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How Capitalism Has Gone Off the Rails

The Zombie System

By Michael Sauga

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Six years after the Lehman disaster, the industrialized world is suffering from Japan Syndrome. Growth is minimal, another crash may be brewing and the gulf between rich and poor continues to widen. Can the global economy reinvent itself?

A new buzzword is circulating in the world's convention centers and auditoriums. It can be heard at the World Economic Forum in Davos, Switzerland, and at the annual meeting of the International Monetary Fund. Bankers sprinkle it into the presentations; politicians use it leave an impression on discussion panels.

The buzzword is "inclusion" and it refers to a trait that Western industrialized nations seem to be on the verge of losing: the ability to allow as many layers of society as possible to benefit from economic advancement and participate in political life.

The term is now even being used at meetings of a more exclusive character, as was the case in London in May. Some 250 wealthy and extremely wealthy individuals, from Google Chairman

Eric Schmidt to Unilever CEO Paul Polman, gathered in a venerable castle on the Thames River to lament the fact that in today's capitalism, there is too little left over for the lower income classes. Former US President Bill Clinton found fault with the "uneven distribution of opportunity," while IMF Managing Director Christine Lagarde was critical of the numerous financial scandals. The hostess of the meeting, investor and bank heir Lynn Forester de Rothschild, said she was concerned about social cohesion, noting that citizens had "lost confidence in their governments."

It isn't necessary, of course, to attend the London conference on "inclusive capitalism" to realize that industrialized countries have a problem. When the Berlin Wall came down 25 years ago, the West's liberal economic and social order seemed on the verge of an unstoppable march of triumph. Communism had failed, politicians worldwide were singing the praises of deregulated markets and US political scientist Francis Fukuyama was invoking the "end of history."

Today, no one talks anymore about the beneficial effects of unimpeded capital movement. Today's issue is "secular stagnation," as former US Treasury Secretary Larry Summers puts it. The American economy isn't growing even half as quickly as did in the 1990s. Japan has become the sick man of Asia. And Europe is sinking into a recession that has begun to slow down the German export machine and threaten prosperity.

Capitalism in the 21st century is a capitalism of uncertainty, as became evident once again last week. All it took were a few disappointing US trade figures and suddenly markets plunged worldwide, from the American bond market to crude oil trading. It seemed only fitting that the turbulence also affected the bonds of the country that has long been seen as an indicator of jitters: Greece. The financial papers called it a "flash crash."

Running Out of Ammunition

Politicians and business leaders everywhere are now calling for new growth initiatives, but the governments' arsenals are empty. The billions spent on economic stimulus packages following the financial crisis have created mountains of debt in most industrialized countries and they now lack funds for new spending programs.

Central banks are also running out of ammunition. They have pushed interest rates close to zero and have spent hundreds of billions to buy government bonds. Yet the vast amounts of money they are pumping into the financial sector isn't making its way into the economy.

Be it in Japan, Europe or the United States, companies are hardly investing in new machinery or factories anymore. Instead, prices are exploding on the global stock, real estate and bond markets, a dangerous boom driven by cheap money, not by sustainable growth. Experts with the Bank for International Settlements have already identified "worrisome signs" of an impending crash in many areas. In addition to creating new risks, the West's crisis policy is also exacerbating conflicts in the industrialized nations themselves. While workers' wages are stagnating and traditional savings accounts are yielding almost nothing, the wealthier classes -- those that derive most of their income by allowing their money to work for them -- are profiting handsomely.

According to the latest Global Wealth Report by the Boston Consulting Group, worldwide private wealth grew by about 15 percent last year, almost twice as fast as in the 12 months previous.

The data expose a dangerous malfunction in capitalism's engine room. Banks, mutual funds and investment firms used to ensure that citizens' savings were transformed into technical advances, growth and new jobs. Today they organize the redistribution of social wealth from the bottom to the top. The middle class has also been negatively affected: For years, many average earners have seen their prosperity shrinking instead of growing.

