FINANCIAL TIMES

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Saving capitalism Martin Wolf on how to make the economy work for everyone — BIG READ, PAGE 7

CAPITALISM.

TIME FOR A RESET.

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Does capitalism need saving from itself?

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6 September 2019

Gillian Tett on why bosses are buying into the idea of a purpose beyond profit

© Illustration by Graham Tuckwell

Marty Lipton does not have the look of an American revolutionary. At the age of 88, he is seldom seen without a carefully pressed suit and dapper tie.

His resume reeks of Wall Street power. In 1965 he co-founded Wachtell, Lipton, Rosen & Katz, one of the most prestigious and lucrative American corporate law groups, and he is famous for having invented, in 1982, the "poison pill" — a legal mechanism used by company boards to prevent takeovers.

"I believe in capitalism. I believe in our [financial] system," Lipton tells me over lunch in the Rockefeller Center Club, an elite venue on the 65th floor of the Rockefeller Center, where Manhattan power brokers can dine while peering down on the teeming city below.

But it is from elevated perches such as this that Lipton has been waging a decades-long battle with parts of America's establishment. The reason is a paper he wrote in 1979 called "Takeover Bids in the Target's Boardroom", which floated a then-revolutionary idea: that corporate leaders and investors should stop focusing on short-term shareholder returns and instead chase long-term value for "stakeholders" such as employees, clients and communities.

In continental Europe or Japan, which have long embraced a more stakeholder-focused model of capitalism, Lipton's idea might not have seemed so controversial. Yet in the US his paper provoked trenchant attacks from other lawyers, academics and investors. "Nobody wanted to listen," Lipton chuckles over the Rockefeller silverware.

But history can move in unexpected ways. Last month, 181 American chief executives issued a collective "statement on the purpose of a corporation" that abandoned their long adherence to shareholder primacy. Instead, the group — which was organised by the Business Roundtable under the leadership of Jamie Dimon, head of JPMorgan — pledged "a fundamental commitment to all our stakeholders".

Marty Lipton in his New York law office in 2016. His once controversial views on corporate responsibility are gaining wider acceptance © Sasha Maslov/New York Times/Eyevine

That move delighted social and environmental activists. However, it infuriated some economists and investors, who declared that companies would be tossed into legal confusion. Rightwing pundits accused the Business Roundtable of shattering America's vision of free-market capitalism, while on the left politicians such as Bernie Sanders accused the executives of hypocrisy, given their sky-high levels of pay.

The battle leaves many questions hanging. Why is the American establishment questioning capitalism now? Could Wall Street ever really embrace Lipton's once-heretical vision? And if it did, what would this mean for growth, and for the current wave

of populism? “I put forward my ideas of stakeholders to save capitalism — not destroy it,” Lipton explains. “But if we don’t act now, I don’t think that capitalism will be around in the next 50 years.”

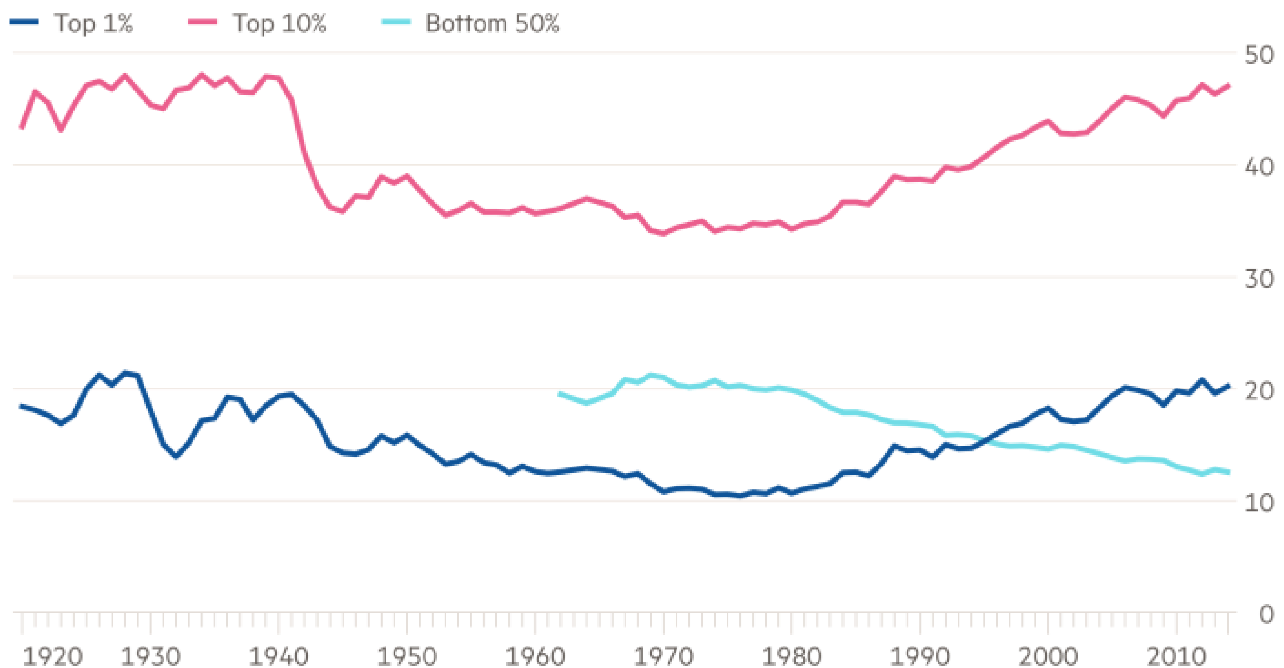
If you want to understand what is at stake in this debate, it pays to ponder the original meaning of the word “company”. Today, this invokes images of balance sheets and profit margins. However, “company” actually arises from the 12-century French word *compagnie*, a “society, friendship, intimacy; body of soldiers”, which hails from the Late Latin phrase *companio*: “one who eats bread with you”. Commerce, in other words, was initially synonymous with social ties.

That original meaning remained in place for centuries. Thus when Adam Smith, the 18th-century Scottish intellectual, wrote his treatises on the “hidden hand” he saw no contradiction between *The Wealth of Nations* (about markets) and *The Theory of Moral Sentiments* (about moral philosophy).

In the 20th century, however, the meaning of “company” changed. The reason was a man who has been Lipton’s nemesis: the Nobel Prize-winning economics professor Milton Friedman. In 1962, Friedman published a book, *Capitalism and Freedom*, which argued that a company had no “social responsibility” to the public or society, but only to its shareholders. Or as he explained in a 1970s essay: “In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business . . . his primary responsibility is to them.”

