



Venice Summer Institute 2006

Perspectives on the Performance
of the Continent's Economies

21 - 22 July 2006

Venice International University, San Servolo



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WHY CAPITALISM NEEDS P.R.S

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ABSTRACT

While fattening people's wallets, capitalism finds it difficult to be loved around the world. In its purest and best form the free market system is unappealing to incumbent firms, because it undermines their established position, forcing them to prove their competence again and again. The only version of capitalism that finds rich promoters is a corrupt one, where vested interests prevent competition from playing its healthy role. This unappealing version fails to win people's hearts, with serious consequences on the long term sustainability of the free enterprise system. Only an educated middle class and a free independent press can overcome this problem.

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The second half of the last century seemed to have settled the debate over economic systems. Natural experiments like the one in Korea where the South espoused capitalism and moved from underdeveloped to developed country status in a generation while the socialist North descended into starvation and destitution have delivered a clear verdict: Capitalism is by far the better system for the production of wealth. At the same time, the collapse of the Soviet Union and the consequent defeat of communism have all but deprived the anticapitalists around the world of a coherent alternative.

If this is true, why the anticapitalist agenda of Chavez in Venezuela and Morales in Bolivia are so popular not only inside their countries, but throughout Latin America? Why so many people protest in the streets against globalization, which they see as a global spreading of capitalism? Why is capitalism still accused of oppressing workers, exploiting the poor and destroying the environment?

The irony is that while capitalism has fattened peoples' wallets and proven itself superior to alternative economic systems, it has made surprisingly little inroads into the hearts and minds of people. But why is capitalism unable to win people's hearts? Why, in spite of its economic successes, it never achieved hegemony of the cultural world, like communism did in its hay days? Is this a simple historical quirk or a problem that we need to analyze? What can be done to alleviate it? These are the questions that I will try to answer in this paper.

The fundamental reason for the poor public image of capitalism, in spite of its successes, is a bad combination of lack of good supporters and excess of bad ones.

A true free market system lacks supporters because nobody has the right incentive to promote it. While everyone benefits from competitive markets, no one in particular

makes huge profits from keeping the system competitive and the playing field level. In fact, entrenched capitalists are the one who will lose the most in promoting competition. Truly free markets create competition, which undermines the position of established firms, forcing them to prove their competence again and again. Hence, they will not be vocal in their defense.

Even worse, the rhetoric of free market and competition is often appropriated by parties that have neither competition nor free entry at heart, but find the capitalist flag a useful cover to promote their own interest. Consider for example Berlusconi in Italy. He campaigned with a pro market agenda against a left that he defined as “communist”. But rather than pro market his agenda has been entirely pro business, protecting local incumbents at the expense of competition. The same problem occurs in the international arena with the United States. Waiving the flag of free market, the United States often pursues a very narrow pro U.S. business agenda.

As a result, the version of capitalism that finds promoters is a corrupted one, where vested interests prevent competition from playing its natural, healthy, role. While probably still more economically efficient than state socialism, this form of capitalism is politically unappealing and intellectually hard to defend. Many of the accusations against capitalism -- that it oppresses workers, that it creates private monopolies, that it is only an instrument for the rich to get richer – relate to this corrupted, uncompetitive systems rather than to a true free enterprise system. With this version of capitalism it is impossible to win over people’s hearts.

Do we care? Yes. The free market system is politically fragile. Precisely because no one in particular makes huge profits from keeping the system competitive and the

playing field level, many have an interest in introducing exceptions to the system, exceptions that might guarantee them healthy profits. The lack of a good public image, thus, makes the free market system extremely vulnerable to political backlashes. As we argue in Rajan and Zingales (2003), these backlashes are particularly likely in time of recessions, when the number of losers is higher and the hopes for a brighter future more limited. Is there any hope?

The lack of lobbying in favor of the better form of capitalism is nothing but one manifestation of the political dominance of vested interests over public interest predicted by Stigler (1971). The reason behind this dominance is that the vast majority of people does not find in their economic interest to become informed on most issues. With the vast majority of voters uninformed, vested interest has easy play.

