a schoolteacher, baker, salesman or mechanic was enough to buy a home, own two cars and provide for a family? Robert Reich does. In the 1950s, his father, Ed Reich, had a shop on the main street of a town, selling women's clothing to the wives of factory workers. He earned enough for the entire family to live comfortably. They weren't rich. But they weren't poor either. And their standard of living rose through the 1950s and 1960s.

According to Reich, this used to be the norm. **For three decades after World War II, America created the largest middle class the world had ever seen**. The earnings of the typical worker doubled, and so did the American economy. Over the *last* 30 years, however, the size of the economy has doubled again, but the earnings of the typical worker have not. **Before, the CEOs of large corporations earned 20 times more than their average worker. Today, they earn 200 times more**. In those years, the richest 1% of Americans took home between 9 and 10% of total income. Today, they obtain more than 20%. Before, the economy generated hope: hard work was rewarded, education brought mobility, and economic growth created more and better jobs. Most saw their living standards improve, thanks to their work. **Children would have a better life than their parents. And the rules of the game were essentially fair. But this is no longer the case today.**

Confidence in the system has been severely undermined. The apparent arbitrariness and unfairness of the economy have eroded the public's faith in its basic tenets. Cynicism is on the rise. Most people see the political and economic system as a fraud,

weighted in favour of those at the top. **Capitalism is no longer threatened by communism or fascism, but by a part of society which seeks growth and stability, and is increasingly losing faith in the system that was meant to provide it.** When a majority of the population stops believing in the system, the social compact is broken. It is replaced by subversion, small and large: petty theft, fraud, kickbacks, corruption. Furthermore, economic resources gradually shift from production to protection.

Nevertheless, Reich claims, we can still change this by recreating an economy that works for the majority, not just for a few. Contrary to Karl Marx, there is nothing about capitalism that leads inexorably to mounting economic insecurity and an increase in inequality. **The basic rules of capitalism are not set in stone. They are written and put into practice by human beings**. Nevertheless, to determine what we must change and how to achieve this, the author believes that it is essential to analyse what has happened.

Focusing on the debate about the merits of the "free market" diverts attention from some critical issues: how the market has come to be organised completely differently from the way it was half a century ago, why its current organisation is failing to deliver the shared prosperity it delivered then, and what the basic rules of the market should be – **because, as Reich insists, the free market does not exist. For their very existence, markets depend on rules that regulate their five basic pillars: property** (what can be owned), **monopoly** (what degree of market power is permissible), **contracts** (what can be exchanged and under what terms), **bankruptcy** (what happens when purchasers cannot pay up), and **how these rules are applied**. This set of rules does not exist in nature. They are created and decided by people.

Over the past few decades, these rules have been altered as large corporations, Wall Street and wealthy individuals have gained increasing influence over the political institutions responsible for establishing them. At the same time, the players who exercised a countervailing power between the 1930s and 1970s, and who enabled America's lower and middle classes to exert influence on the system – trade unions, small businesses and investors, and political parties anchored at the local and state levels – have faded away. The consequence has been a market organised by those who have great wealth and who can mobilise it to obtain even more income. **If democracy were to function as it should, Reich observes, elected officials, politicians and judges would be making rules in accordance with the values of the majority**. Therefore, the “free market” would generate outcomes that improve the majority’s standard of living. **However, if democracy is failing, the rules can significantly enhance the wealth of an opulent minority, while keeping everyone else in an economic state which is both relatively precarious and uncertain**. In this scenario, those with sufficient power and resources wield sufficient influence over politicians, regulatory heads and judges to ensure that the "free market” works, above all, to their benefit.

This is not corruption as it is commonly understood. In the US, those with sufficient power and wealth rarely directly bribe public officials in order to receive specific and visible favours, such as advantageous government contracts. Instead, **they usually make generous contributions during election campaigns and, now and again, they promise lucrative jobs at the end of government careers**. In return, they receive something of great value: market rules that appear to be neutral and applicable to all, but which disproportionately benefit them. An example of one of the market's pillars, **property**, can be seen in **the rules by which pharmaceutical companies are governed**. The law allows them to pay doctors for prescribing their drugs. Over just five months in 2013, doctors received some $380 million in fees for conferences and consulting from pharmaceutical companies and device makers. Moreover, **pharmaceutical companies pay the makers of generic drugs to delay the launch of their products**. These payments generate huge profits for both parties – profits which are paid for by consumers, health insurers and government agencies when they buy the drugs at an inflated price. Reich points out that these tactics cost Americans around $3.5 billion a year. The major pharmaceutical companies and generics have fought against any attempt to put an end to this practice, which is prohibited in Europe.