Inequality rose after the shift to free-market policies in the 1980s

Share of US pre-tax income, by groups in the income distribution (%)



Source: World Inequality Database
© FT

The essay sparked a wider revolution. In politics, Ronald Reagan and Margaret Thatcher used advice from Friedman to launch radical free-market policies. In the corporate sphere, US and UK boards stopped assuming that companies should invest revenues into their business (which had been the C-suite mantra in the early 20th century) and started focusing on dividend payments to shareholders. In universities, economists such as Eugene Fama declared that free markets were the only valid engine of growth and value, while law professors such as Lucian Bebchuk insisted corporate boards had no right to ever overrule investors, however short-term their focus.

On Wall Street, a new army of financiers, lawyers and consultants seized on the new paradigm to create booming businesses managing equities, as a new pension and mutual fund sector emerged. Then a wave of hostile company takeovers and raids got under way, as financiers scooped up the shares of weak companies to extract value. These raiders operated under the flag of Friedman — and Smith, who would probably have been turning in his grave.

In January 1979, American Express launched a hostile $880m bid for McGraw Hill, the information conglomerate. Lipton was hired to defend McGraw Hill.

It was a defining moment for Wall Street — and Lipton's career. He had been born, in Depression-era 1931, into a modest New Jersey family, and when he co-founded his legal practice he seemed poorly placed to shake up Wall Street. But he found a niche advising companies dealing with raiders. That was in part a canny business decision, but Lipton also liked to present himself as the defender of old-fashioned business values: even today Wachtell, Lipton, Rosen & Katz hires its staff "on a handshake" and operates from one office with a mere 270-odd lawyers, who always eat lunch together every Tuesday. It has a flat pay structure by Wall Street standards, albeit with remuneration reportedly averaging well over $5m per partner. "Money is not the reason people work here," Lipton sometimes says.

Economics professor Milton Friedman, on the balcony of his San Francisco home in 1986. Friedman argued that executives' primary responsibility was to their shareholders © Getty

When Lipton looked at American Express's hostile bid back in 1979, however, he knew that money did matter. Since the Amex bid offered shareholders a fat, immediate gain, Friedman's creed implied that shareholders should accept it. But the McGraw Hill board insisted it would smash the long-term value of the company. So was there any way to stop this?

Lipton decided his best route was to attack Friedman directly. In "Takeover Bids", he asked whether "the long-term interests of the nation's corporate system and economy should be jeopardised in order to benefit speculators interested not in the vitality and continued existence of the business enterprise in which they have bought shares, but only in a quick profit on the sale of those shares?"

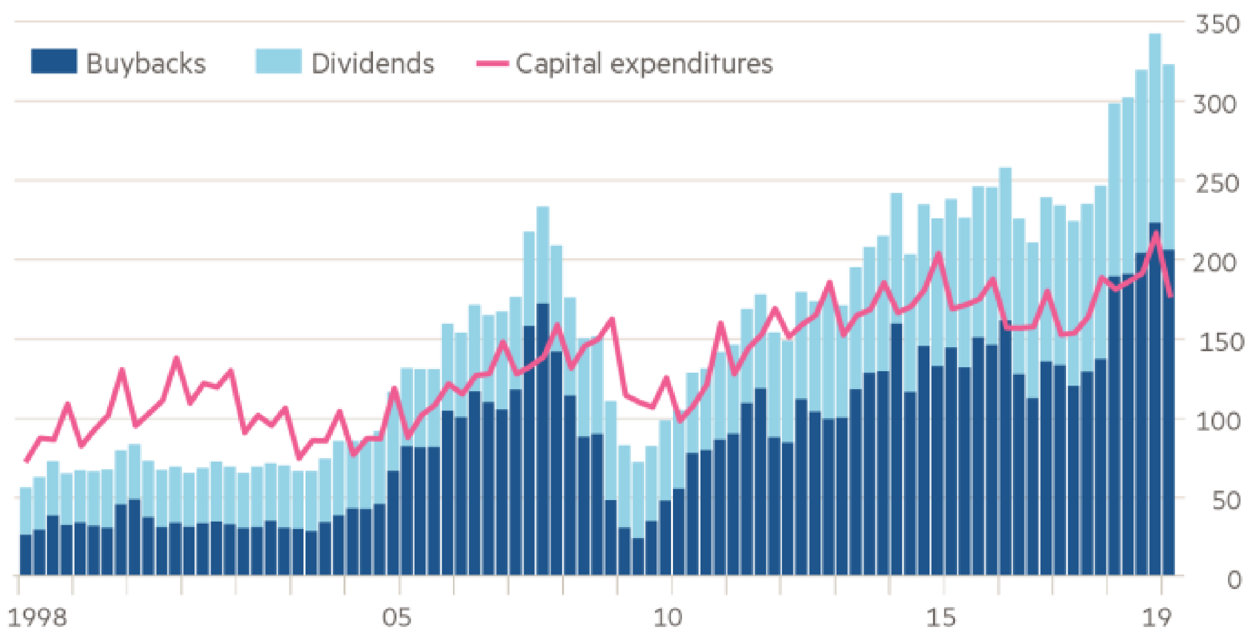
Amex eventually dropped the bid, and in 1985 the Delaware court — which shapes American corporate finance since so many companies are based in the state — issued rulings on cases involving Unocal and Household International that partly supported Lipton's stance. But any sense of victory was shortlived. The Delaware court made a ruling linked to Revlon that upheld shareholder primacy, and in 1992 the Securities and Exchange Commission introduced rules that reinforced shareholder activists. More important still, institutional investors started to outsource their voting decisions to specialist proxy services whose only mandate was to maximise shareholder returns. In 1994, pension industry reforms further entrenched the idea of shareholder primacy.

> Shareholder rights are essential for keeping managers and directors accountable
>
> Lucian Bebchuk, law professor

Thus by the start of the 21st century, the concept of shareholder primacy seemed ever more entrenched. Lipton's critics dismissed his crusade as just a self-interested marketing stance and insisted that his desire to defend corporate leaders over all matters — even with their sky-high pay — was undemocratic. "Shareholder rights are essential for keeping managers and directors accountable," insists Bebchuk, who often exchanged bitter words with Lipton. Moreover, the Friedman camp appeared to have history on its side: America's vision of capitalism had not only triumphed over Soviet socialism, but it had also unleashed much stronger growth than Japan and continental Europe, which respected stakeholders more.