While it might not be in their economic interest, voters can become informed for other reasons, when the cost of becoming informed is limited. After all a majority of people in most country vote at general election, even if this is not in their economic interest, as long as the cost of voting is not too high. Voters also become informed when they derive enjoyment from the process. It is the presence of a complementarity between news and entertainment that motivate profit maximizing media to inform. As we argue in Dyck, Moss and Zingales (2005), profit motives will push the media to cater to the majority of the population promoting their interest. Since a free market system is in the majority's interest, independent, profit maximizing media will naturally become the defenders of free market. The problem is that in most of the world (see Djankov et al. (2003)), media are not independent. Televisions are generally controlled by the governments and hence by the vested interests that capture them. The problem with

newspapers in most countries, however, is the restricted set of potential customers. Only literate and relatively well-off people buy and read newspapers. In developing countries, where literacy rates are still low, most of the voters do not satisfy this criterion. As a result, in these countries newspapers are not catering to the median voter, they are catering to the median reader, who tends to belong to the ruling elite. Rather than promoting free markets in these countries newspapers will argue in favor of a system that protects the rents of incumbents. Hence, the precondition for a cultural hegemony of the free market system is a combination of an educated middle class and a free independent press.

The rest of the paper proceeds as follows. Section 1 argues why capitalism needs a good public image. Section 2 explains why the free market system needs political support and why it finds it difficult to obtain it. Section 3 discusses what forms of capitalism find indeed support and why this ruins the reputation of the capitalism system. Finally, section 4 describes the positive role the media can have in promoting the free market agenda. Section 5 concludes.

1. Why Capitalism's Public Image Is Important

Political outcomes are not determined uniquely by economic interests. Even a true Marxist as Antonio Gramsci recognizes the importance that the dominant culture plays in determining political outcomes. By establishing its own cultural values, an interest group can gain consensus in other social groups and better achieve its political objectives.

Gramsci (1949) applies this idea to the socialist revolution and claims that it cannot be achieved before the working class has achieved a cultural hegemony. His ideas, however, are broader and can apply for any the idea of free market itself.

In many political decisions there are a lot of bystanders, who are inclined to vote for the solution that appears more appealing on purely ideological consideration. What solution they find more appealing depends upon their system of value and hence ultimately the culture that they have absorbed. The question, then, is what determines the culture people absorb. An answer to this question is well beyond the scope of this paper. Here it suffices to say that economic interests can and do battle to win people hearts. Much of the classic theory of regulation (Stigler, 1971), hence, can be applied to explain the relative strength of different groups in influencing the dominant culture. As we will explain in the next section, however, a true free market system does not find a lot of supporters and hence easily lose the battle to win people's hearts.

2. The public good nature of the free market system

Many Americans are often too simplistic when it comes to exporting capitalism to other countries. They think it is sufficient to export American law to make capitalism blossom instantaneously. It worked for them, why shouldn't it work for other countries? And for this reason economics, which in the last fifty years developed mostly in the United States, has traditionally been quite oblivious of the political preconditions for the development of capitalism. The fall of the Berlin Wall and the massive social experiment in transition economies, however, provided a rude awakening. The experience of the last decade shows that to work capitalism needs more than a good set of laws. It needs norms

and institutions, it needs rules and enforcement of these rules, it ultimately needs widespread political consensus. Without political support free markets cannot survive.

Once we recognize this simple truth, then American optimism on the ease of spreading capitalism disappears. In fact, it is substituted by a moderate pessimism for the intrinsic fragility of capitalism, not an economic fragility (as Marx theorized), but a *political* fragility. In a nutshell, the idea is as follows. While everyone benefits from competitive markets, no one in particular makes huge profits from keeping the system competitive and the playing field level. Thus, nobody has a strong vested interest in promoting and defending free markets.

On the contrary, many people have an interest in restraining them. Not only do the ranks of the opponents include distressed workers who lose their jobs because of the competitive pressures, but also large industrialists themselves: truly free markets create competition, which undermines the position of established firms, forcing them to prove their competence again and again. Hence, not only does a truly capitalist system find it difficult to generate political support, it often finds explicit opposition among the most influential groups. It should be no surprise then that capitalism is so difficult to export.

After the 1994 Mexican crisis, for instance, the World Bank decided to help the government improve the financial infrastructure. Among the fundamental institutions that were missing was a credit registry, where assets posted as collateral for a loan could be officially recorded so that any potential lender could be aware of what a borrower had already pledged. In turn, such a registry would make it easier for small and medium firms to raise finance against their assets, since potential lenders would now have the confidence to lend. In setting up this registry the World Bank experienced strong

resistance from the existing banks. Why? Existing banks had enough clout that they could get this information regardless of the credit registry. Not only would they not benefit from it but they would see their competitive position eroded as less established lenders could access that information and compete for business on an equal footing. Access to credit was curtailed to support the interests of the few incumbent interests!