Harvard economist Larry Katz rails that US society has come to resemble a deformed and unstable apartment building: The penthouse at the top is getting bigger and bigger, the lower levels are overcrowded, the middle levels are full of empty apartments and the elevator has stopped working.

'Wider and Wider'

It's no wonder, then, that people can no longer get much out of the system. According to polls by the Allensbach Institute, only one in five Germans believes economic conditions in Germany are "fair." Almost 90 percent feel that the gap between rich and poor is "getting wider and wider."

In this sense, the crisis of capitalism has turned into a crisis of democracy. Many feel that their countries are no longer being governed by parliaments and legislatures, but by bank lobbyists, which apply the logic of suicide bombers to secure their privileges: Either they are rescued or they drag the entire sector to its death.

It isn't surprising that this situation reinforces the arguments of leftist economists like distribution critic Thomas Piketty. But even market liberals have begun using terms like the "one-percent society" and "plutocracy." The chief commentator of the *Financial Times*, Martin Wolf, calls the unleashing of the capital markets a "pact with the devil."

They aren't alone. Even the system's insiders are filled with doubt. There is the bank analyst in New York who has become exasperated with banks; the business owner in Switzerland who is calling for higher taxes; the conservative Washington politician who has lost faith in the conservatives; and the private banker in Frankfurt who is at odds with Europe's supreme monetary authority.

They all convey a deep sense of unease, and some even show a touch of rebellion.

If there is a rock star among global bank analysts, it's Mike Mayo. The wiry financial expert loves loud ties and tightly cut suits, he can do 35 pull-ups at a time, and he likes it when people call him the "CEO killer."

The weapons Mayo takes into battle are neatly lined up in his small office on the 15th floor of a New York skyscraper: number-heavy studies about the US banking industry, some as thick as a shoebox and often so revealing that they have enraged industry giants like former Citigroup CEO Sandy Weill, or Stan O'Neal in his days as the head of Merrill Lynch. Words of praise from Mayo are met with cheers on the exchanges, but when he says sell, it can send prices tumbling.

Mayo isn't interested in a particular sector but rather the core of the Western economic system. Karl Marx called banks "the most artificial and most developed product turned out by the capitalist mode of production." For Austrian economist Joseph Schumpeter, they were guarantors of progress, which he described as "creative destruction."

But financial institutions haven't performed this function in a long time. Before the financial crisis, they were the drivers of the untenable expansion of debt that caused the crash. Now, focused as they are on repairing the damage done, they are inhibiting the recovery. The amount of credit ought to be "six times faster than it has been," says Mayo. "Banks now aren't the engines of growth anymore."

Mayo's words reflect the experience of his 25 years in the industry, a career that sometimes sounds like a plot thought up by John Grisham: the young hero faces off against a mafia-like system.

He was in his late 20s when he arrived on Wall Street, a place he saw as symbolic of both the economic and the moral superiority of capitalism. "I always had this impression," says Mayo, "that the head of a bank would be the most ethical person and upstanding citizen possible."

The Blackest of Boxes

But when Mayo, a lending expert, worked for well-known players like UBS and Prudential Securities, he quickly learned that the glittering facades of the American financial industry concealed an abyss of lies and corruption. Mayo met people who recommended buying shares in technology companies in which they themselves held stakes. He saw how top executives diverted funds into their own pockets during mergers. And he met a bank director who only merged his bank with a lender in Florida because he liked boating in the Keys.

What bothered Mayo most of all was that his employers penalized him for doing his job: writing critical analyses of banks. He lost his job at Lehman Brothers because he had downgraded a financial institution with which the Lehman investment department wanted to do business. Credit Suisse fired him because he recommended selling most US bank stocks.

Only when the real estate bubble burst did the industry remember the defiant banking analyst, who already saw the approaching disaster even as then-Deutsche Bank CEO Josef Ackermann issued a yield projection of 25 percent. *Fortune* called him "one of eight people who saw the crisis coming." The US Congress called on him to testify about the crisis.