Yet as so often in history, the Friedman doctrine's moment of triumph was when the seeds of doubt were sown. These years saw the eruption of a wild financial boom, driven by cheap credit, deregulation, dealmaking and faith that free markets would solve all problems. The sheer exuberance of the markets left some uneasy, even on Wall Street.

Take the story of Jay Coen Gilbert, Bart Houlahan and Andrew Kassoy. In the 1990s, Gilbert co-founded a basketball apparel company called AND1, which was sold for a hefty sum to American Sporting Goods in 2005. It seemed a classic example of American capitalist success. But Gilbert was horrified to see that once the deal was done, the new owners restructured the company to make quick returns, hurting its long-term strategy.

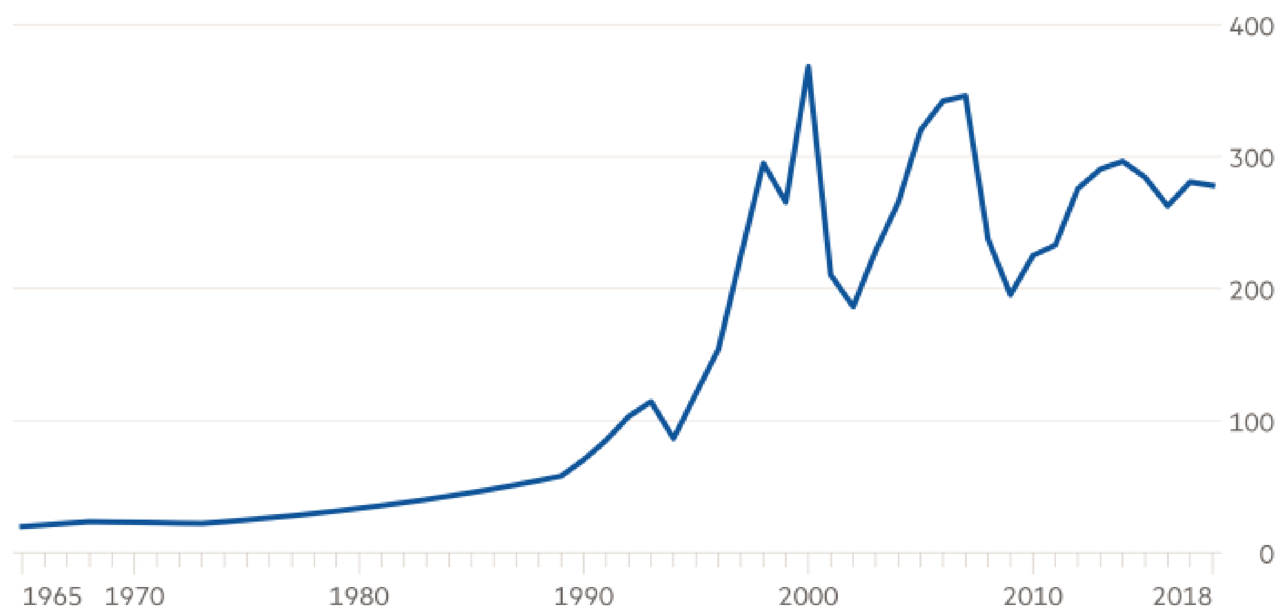


Could this have been prevented, he wondered? Not under Delaware law, it seemed. Gilbert teamed up with Houlahan and Kassoy to float a novel idea: why not create a new legal structure to protect stakeholders? "We wanted to redefine the company," Kassoy says.

In 2006 they launched this new legal structure, dubbed a "Benefit Corporation" — or "B Corp" — with the authorisation of the Delaware courts, creating a legal framework for companies that requires managers to not just chase financial metrics (for shareholders) but environmental and social goals too. It seemed terrible timing. During the credit boom few company executives wanted to change the status quo. And after that bubble burst in 2008, even fewer had the energy to fret about legal structures.

But by 2010 Kassoy was noticing something odd: though relatively few large companies actually turned themselves into B Corps, many started to embrace B Corp metrics to assess their performance around non-monetary factors. "Companies suddenly woke up and looked at how they measured themselves," Kassoy recalls.

Why? One reason was that the 2008 financial crisis had undermined faith in unfettered free markets. Another was that companies and investors were starting to realise that environmental risks could have an impact on their operations and portfolios. However, a third factor was politics: the 2008 crisis had unleashed a popular anger against America's corporate and political elite. And while most executives initially assumed that this anger would die away when the recession ended, the reverse occurred: even after recovery resumed, resentment grew.



Some of this anger was focused on issues such as immigration and globalisation (later stoked by politicians such as Donald Trump.) However, chief executives could sense that they were vulnerable too. Data were emerging that showed that decades of shareholder primacy had — unsurprisingly — left labour losing out badly to capital (ie investors) and executives. By 2007 chief executive pay was 345.9 times that of the average worker, up from a ratio of 29.7 in 1978 — and labour's share in the overall economic output in America (ie wages) had fallen steadily over the same period, even as corporate profits boomed. Meanwhile, payouts to investors soared: today dividend payouts and net equity issues at companies are worth almost 100 per cent of after-tax profits; in 1972 these payouts were just 24 per cent, since spare cash was being invested or paid to workers.

Nobody had fretted about this during the boom. But the 2008 crisis had prompted a reappraisal of the American success story: in 2017 a poll suggested that 44 per cent of millennials preferred socialism to capitalism.

Wall Street executives and financiers scrambled for ways to defend themselves. Lynn Rothschild, a former telecoms executive married to a scion of the European banking lineage, was a case in point. In 2014 she created a forum called "Inclusive Capitalism", with a roster of luminaries — ranging from Prince Charles to Steve Schwarzman to Christine Lagarde — to champion a vision of business based around stakeholders. A decade earlier, that title might have seemed like a contradiction in terms. But Rothschild joined forces with Ernst & Young, and won support from asset managers with $30tn

behind them. “The people saying the system is broken are not wrong,” Rothschild explains. “If we don’t have [inclusive capitalism], we can surely expect capitalism to be replaced with something far worse.”

Lynn Rothschild, left, talks to Prince Charles and Christine Lagarde before the start of the 'Inclusive Capitalism' conference in London in 2014 © Getty

Other initiatives — bearing pious names such as “The CEO Force For Good” — emerged too. Then another factor started change the zeitgeist: it became increasingly clear that climate change could wreak havoc on some company operations, and investor portfolios, in the long term. In January 2018, Larry Fink, head of BlackRock, declared that to “prosper over time, every company must not only deliver financial performance but also show how it makes a positive contribution to society . . . [and] benefit all of their stakeholders”. Leftwing critics cried hypocrisy and some investors pointed out that BlackRock itself had contributed to the crisis of capitalism since it had promoted passive funds (or computer-driven investing). However, the sheer size of BlackRock made it hard for other investors to ignore the trend. “Suddenly everyone was saying capitalism had failed,” recalls one Wall Street chief executive. “We started worrying about pitchforks.”