This is not an isolated case. Throughout the world, large and established firms (and financial institutions) have the greatest influence on policy, including the setting up of market infrastructure. Often (but not always), they simply are not interested in expanding access to everyone, for that would unnecessarily push up competition. No wonder then that the interest of free markets is not well served and that the poor around the world see markets as being against them, not realizing that what they experience is a very corrupted version of what capitalism should and could be.

Not only does this corrupt version of capitalism generate economic inefficiencies and social injustice, it also undermines the political consensus for a truly free market system. In the early 1990s Robert Shiller documented that Russians had attitudes toward private property and markets that were very similar to Americans. A recent survey, however, finds that 72% of the Russians would like to return privatized property to the Government. Ten years of corrupt capitalism have undermined the consensus in favor of free markets more than then seven decades of communist propaganda!

The essence of true capitalism is not just private ownership but free access and competition. For these to emerge, we need neither too little nor too much of the government. To understand why consider the following example. If you wanted to fly and there was no supervisory authority in the airline industry and no regulations

enforcing safety standards, you would be very reluctant to fly fledgling airlines. You would prefer the established ones that had the track record and the reputation. So a complete lack of safety regulations in the airline industry would favor established firms, making entry impossible, and killing competition.

But if the regulation said that you had to have a proven five year track record of profitable flying before you would be allowed to take passengers, new entry would again be killed off, for how can new entrants have a proven record? It is the delicate middle ground, where enough rules are in place so that people feel confident in flying the new entrants, but not so much that the new entrants can never qualify, where competition flourishes.

This balance can only be achieved when there is a broad consensus in favor of markets. But who has an interest in promoting this consensus? The same vested interest that lobby the legislators to restrain entry and competition have also an interest in supporting an ideology that is more in tune with their goals. The free market system, thus, desperately needs a P.R. agent.

3. The capitalism that finds support

The public image problem of capitalism is not limited to the lack of interested promoters. The rhetoric of free market and competition is often appropriated by parties that have neither competition nor free entry at heart, but find the capitalist flag a useful cover to promote their own interest. Consider for example Berlusconi in Italy. He campaigned with a pro market agenda against a left that he defined as “communist”. But rather than pro market his agenda has been entirely pro business, protecting local

incumbents at the expense of competition. An interesting question is why people like Berlusconi find it so easy to disguise their interest behind the capitalist agenda.

The same problem occurs in the international arena with the United States. Waiving the flag of free market, the United States often pursues a very narrow pro U.S. business agenda. When it comes to financial services, for example, where they have a strong competitive advantage, the United States is a very strong advocate of free market and competition. When it comes to agriculture, however, the advocacy of free market disappears and the use of state subsidies widespread. Even on such important positions such as protection of property rights, the U.S. ideological position seems to adapt to U.S. economic interest. While strong advocate of property right protection for drugs even in the face of major epidemics such Aids in Africa, the United States started to discuss the possible violation of an antibiotic patent held by a Canadian firm when the anthrax scare hit the United States in the Fall of 2001.

Unfortunately, this self serving version of capitalism that is promoted in most parts of the world creates a huge political backlash. It is interesting, for example, to see that the support for competition is strongest in those countries where the United States had less influence. While in Latin America, where the political influence of the United States has been strongest, we observe a flourishing of anticapitalists movements, in China and India, where this influence has been limited or no existent, we see much greater support for capitalism.

4. The role of the free press

The lack of lobbying in favor of the better form of capitalism is nothing but one manifestation of the political dominance of vested interests over public interest predicted by Stigler (1971). The reason behind this dominance is that the vast majority of people does not find in their economic interest to become informed on most issues. With the vast majority of voters uninformed, vested interest has easy play.

The maintained assumption in Stigler's theory is that Downs' rational ignorance result always holds. If it did not, the balance of power in Peltzman's (1976) framework will heavily shift in favor of public interest. If voters were informed on issues, a self-interested politician would want to cater to their interest, to capture more votes.