As for the second pillar, **monopoly**, the author of *Saving Capitalism* highlights **the powerful position of companies such as Amazon**. This company's business model allows consumers to save money and enjoy the convenience of purchasing online, while its platforms enable authors to sell their books directly to readers. But at the same time, **Amazon is contributing to the disappearance of bookstores and publishers and reinforcing its position of power with respect to other players, including the authors themselves**. If authors do not agree with the prices that Amazon sets, they have few if any avenues for ensuring that their work reaches readers. In this way, Amazon may end up limiting the marketplace of ideas. As Amazon's power grows, so too does its political influence. Reich points out that in 2012, Amazon was quick to put pressure on the US Justice Department to file suit against five major publishers and Apple for illegally colluding to raise the price of e-books. However, in 2014, the Justice Department did not question the tactics employed by Amazon to squeeze publishers. **Other countries, Reich notes, have laws to protect their bookstores and publishers**. For example, in France no seller can offer a discount of more than 5% on the price stipulated for new publications. As a result, the price of books is practically the same wherever you may buy them in France. Yet in the US, this market would appear to be regulated very differently, and Amazon has an increasing hold on it: the firm's annual lobbying expenditure rose from $1.3 million in 2008 to $4 million in 2014.

The rules that govern the third pillar of the market, **contracts**, also appear to have been reshaped. Reich highlights the fact that **for a long time, it was stipulated by law that a contract could not be enforced if one of the parties had been coerced to accept the agreement**. This is also a moral principle. But how is coercion defined? Buyers and sellers have no real alternative when large companies control the market

through their intellectual property, standards and an army of lawyers and lobbyists. Under such circumstances, a contract is inherently coercive. **Today, the author notes, contracts contain numerous conditions that deny employees, borrowers and customers any meaningful choice**. One contractual clause that has become common in recent years is the requirement of accepting recourse to a mediator (often selected by the company) in the event that there is a disagreement regarding the contract. The same clause stipulates that the mediator's verdict must be accepted, without appealing to a court. Clearly, this clause is biased towards large corporations. Robert Reich points out that, according to a recent study, workers' complaints were accepted in 21% of cases when they went to mediation, compared with 50-60% when they went to court. Thus, Reich emphasises, **the new contracts are the result of a process of negotiation in which the parties are not on a level playing field**. Among others, he highlights the clauses that employees in large corporations are made to sign, which prohibit them from working for rival companies (non-compete clauses), thus significantly reducing their job prospects.

The fourth pillar of the market, **bankruptcy**, is the system used in most capitalist economies to find the right balance: **allowing debtors to reduce their debt to manageable levels and spread the losses equitably among all creditors. The central idea is shared sacrifice**. Here again, the mechanism requires decisions of all kinds. For example, who is entitled to file for bankruptcy? For what kind of debts? What constitutes an equitable allocation of losses among creditors? And what happens when bankruptcy is not an option? Answers can be found to all these questions. But according to Reich, it is not the "free market" that provides them, but powerful interests. For example, **under the bankruptcy code, employment contracts stipulating workers' pay have a relatively low priority when it comes to who gets paid off first**. In 2003, **American Airlines** CEO Don Carty used this clause when approaching the unions with the threat of bankruptcy, and managed to save $2 billion in concessions. Carty emphasised the need for shared sacrifice, but failed to mention that a supplemental retirement plan had secretly been established, whose assets could not be touched in the event of bankruptcy. Thus, when Carty resigned, he walked off with nearly $12 million, courtesy of his secret plan. And despite the workers' salary concessions, American Airlines ended up filing for bankruptcy in 2013. The company rejected the agreements in force with the workers and froze their pension plans. However, on emerging from bankruptcy, all the creditors were repaid, with interest, and so they even ended up better off than before the crisis. To top it all off, Reich notes that Tom Horton, the CEO who had led the company into bankruptcy, received a severance pay estimated at around $19.9 million. **This situation contrasts with that of students, who are not allowed to declare themselves bankrupt if they are unable to pay back their student loans**. According to the Federal Reserve Bank of New York, in 2014 student loans represented 10% of all debt in the US, second only to mortgages. Furthermore, Reich stresses, if upon retirement borrowers are still paying off their student loans, lenders can even seize their social security cheques.

Large corporations also accumulate excessive power in the fifth pillar of the market, **the contract enforcement mechanism**. Worthy of note here is **the decision made by Attorney General Eric Holder in 2014, when he declared Credit Suisse guilty of helping rich Americans to avoid paying taxes**. According to Holder, this case showed that no financial institution, regardless of its size or global reach, was above the law. Nevertheless, financial markets shrugged off the $2.8 billion fine. In fact, **the bank's shares rose the day the sentence was announced**. Credit Suisse was the only large institution that reported a profit that day. Its CEO even showed defiance when he heard the news, saying that he had been talking to his clients to reassure them that nothing would happen to them. And nothing did, because **the Justice Department did not even require the bank to turn over its list of tax-avoiding clients**. In the author's opinion, when studying this fifth pillar, it is worth looking at the way in which judges and public prosecutors are selected in the United States. **Nationwide, 87% of state judges are selected by means of elections**; and public prosecutors are selected through elections in 32 states. This is in stark contrast to other countries, where judges are appointed with the advice and consent of legislative bodies. This provides yet another channel for money to influence the interpretation and enforcement of market rules.