These days, when Lipton ponders the state of the corporate world, he feels partly vindicated. “The Business Roundtable memo is a real turning point,” he enthuses. What makes him equally excited is the explosion in financial and business activity that supports environmental, social and governance (ESG) goals. This idea is certainly not new: socially minded investors (such as nuns or Swedish pension funds) have long used finance to promote social good. But in recent years ESG has moved from being a tiny cottage industry into a mainstream endeavour worth $31tn, according to the broadest definitions.

Critics claim that much of this ESG business is so dangerously ill-defined, fragmented and opaque that it conceals a multitude of ethical sins. Optimists retort that these criticisms were found in the early phases of other waves of financial innovation too, until those sectors matured. “The situation with ESG looks similar to what I saw in the early days of leveraged finance,” says Marisa Drew, chief executive officer of the impact advisory and finance department at Credit Suisse. Either way, just as an army of accountants and lawyers once scrambled to turn the Friedman doctrine into a business plan — and fat fees — a race is now on to create a more professional framework for ESG too. “We are finding ways to measure stakeholder issues in accounts,” enthuses Ronald Cohen, a luminary of British venture capital, who is working with Harvard academics to overhaul accounting systems.

> Suddenly everyone was saying capitalism had failed. We started worrying about pitchforks
>
> Anonymous Wall Street chief executive

Yet even amid this apparent “success”, Lipton remains worried about a backlash. The Council of Institutional Investors, for example, lambasted the Business Roundtable memo, warning that “accountability to everyone means accountability to no one”. Luigi Zingales, a Chicago economics professor, dismissed it too as “at best misleading marketing, at worst a dangerous power grab” by overconfident chief executives. Moreover, while few in business will publicly criticise the Roundtable, some fear it will lead to more regulation by government. “It’s ridiculous — this is not how capitalism is supposed to work,” one prominent chief executive argues.

More worrying still, in Lipton’s eyes, is the risk that leftwing politicians could go much further. In the UK, the Labour leader Jeremy Corbyn recently proposed an “Inclusive Ownership Fund” to give workers mandatory stakes in big companies. American figures such as Elizabeth Warren are also pushing for a pro-worker corporate overhaul, and for Lipton the lessons are clear.

Recommended

"The failure to recognise the existential threats of inequality and climate change, not only to business corporations but also asset managers, institutional investors and all shareholders, will invariably lead to legislation that will regulate not only corporations but also investors," Lipton recently wrote to the CII. "Shareholder primacy was ill-conceived in the first place . . . The alternative is state corporatism in the form of legislation such as Senator Warren's Accountable Capitalism Act."

Friedmanites — and the CII — disagree: in their eyes it is Lipton who is undermining capitalism. Meanwhile, critics such as Warren might dismiss the battle as just an inward-looking elite fight that excludes workers. But either way, the one thing that is crystal clear is that there will not be a resolution anytime soon. "I am going to keep fighting for the rest of my life," Lipton chuckles. Welcome to the next 50 years.

Gillian Tett is chair of the editorial board and editor-at-large, US of the Financial Times. She will be speaking at the FT Weekend Festival on Saturday September 7 on the state of liberalism and the dreams of '89

This story has been amended since original publication to clarify Bart Houlahan's role as a co-founder of the B Corp certification system

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Business must act on a new corporate purpose

ft.com/content/3732eb04-c28a-11e9-a8e9-296ca66511c9

19 August 2019

Companies must realign incentives and define targets beyond profits

Jamie Dimon, the JPMorgan boss and Business Roundtable chairman, has been a leading advocate for a more sustainable and inclusive form of capitalism © Bloomberg

The editorial board

August 19, 2019
45

An important shift may be under way in corporate America. The largest US business group has replaced the long-held view that maximising shareholder value is the defining corporate goal with a more inclusive vision that takes account of other stakeholders. Explicitly elevating broader interests such as those of employees, the environment and customers is intended to set a new standard for companies across the US. This welcome, wider approach to corporate purpose should create a more sustainable and inclusive form of capitalism. Business must now show it is ready to put the change into practice.

The update of corporate purpose from the Business Roundtable on Monday encapsulates a major change in thinking. The principle of shareholder primacy has dominated US capitalism for two generations and has, for more than 20 years, been at the heart of the BRT's governance principles. Since the BRT includes some of the largest US companies representing $7tn in annual revenues, its shift has at least the potential to trigger broader changes in corporate behaviour.

Pressure has been building for some time. Maximising shareholder returns has come at the expense of other stakeholders and created incentives to pay less tax. Investors and politicians such as Democratic presidential hopefuls Elizabeth Warren and Bernie Sanders have voiced concerns over rising disparities between profits and wages, leading to scepticism that business may simply be trying to propose cosmetic changes before more substantial reform is imposed. Jamie Dimon, the JPMorgan CEO and Business Roundtable chairman, has been a leading voice in promoting change. In his annual letter to shareholders in April, Mr Dimon set out a list of issues that needed to be addressed — including education, immigration, and tax reform, and promised JPMorgan would “take advocacy to the next level”.

Scepticism about such lofty declarations is in order. Corporate America must now prove this is not just a symbolic shift. One task is to align management interests with the broader stakeholder view. Over-reliance on share price performance, long an integral part of management incentives, and often with a time horizon of just a year or two, must change. Tying executive pay to broader financial and non-financial performance measures would ensure priorities are better aligned.

Recommended

Companies should be encouraged to articulate a purpose beyond merely maximising profits. The BRT’s move tacitly acknowledges that if businesses ignore their responsibilities towards society, they risk losing their licence to operate.

Promoting longer-term interests will undoubtedly run into conflict with quarterly reporting requirements. Offering better deals for employees and suppliers, or investing in local communities, may enhance overall performance in the longer term, but hold back profits in the near-term. Short-term investors, or activists looking for an immediate return, may dig in their heels. Firm and clear statements of long-term purposes may help persuade the doubters.

One final way companies can prove their commitment to a stakeholder approach is to ensure it is not used as a way to avoid paying tax. Incentives tied to operating profits are one way around this. Promoting a culture of investment, rather than share buybacks, would also help. Fifty years of shareholder primacy has fostered short-termism and created an environment of popular distrust of big business. A new corporate purpose has the chance to generate wealth more sustainably and to share prosperity more evenly.