Voters' rational ignorance does not seem such a strong assumption, since it is true that it is prohibitively expensive for them to collect information directly. But voters do not have to collect this information directly. There are information intermediaries (the media), that collect, filter, and aggregate information.

An obvious point, albeit not adequately emphasized in the literature, is that the collection and aggregation of information performed by the media can dramatically reduce voters' cost of information collection.

More importantly, however, media can also eliminate the personal cost of absorbing this information by making news entertaining. If there is any complementarity between information and entertainment (as assumed in the Becker and Murphy (1993) model), then profit seeking media will inform in order to entertain. In so doing media can overcome Downs' rational ignorance result and thus potentially change the balance of power in political decision making.

How does this complementarity affect political economy outcomes? The answer clearly depends upon the objective function of the information intermediaries, who have the ability to package news and entertainment. While there is no question some entertainers have a precise political agenda, like Michael Moore, Dyck et al. (2005) shows that complementarity between news and entertainment can have far reaching political economy consequences even if we assume that media have only the goal of profit maximization in mind.

They show that even if the income distribution were uniform, a profit maximizing media outlet will have an interest in catering to a below-the-median voter. A fortiori, with a skewed income distribution, the media outlet will cater to the masses, rather than to the elite. That is the reason why in talking about environmental issues media tend to present the fact from the point of view of consumers, rather than from the point of view of the producers.

In the context of printed media the idea is as follows. A voter will buy a magazine only if the utility it gives him in term of entertainment exceeds its cost (disutility generated by the money spent to buy the magazine). His utility is a function of how entertaining the magazine is and how close the facts are presented from his point of view, which is summarized by his position in the income distribution.

In this context if the printing technology is not too expensive relative to the average income a profit maximizing magazine will not cater to the median voter, but to a voter below the median income. The reason is very simple. Each voter buys at most one magazine. And if potential readers are equally distributed positioning at the median minimizes both the average and the median distance each reader has to travel

“ideologically”. But an equal cost of traveling is compared with a different disutility produced by the cost of purchasing the magazine. Richer people have a lower marginal utility of money and hence care less about the purchase price. As a result, for a given ideological distance richer people are less on the margin of not buying than poorer people. It follows that to maximize the number of copies sold a magazine want to cater to a reader below the median point. Moving to the left of the median makes it lose fewer rich people than poor people it gains. Hence, the result that profit maximizing magazines are naturally “populist”. If we relax the assumption of equal distribution along the real line and we make the more reasonable assumption that there are more poor than rich, this result is further strengthened. As a result, profit maximizing media will tend to advance the interest of the below-the-median voter, which coincides with a free and competitive market.

This result, however, is conditional on the assumption that the printing technology is sufficiently cheap relatively to the income distribution that the magazine can be sold profitably to even the poorest segment of the population. If this is not the case, then a fraction of the people’s distribution is cut off from the set of potential readers, because they cannot afford to buy the magazine. Hence, a profit maximizing magazine will locate below the median point of the truncated distribution. In this case, thus, the ideological position of the magazine will be more and more pro rich, the more expensive the printing technology is and the less literate a country is.

In developing countries, where literacy rates are still low and income level of the vast majority of the population very low, most of the people are not potential readers. As

a result, in these countries newspapers are not catering to the median voter, they are catering to the median reader, who tends to belong to the same ruling elite. This is the reason why in these countries there is less ideological support for free market. For the free market ideology to be promoted we need a combination of an educated middle class (who read newspapers) and independent media that maximize profits and not the political power of their owners. Unfortunately, as Djankov et al. (2003) document this situation is the exception, rather than the rule, in most of the world.

5. Conclusions

In spite of its economic successes, capitalism finds it difficult to win people's hearts around the world. This failure is due to lack of interested promoters. In its purest and best form the free market system is unappealing to incumbent firms, because it undermines their established position, forcing them to prove their competence again and again. Hence, vested interests are ideologically against free markets and will not promote them. Without any explicit support the interest of free markets finds it difficult to achieve cultural hegemony.

The only hope is represented by an independent press. An independent press that maximizes profit will tend to cater the public interest to attract more readers. In so doing it will promote free markets. This effect, however, is present only in countries where an educated and relatively well-off middle class creates a market for news. When these two conditions are not present the media will tend to cater to the interest of the ruling elite, which generally does not coincide with the interest of free markets.

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