The way the market is set up has a direct impact on who gets what, and it creates an economy with increasingly unfair and unequal outcomes. **If in 1965 the ratio between the salary of a CEO and a worker was 20 to 1, today it is 200 to 1. The main problem is that, nowadays, workers do not have the same bargaining power that they had in the past**. The standard explanation attributes this to market forces, principally globalisation and technological progress. However, this does not explain why the transformation has been so swift and why other economies subject to the same market forces – such as Germany – have resisted. In 2011, Germany grew more quickly than the US, but the richest 1% accumulated 11% of total income, compared with 20% in the US. **One of the reasons why the American middle classes have lost bargaining power can be found in the policies pursued by Reagan and the governments that succeeded him. The policies before this shift, which emerged during the *New Deal* and World War II, meant that large corporations had to take on most of the risks**. The majority of workers stayed with a company for life, and their salary rose with seniority, productivity, corporate profits and the cost of living. It is no exaggeration to say that, in those days, employees possessed property rights in their companies.

Today, the opposite occurs: most of the risk is taken on by employees. In 2014, 66% of workers were living pay check to pay check. The risk of reaching old age without a pension is also rising. If in 1980 more than 80% of large and medium-sized companies guaranteed their workers retirement benefits, today less than a third do so. Another reason why workers have less bargaining power is the disappearance of trade unions. **50 years ago, General Motors was the largest employer in the US. A typical worker's wage was $35 an hour. In 2014, the largest employer was Walmart. But the average**

salary was $11.22 an hour. Does this mean that the American worker was worth more half a century ago? No. It means that, today, workers have less bargaining power. And this is not the direct result of market forces. Germany still has powerful trade unions, which negotiate to provide the middle class with significant control over the economy. Unlike the majority of Americans, whose earnings have been stagnant for decades, in Germany salaries have risen 30% since 1985. **Furthermore, in the US, even when companies violate rights that workers still have, the penalty is minuscule**. For example, when a business is found guilty of having dismissed a worker illegally, the penalty imposed merely requires it to pay the wages lost since the worker was dismissed. Reich points out that **a succession of Democratic presidents have been promising to make the process for forming unions easier and to increase the fines meted out to entrepreneurs who infringe the law. But they have proved to be no more than promises**.

The problem is that whereas poverty used to be limited, for the most part, to those who were not working, this is no longer the case today. At present, more than half the 46 million Americans on food stamps are workers. **This dynamic, Reich emphasises, is neither economically nor politically sustainable for much longer**. In 2001, a Gallup poll revealed that 77% of Americans thought they could improve their situation if they worked hard. By 2014, this percentage had dropped to 54%. **This growing feeling of arbitrariness and unfairness among the population is undermining institutions**. **And the losers are beginning to refuse to take part in the game. Clear evidence of this can be found in the majority who are opposed to negotiating international trade agreements**. Although history and politics bear witness to the general benefits to be derived from the expansion of trade, over the last few years investors and executives have taken the overwhelming share of those benefits, while the middle class has felt the downsides to a disproportionate extent. But why would someone reject an agreement that can improve their situation simply because it improves someone else's situation much more? In the words of Reich, because it is unfair.

The only way to return to a functioning democracy and economy, according to the author, is to restore the power of counterbalances. **Unless one of the two principal American parties moves away from the current centres of political and economic power, a new power could emerge. This would take the form of a new party that would bring disillusioned people together and recover the voice of the 90% of Americans who have been losing influence and power in recent decades**. This power **would commence by reforming the system of election campaign finance** in order to get big money out of politics, and it would establish a new public finance system, which would be combined with small donations. **It would also reduce or eliminate revolving doors** between government service, Wall Street, large corporations and lobbying firms. At a minimum, all elected and appointed government officials would be prohibited, for a period of five years from the end of their government service, from

accepting employment from companies they regulated, controlled or with which they had any kind of relationship. On the other hand, **experts, academics and consultants in think tanks would be obliged to disclose any funding that has contributed to the publication of their testimony, books, papers and other studies**. In this way, if an "expert" claims, for example, that humans are not responsible for climate change, we would be able to evaluate the neutrality of their comments. This power would also seek to **end the upward redistribution** currently guaranteed by the market and it would prohibit companies from obliging their employees to accept forced mediation in cases of conflict. **The minimum wage would be raised** by 50% and thereafter adjusted for inflation. Workers in low-paid industries would be able to form unions by simple majority. And contract enforcement mechanisms would detect when companies are infringing the law, with sufficiently high fines to dissuade them from continuing these practices. Reich also proposes **achieving a fairer pre-distribution of the market, which would make taxes and transfer payments less necessary**. One way of achieving this would be, for example, **to link the corporate tax rate to the ratio between CEO pay and the pay of the average worker in the company**. But this would only be the start.

Fortunately, Reich concludes, the market is a human creation. It is based on rules that we have created ourselves. The key question is who shapes those rules and for what purpose. **The challenge we face is not technological or economical. It is a challenge to democracy**. The critical debate will not be about the size of government, but about who government is for. Therefore, the central choice is not between "free market" and government, but between a government organised for the majority and based on prosperity, and one designed to deliver most of the gains to a minority. **In Robert Reich's opinion, if they join together, the broad majority of citizens have the capacity to change the rules of the game. But to do this, they must understand what is happening. And if history is any guide, the author is optimistic: "We have done so before [... and] we will do so again".**