Liberalism will endure but must be renewed

FT ft.com/content/52dc93d2-9c1f-11e9-9c06-a4640c9feebb

2 July 2019

FT Collections Liberalism and autocracy

In this column, Martin Wolf responds to Vladimir Putin's claim, made in an exclusive interview with the Financial Times, that the "so-called liberal idea has outlived its purpose". The FT has had Martin's article translated into Russian and has made it free to read here.

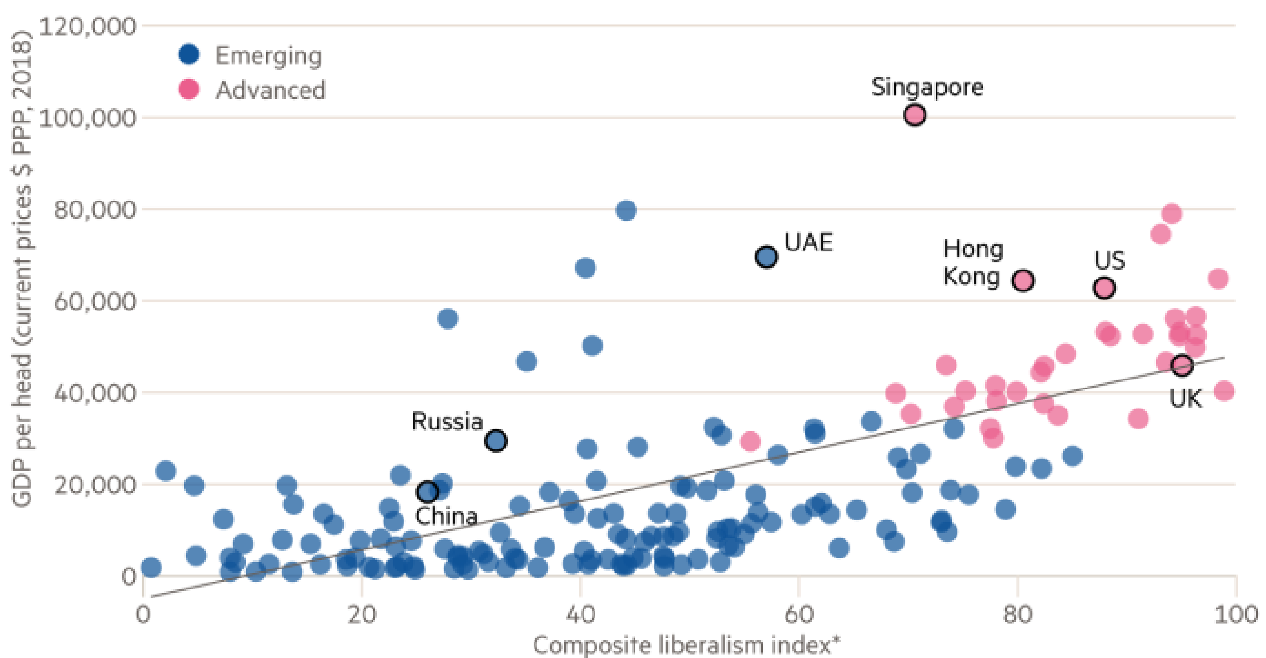
"There is also the so-called liberal idea, which has outlived its purpose. Our western partners have admitted that some elements of the liberal idea, such as multiculturalism, are no longer tenable." Thus, did Vladimir Putin claim to be on the right side of history, in a remarkable interview with the Financial Times. But, as Mark Twain might have said, the report of liberalism's death is an exaggeration. Societies based on core liberal ideas are the most successful in history. They need to be defended against their enemies.

What is "liberalism"? To answer this question, I would first ask American readers to forget what liberalism means to them: the opposite of conservatism. This is a uniquely American meaning that makes sense in the unique American context: immigrants who founded their new state on a set of liberal ideas — liberal in the European sense, in opposition to authoritarian. When Thomas Jefferson wrote of "life, liberty and the pursuit of happiness", in the declaration of independence, he was building on one of the great liberal thinkers, John Locke, replacing "property" with "happiness".

The root word in liberal is *liber*, the Latin adjective denoting a free person, as opposed to a slave. Liberalism is not a precise philosophy, it is an attitude. All liberals share a belief in individual human agency. They trust in the capacity of human beings to decide things for themselves. This belief has radical implications. It implies the right to make their own plans, to express their own opinions and to participate in public life. These attitudes were realised in the system we call "liberal democracy".

Liberals share a belief that agency depends on possession of economic and political rights. Institutions are needed to protect those rights — independent legal systems, above all. But agency also depends on markets to co-ordinate independent economic actors, free media to allow the spread of opinions, and political parties to organise politics. Behind these institutions are values and behaviours: the distinction between private gain and public purpose needed to curb corruption; a sense of citizenship; and belief in toleration.

There is a link between liberalism and economic performance



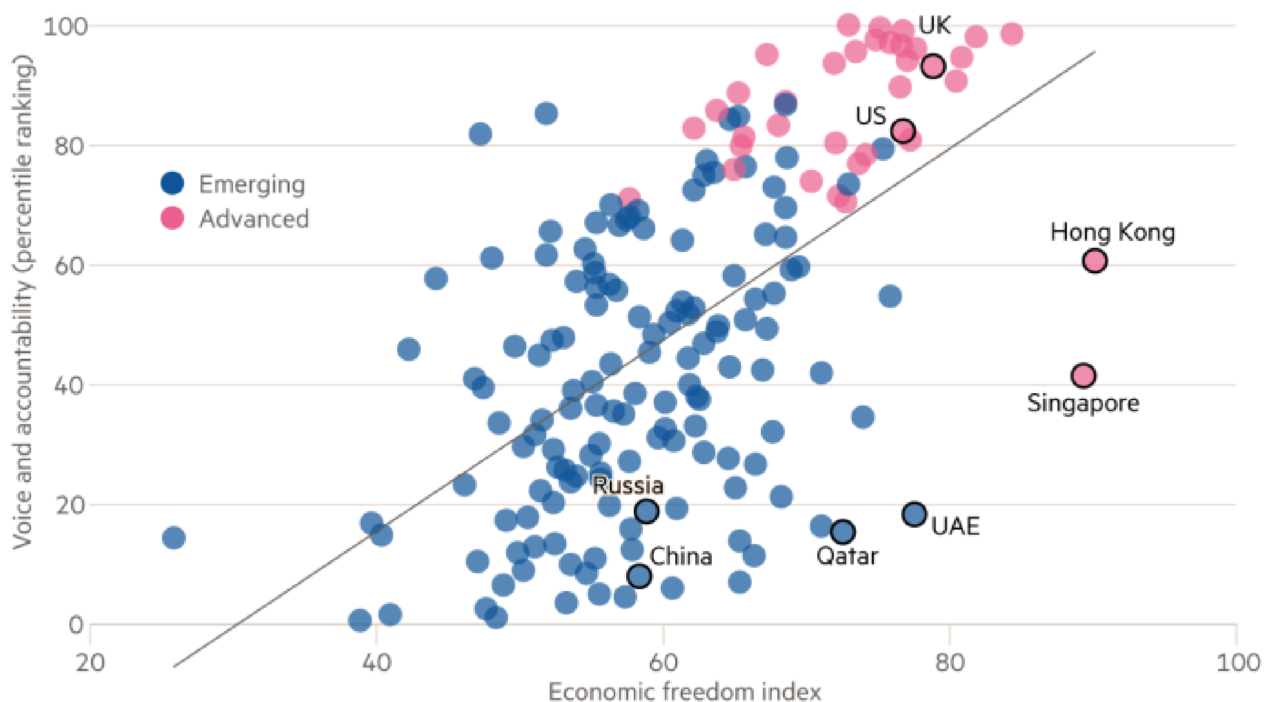
* Composite value based on percentile rankings of economic freedom index and voice and accountability index
Sources: World Bank; IMF; The Heritage Foundation; FT research
© FT

