

6<sup>th</sup> Annual Conference  
Center on Capitalism and Society  
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## Introductory Remarks: Emerging from the Financial Crisis: Reform and Restructure

Edmund S. Phelps\*

I greet you on behalf of the Center on Capitalism and Society. Later today President Bollinger will welcome you on behalf of the University.

We are in our 6<sup>th</sup> year, roughly, since “coming out” with our Inaugural Conference in spring 2004. Little by little, the Center has been improving – witness our electronic journal and our new website. Unfortunately large parts of the global economy have been getting worse. Of course that is not our fault. Yet it is evident that the world has learned little about the perspectives adopted by the Center (perspectives that emerged in the Interwar years and were rejected by the postwar Keynesians and resisted by deterministic, rational-expectations schools) and the insights the Center is offering. We have to do better.

The Center was established to develop an *alternative economics* that would illuminate *what* it is that *capitalist* systems do and *how* they do it. The pretense of standard economics that everything important to know is *known* – the future is *predictable*, aside from an element of randomness, and the returns that additional private investments would earn and the

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\* Director, Center on Capitalism and Society, Columbia University. The Center’s website is at [www.capitalism.columbia.edu](http://www.capitalism.columbia.edu).

benefits that additional policy reforms would offer are *unambiguous* – makes the standard economics *unusable* for many questions and seriously *unreliable* where it is used for analyzing an economy operating on a capitalist system.

The “alternative economics” toward which we are working centers around the process of *innovation* in capitalist systems and its fundamental *consequences*. One of these is the new and rich dimension to human welfare that innovation (both the process and the resulting economic change) generates: the rewards – even for ordinary people – from the mental stimulation, problem-solving, imagination and exploration that work involves in an innovative economy. A second consequence is the attendant difficulties many have in entering –qualifying for, the French would say – this sort of economy. A third is the massive uncertainty created and thus the “speculative excesses” that may result. In this view, the performance of an economy – an advanced economy, at any rate – is primarily measured by its *dynamism* (innovativeness under standardized conditions), the *inclusiveness* of its business sector (where the innovation takes place), and its *robustness* (or *vulnerability*) to malfunctions, or pathogens. These malfunctions – such as widespread insolvency resulting from speculation gone awry – are what cause financial crisis and the possibility of business depression.

This quest is not for its own sake. Many nations may find it *valuable* in deciding what kind of system to adopt to understand better the sources of the dynamism, the inclusion and the robustness found in most or all high-performance economic systems. And nations with capitalist systems may find it *crucial* to understand (as well as we can) how modifications to the system would affect dynamism and the other performance measures.

It is exciting to see so many thinkers with so much expertise gathered here. It is obvious why you have come. The financial crisis, with its attendant uncertainties, has thrown a monkey wrench (albeit a temporary one, we hope) into the performance of capitalist systems: in the U.S., dynamism is down (even if the potential for the dynamism is still present) and so is inclusion: low wage workers are hard hit. No one is expecting a wave of innovation that, if it comes, will pull us out of a mild depression we may be headed for. (The 1920s saw innovations, which create jobs, followed by productivity advances built on them, which destroy jobs.) I think all of you here sense that this situation holds danger for the continued political support for a capitalist system, even its best parts – just as the 1930s saw a brief rise of corporatist thinking.

Moreover, what the U.S. government, including the Congress, does to *repair and reform* the financial sector may be extremely dangerous to capitalism's performance. The financial sector is the heart – or the brain – of the capitalist system. So it is important that we debate here the possible ways in which the financial sector might be reshaped *not only* from the perspective of the recent *vulnerability* of the financial sector (and of the economy) to a collapse of real estate speculation but *also* from the point of view of restoring and improving the economy's *dynamism* and *inclusion*.

In my mind, the financial crisis in which the world now finds itself raises the question of whether a basic restructure, or reconstruction, of capitalism is in order – the capitalism of the U.S., the U.K and a few other nations. Has sustaining the historical level of innovativeness in the U.S. economy come to require excessive risk-taking? Is there a trade-off, so that these countries must accept less innovation if they opt to reduce the risk? Will reforming *incentives* in the financial sector in hopes of reducing the susceptibility and vulnerability of the sector to speculative swings cost the

economy some of its dynamism and inclusion? Must all financial and economic reforms intended to boost dynamism expose the economy to increased risk? Or can it be expected that there are better possibilities?<sup>1</sup>

Panel 1 offers the view that a financial sector in which the banks thrive on mortgage lending is no longer viable, if indeed it ever was – that we “cannot put Humpty Dumpty together again.”<sup>2</sup> The panel will explore ways to *reshape* the financial sector – ways that give some promise of increasing the dynamism and inclusion in the economy (both of which appear to have waned over the past decade), *and* decreasing the financial sector’s *vulnerability* to speculative swings at the same time. (Of course, speculative swings are normal and often desirable in a well-functioning capitalist system.)

Panel 2 addresses the tension between innovation and regulation. One

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<sup>1</sup> In the crisis talk, there is a raft of unexamined assumptions that – right or wrong – ought to be questioned before policy and institutions are built on these assumptions.

- One of the unexamined assumptions is that we can rein in risk-taking (or the “underpricing of risk”) at the banks – increasing capital ratios and reducing leverage – without causing a lengthy weakness in aggregate investment activity far beyond the mere decline to normalcy (which took place from 3<sup>rd</sup> Quarter 2007 to 3<sup>rd</sup> Quarter 2008.)

- The assumption behind that assumption appears to be that the resulting shortfall from normalcy can and ought to be filled in by increased public investment *rather than the creation of new banks*. Why not more banks?

- Another assumption is that economic policy must strive to restore the price level of houses, say, the Case-Shiller index, to its previous high level.

- Yet another assumption is that we must restore not only functionality to the banks (i.e., their ability to lend) but also recreate them as they were – as serving to help expand housing and support the construction industry.

- The last of the unexamined assumptions is that business investment and innovation are already ample or will become so once construction is largely revived and public investment makes up the remaining shortfall. The underlying assumption appears to be that there are no significant signs of weakness in the business innovation and investment generally.

Thus, a great deal of the discussion commits the fallacy of taking it for granted – without any analysis – that the construction activity can be restored at least to a normal level and any shortfall can be provided by the federal government: that Humpty Dumpty *can* be “put together again”!

<sup>2</sup> The famous nursery rhyme (which also appears in Lewis Carroll’s *Through the Looking Glass*) is:

Humpty Dumpty sat on a wall;  
Humpty Dumpty had a great fall.  
All the King’s Horses  
And all the the King’s men  
Couldn’t put Humpty together again!

of the issues is addressing the question of whether standard concept of “market failure” in asset markets and the banking industry, though unquestionably valuable, will be sufficient to create a financial sector conducive to dynamism. While some regulatory changes are surely helpful in every dimension, we must not let through regulations that cause considerable damage to dynamism. Is it safe to redesign the regulation of finance on the basis of a theory that, by its construction, omits dynamism?

Panel 3 will debate the question of whether the international financial system is ultimately responsible for the increased frequency of crisis in recent decades. Would the present crisis not have occurred – or been less likely to occur – had China and Germany and, earlier, the Middle East not found themselves needing to export capital to the world capital market, thus reducing world cost of capital (and boosting the world cost of labor)?

Panel 4 will ponder the question of what sort of a future is in store for capitalist economies. Can we look forward to the restoration of dynamism and inclusion? Or must we brace ourselves for a period of depressed economic activity, especially in the business sector?

I look forward to the debates!