Liberalism then demands a balance between conflicting goods. Some liberals believe more in economic freedom and so oppose an active state. Others believe more in equality among citizens and fear plutocracy. Both of these sides can be liberal, broadly defined. Yet Mr Putin is an enemy of liberalism. The tradition from which he comes is Tsarist autocracy. As Anders Aslund argues in *Russia's Crony Capitalism*, Mr Putin "has meticulously annihilated the budding institutions of capitalism, democracy, and the rule of law that emerged in Russia in the 1990s. In their place, he has formed a strong vertical of power controlled by his cronies, who oppose the rule of law, favouring their own unlimited powers over the state."

To measure the success of liberalism, we combine the World Bank's measure of "voice and accountability" and the Heritage Foundation's "index of economic freedom". Economic and political freedoms do tend to go together, partly because both depend on the rule of law. Liberalism, so measured, is associated with prosperity: liberal societies tend to be rich and rich societies tend to be liberal. (See charts.)

Under Mr Putin, Russia has turned away from liberalism. Largely as a result, Russia's economy is in a poor state. Even though gross domestic product per head is less than half US levels, average growth of GDP per head between 2009 and 2018 was only 1.8 per cent a year. Convergence has slowed to a crawl. Few expect this to improve. Mr Putin's posturing on the world stage is a way of turning the attention of the Russian people away from his regime's corruption and its failure to give them a better life. Even in the case of the more successful Chinese economy, we can speculate that Xi Jinping's turn towards greater state control and political repression will undermine dynamism.

Economic freedom and democracy go hand in hand



Sources: World Bank; The Heritage Foundation
© FT

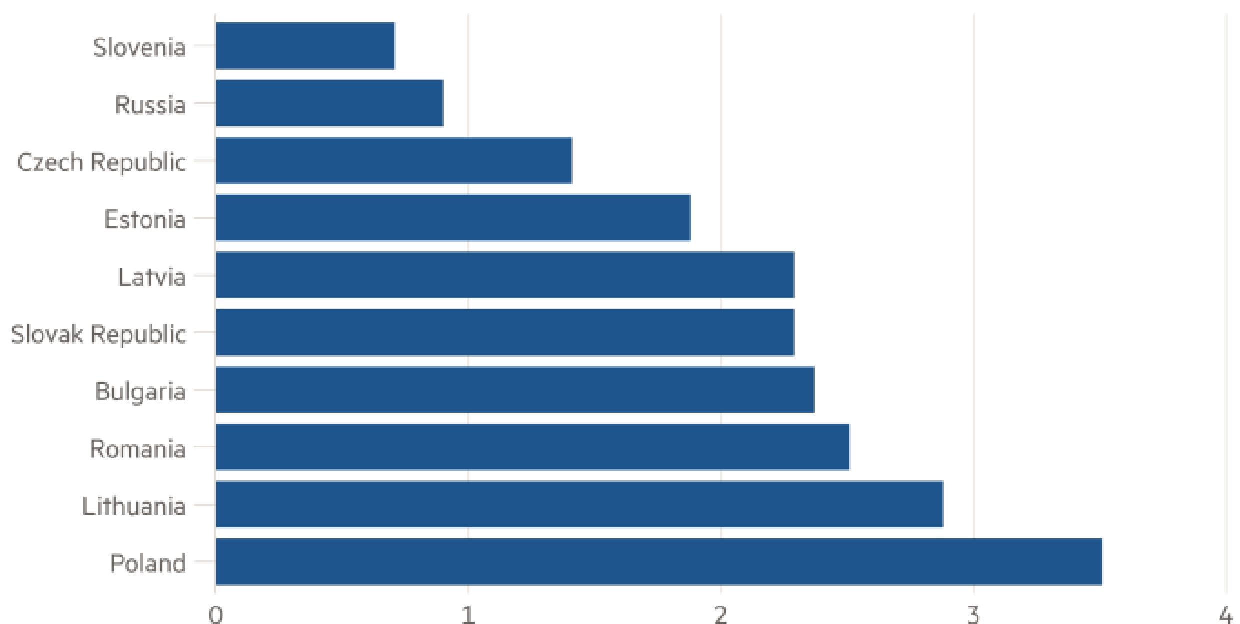
Yet Mr Putin is right on one point. Liberal democracies have run into difficulties, notably over their ability to absorb immigrants and manage inequality. Liberal societies do need shared values and identity. That is perfectly compatible with immigration and enduring cultural differences. But both need to be managed: otherwise, popular discontent will bring to power leaders who despise the norms of liberal democracy. The fragile balance might then collapse. Much that US president Donald Trump says and does indicates his contempt for those norms, notably a free press and an independent judicial system. The risk then is that liberal democracy will turn into "illiberal democracy", which is, in truth, neither liberal nor democratic.

In *Freedom in the World 2019*, the independent US watchdog Freedom House reported a 13th consecutive year of decline in the global health of democracy. This decline, it noted, also occurred in western democracies, with the US — the most influential upholder of democratic values — leading the way. This development is indeed worrying. Liberalism may be much the most successful approach. But in many liberal democracies people, especially elites, have forgotten the balance that needs to be struck between the individual and society, the global and the domestic, and freedom and responsibility.

Liberalism is not a utopian project, it is a work in perpetual progress. It is an approach to living together that starts from the primacy of human agency. But that is only the starting point. Making that approach work requires constant adaptation and adjustment. Mr Putin has no idea what this means: he cannot conceive of a social order that does not rest on force and fraud. We know better. But we also need to do better — far better.

Most post-communist states have grown faster than Russia

Average annual growth in real GDP per head, 2008 to 2019 (%)



Source: The Conference Board
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martin.wolf@ft.com

The age of wealth accumulation is over

FT ft.com/content/fd13020e-b502-11e9-bec9-fdcab53d6959

4 August 2019

© Matt Kenyon

Roughly four decades ago, America kicked off the developed world's last major economic paradigm shift — the supply side revolution.

Capital gains taxes were slashed. President Ronald Reagan and UK prime minister Margaret Thatcher took on air traffic controllers and coal miners. The power of unions faded and that of corporations grew. Some people got very rich. But inequality rose, and eventually, overall trend growth slowed.

Watching the Democratic presidential primary debates last week, I couldn't help but think that we may be witnessing the next great shift, from an era of wealth accumulation to

one of wealth distribution. Moderates like Joe Biden and John Delaney tried to argue for middle of the road answers on issues like healthcare and trade.

But the pole positions were set by Bernie Sanders and Elizabeth Warren, who hold similar views on everything from shifting Americans on to a national healthcare system and relief for indebted students. Both also seek higher taxes for the wealthy and tougher rules for corporations.

While little of this would seem radical in many other parts of the world, in the context of US politics, it was truly something new. The set point for economic debates, even for Democrats, used to be how the government could help the markets work better. Now it's how the public sector can rein them in, and slicing the economic pie more fairly.

What's more, it's not only Democrats. Some Republicans are looking for a paradigm shift as well. Marco Rubio, an influential Republican senator who hopes to be president someday, recently put out a paper on the problems with shareholder capitalism and the merits of industrial policy.

The signs of this new post-supply side era are all around us. Witness the rise of the B-corporations, which balance purpose and profit, and the growth of investing based on environmental, social and governance factors.

In government, note the growing bipartisan enthusiasm for tougher antitrust scrutiny and calls for trade protection, as well as efforts to politicise the US Federal Reserve. It's not just President Donald Trump's tweet seeking rate cuts but also progressive Democrats who see "modern monetary policy" as a way to pay for their priorities without having to fund them through tax rises agreed upon by Congress.

These views are increasingly part of the mainstream. Last week, two senators introduced a bipartisan bill that would force the Fed to devalue the dollar in order to boost exports and balance current accounts with China.

This isn't passing populism, but something much bigger, argues Kiril Sokoloff, founder of 13D Global Strategy & Research, who has been ahead on recognising previous turning points, from supply side economics and the slowing inflation that began in the early 1980s, to the rise of China and the spread of smartphones. "What we're about to see is a backlash against the second gilded era, and it will have a massive impact on the world — and the markets."

One likely impact will be fundamental changes in who holds wealth. The Democratic race reflects the growing conflict between two primary US voting groups — the baby boomers, represented by candidates like Mr Biden, and the millennials, who backed Mr Sanders in 2016, and now like him and younger candidates such as Pete Buttigieg. A decade of loose monetary policy has benefited the former, who have seen their assets appreciate, at the expense of the latter, who cannot afford to get on the housing ladder.

One of the big political battles will be over who gets what share of what looks to be a slower growing pie in what appears to be a slower growth economy.

Another battle will be between capital and labour. Rising wages are taking a bite out of US corporate profit margins and, frankly, they should. When consumer spending makes up 70 per cent of the economy, we need a bit of wage inflation to ensure that people have money to spend. That's particularly true at a time when governments aren't investing, and the shift from a tangible to an intangible economy has led to decreased private sector capital expenditure.

But it has taken trillions of dollars in unconventional monetary policy to cook up relatively small wage increases. And for many Americans the gains are immediately eaten up by increases in healthcare premiums or prescription drug prices, two other hot topics on the campaign trail. That's one of the reasons there's now broad support for higher taxes on the wealthiest.

It remains to be seen when and what form tax rises will take. But the age of wealth distribution is coming and will have major investment consequences. The value of US equities has probably peaked, and hard assets like gold, other commodities, housing, even art — anything in fixed supply — may benefit relative to the equity and debt of multinational companies.

This isn't the end of the world — we've been going through cycles of wealth accumulation and distribution forever. But it does mean that the rules of the road for investors are changing. Some asset prices may fall, but it's possible income growth will be higher. That would come with an upside of its own, economically and politically.

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Central bankers rethink everything at Jackson Hole

FT ft.com/content/360028ba-c702-11e9-af46-b09e8bfe60c0

25 August 2019

Central banks

Policymakers debate regime shift in global economic conditions in which little is certain

US Federal Reserve chair Jay Powell and Bank of England governor Mark Carney in Jackson Hole, Wyoming, on Friday © Reuters

Brendan Greeley in Jackson Hole

August 25, 2019

135

For the world's central bankers gathered in Jackson Hole, there was a sense that things would never be the same again.

The developed world had experienced a "regime shift" in economic conditions, James Bullard, president of the St Louis Federal Reserve, told the Financial Times. "Something is going on, and that's causing I think a total rethink of central banking and all our cherished notions about what we think we're doing," he said. "We just have to stop thinking that next year things are going to be normal."

Interest rates are not going back up anytime soon, the role of the dollar is under scrutiny both as a haven asset and as a medium of exchange, and trade uncertainty has become a permanent feature of policymaking.

Policymakers acknowledged they had reached a turning point in the way they viewed the global system. They cannot rely on the tools they used before the financial crisis to shape the economic environment, and the US can no longer be considered a predictable actor in economic or trade policy — even though there is no imminent replacement for the US dollar in sight.

The gathering at Wyoming came as US president Donald Trump on Friday vowed to raise tariffs on $250bn worth of Chinese imports. His threat capped a tumultuous day on the world's financial markets that began with Beijing announcing new levies on $75bn of US imports and saw Jay Powell, Federal Reserve chairman, caution that it was not the central bank's job to run trade policy.

The resulting market sell-off suggested investors were waking up to the reality that there will be no deal between the world's two largest economies and no clear end to the trade conflict, just continued uncertainty.

"They've priced in that there's going to be uncertainty, there are going to be tweets, there are going to be threats and counter-threats," said Mr Bullard. "And that's the way it's going to be."

He said it was becoming clear that there had been two long-term changes to the underlying economic environment. The first is that central banks will not be able to return to the policies they relied on before the global financial crisis. Policy rates will not rise again to 5 per cent and central bank balance sheets will not soon return to zero.

This problem is worse for Europe and Japan than it is for the US, but given the interconnectedness of the global economy it is relevant around the world.

The second shift highlighted by Mr Bullard is that for businesses, the Fed and global central bankers, the US is no longer in trade negotiations. It is in a period of extended trade uncertainty, with long-term consequences for corporate investment.

Both Mr Bullard and Robert Kaplan, president of the Dallas Fed, pointed to Mr Trump's trade policy on Mexico — rather than China — as a crucial driver of this uncertainty. In May Mr Trump threatened tariffs on the US's neighbour, a country with which he had already negotiated a new trade deal to modify Nafta.

For companies in the Dallas Fed's district, with supply chains that reach across the border, Mr Kaplan said, "the light went on and they shifted their stance".

"We have to position ourselves understanding that we could wake up any day of the week and have a trade surprise even with people we have agreements with — and that's not just with China," he said.

For the first time in years, according to Mr Kaplan, central bankers are dealing with a problem that monetary policy did not cause and cannot fix. “The fulcrum for what’s happening and the direction of the economy is more about trade policy,” he said.

And there is another aspect of the US role in the global economic system that preoccupied Jackson Hole attendees: the status of the dollar in the international monetary system.

The US accounts for only 10 per cent of global trade and 15 per cent of global gross domestic product but the dollar is used to price half of trade invoices and two-thirds of global securities issuance, said Mark Carney, the Bank of England governor. He argued that this created distortions in the global monetary system that undermined the effectiveness of policymaking.

Maurice Obstfeld, a former chief economist of the IMF now at the University of California, Berkeley, said that when other countries could predict US behaviour, they were more willing to cede control of the global monetary system to Washington. But that approach is coming under increasing scrutiny. “When the US was viewed as a responsible leader of the world economy, there was less concern,” he said.

Sebnem Kalemli-Ozcan from the University of Maryland said US monetary policy pushed investment in and out of developing economies in ways that their own central banks could not control.

Mr Carney made the radical suggestion that a private or state-run digital currency could serve as a global counterbalance to the dollar. But he and others acknowledged that there was no realistic mechanism to decouple the global economy from the US dollar in the short term.

Leaving Jackson Hole, central bankers were left with little space for monetary stimulus to counteract an increasingly gloomy trade outlook they cannot control.

“The best [policy] would be: get rid of this political uncertainty,” said Mr Bullard. “Then you wouldn’t have this issue.”

Use the market to clean up the web

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Make *sense* of a disrupted *world*

Explore the new agenda

In July 1855 the eminent scientist Michael Faraday took an unpleasant boat trip down the river Thames. So appalled was he by the state of the "fermenting sewer" that he wrote a letter to The Times urging a clean-up.

"If we neglect this subject, we cannot expect to do so with impunity; nor ought we to be surprised if, ere many years are over, a hot season give us sad proof of the folly of our carelessness," he wrote.

Three years later, a heatwave struck London and Faraday's warning become a smelly reality. The Great Stink, as it became known, forced MPs to pass a bill to refurbish the river. Joseph Bazalgette was entrusted with the task, building embankments along the Thames to encase an extensive sewerage system.

This remarkable feat of civic engineering should inspire us to tackle the Great Stink of our own times emanating from the open sewer that is the internet. For years now, users have been chucking chamber pots of informational filth into cyber space with no respect for public hygiene. Little surprise that the internet has turned into a political and social health hazard.

The maladies of social media are infecting societies everywhere. The persecution of the Rohingya population in Myanmar was fuelled by online hate campaigns. Elections across the world, including the supposedly mature democracies of the US and the UK, have been swayed by overt digital manipulation. The threatening trolling of many female politicians and the cyberbullying of teenage students have destroyed lives.

One of the great challenges of our age will be how to deal with this online filth while preserving free speech and the remarkable promise of our connected world. Who will build a sewerage system for the digital age?

The big tech companies have belatedly acknowledged the problem and finally appear serious about trying to deal with this scourge. They have written smart algorithms and hired thousands of moderators to flag and delete offensive content.

Twitter and Facebook have just shut down hundreds of accounts of Chinese trolls trying to provoke protesters in Hong Kong. Facebook is setting up a 40-person oversight board to provide a new form of supranational governance, although this initiative has already attracted its doubters.

Last month, the network provider Cloudfare terminated its contract with 8chan, an online forum that ran screeds of white supremacist propaganda, denouncing it as a “cesspool of hate”. Scientists are exploring ways to remodel social networks and defang the “online hate ecosystem”.

Politicians are slowly figuring out how to update free speech laws for the internet age. And smart journalists, such as Maria Ressa, chief executive of the Rappler website in the Philippines, are leading efforts to improve the credibility and influence of professional journalism.

Most of these collective efforts are worthwhile and necessary, but they can never be sufficient. The scale of the challenge is colossal, given that some 4.4bn people are now connected to the internet. Every minute of the day these users post 350,000 tweets and upload 300 hours of video to YouTube.

We can never stop those who want to post false or hateful content. But we can certainly go further to redesign the market to reward those who publish socially valuable information and squeeze those who promote viral misinformation.

Dhruv Ghulati, an investment banker turned entrepreneur, is one of those trying to do just that by changing the way the $333bn global online advertising market works.

The company he runs, Factmata, can quickly and algorithmically ascribe a trust score to millions of pieces of online content depending on toxicity, objectivity, political bias and so on. His ultimate goal is to create a new metric for the advertising industry that includes content quality, not just virality.

At present, advertisers mostly buy online ads on the basis of CPMs, or the cost per one thousand clicks or views. But such programmatic advertising takes little or no account of the nature of the content. Factmata is aiming to introduce a quality component to this metric, creating a Q-CPM, a kind of nutritional label for information.

“Fundamentally, there is a pricing problem,” Mr Ghulati says. “The value that society derives from a piece of information is different from the value that the market ascribes to that same information. The market value is determined solely by its propensity to serve ads.”

The obstacles to creating any such metric are obvious and daunting. The algorithmic determination of “quality” would also trigger endless controversy. But it is clear that advertisers must take far more responsibility for where their ads appear and whom they reward online.

By itself, this would create a powerful engine for change. Social networks and food companies, for example, really should care that cookie ads are being served up on white supremacist sites, even if racists eat cookies, too. If advertisers prove resistant, then consumers must force them to act.

“If we neglect this subject, we cannot expect to do so with impunity,” as Faraday warned long ago.

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