Today Mayo writes his analyses for the Asian brokerage group CLSA and they still read like reports from a crisis zone. Central banks have kept lenders alive with low interest rates, and governments have forced them to take up additional capital and comply with thousands of pages of new regulations. Nevertheless, Mayo is convinced that "the incentives that drove the problems … are still in place today."

Top bank executives are once again making as much as they did before the crisis, even though the government had to bail out a large share of banks. The biggest major banks did not shrink, as was intended, but instead have become even larger.

Incalculable Risks

New accounting rules were passed, but financial managers can still hide the value of their receivables and collateral behind nebulous terms like "transaction" or "customer order." Bank balance sheets, British central banker Andrew Haldane said caustically, are still "the blackest of boxes."

Before the crash, investment banks gambled with derivatives known by acronyms like CDO and CDS. Today Wall Street institutions try to get the upper hand with high-frequency trading, with their Dark Pools and millisecond algorithms. Regulators fear that high-frequency trading, also known as flash trading, could create incalculable risks for the global financial system.

When analyst Mayo thinks about the modern banking world, he imagines a character in the Roman Polanski film "Chinatown," California detective Jake Gittes. The man solves one corruption case after another, and yet the crime level in Los Angeles doesn't go down. "Why is that?" he finally asks another character, who merely replies: "Forget it, Jake. It's Chinatown."

It's the same with the banking industry, says the analyst. Individual institutions aren't the problem, he explains. The problem is the system. "The banks are Chinatown," says Mayo, "and it is still the situation today."

The little village of Wimmis lies in an area of Switzerland that still looks quintessentially Swiss, the Bernese *Oberland*, or Highlands, where Swiss flags flutter in front yards. The local tanning salon is called the "Sunne Stübli" (little sun room) and under "item five" of the latest edition of the town's "Placard Ordinance," posted outside the town administration building, organizations must secure their public notices "with thumbtacks" and "not with staples." Everything has its place in Wimmis, as it does in Markus Wenger's window factory. The business owner, with his thinning hair and crafty eyes, is the embodiment of the old saying, "time is money." He walks briskly through his production building, the size of a football field, passing energy-saving transom windows, energy-saving patio doors and energy-saving skylights, which can be installed between solar panels, also to save energy, a system Wenger developed. "We constantly have to think of new things," he says, "otherwise the Czechs will overtake us."

Wenger could pass for a model businessman from the regional chamber of commerce were it not for his support for a political initiative that's about as un-Swiss as banning cheese production in the Emmental region. Wenger advocates raising the inheritance tax.

For decades, Switzerland was based on a unique form of popular capitalism, which promised small craftsmen as many benefits as those who worked in high finance. Switzerland was the discreet tax haven for the world's rich, while simultaneously laying claim to Europe's highest wage levels -- a Rolex model of the social welfare state.

But the country's established class consensus was shattered by the excesses of the financial crisis -- the $60 billion bailout of its biggest bank, UBS, and the millions in golden parachutes paid out to executives so that they wouldn't go to the competition after being jettisoned by their companies.

Since then, a hint of class struggle pervades Swiss Alpine valleys. A series of popular initiatives have been launched, initiatives the financial newspapers have labeled "anti-business." To begin with, the Swiss voted on and approved a cap on so-called "rip-off salaries." Another referendum sought to impose a ceiling on executive compensation, but it failed. A proposal by Social Democrats, Greens and the socially conservative EVP, to support government pensions with a new tax on large inheritances, will be put to a referendum soon.

'The Wealth of Medieval Princes'

Income isn't the problem in Switzerland, where the gap between rich and poor is no wider than in Germany or France. The problem is assets. No other country has as many major shareholders, financiers and investors, and in no country is as much capital concentrated in so few hands. The assets of the 100 wealthiest Swiss citizens have increased almost fivefold in the last 25 years. In the Canton of Zürich, the 10 richest residents own as much as the poorest 500,000. When a Swiss business owner died recently, his two heirs inherited an estate worth as much as all single-family homes and owner-occupied flats in the Canton of Appenzell Innerrhoden. Wealth has become so concentrated in Switzerland, says the former head of the Zürich statistics office, that it "rivals the wealth of medieval princes."

The government benefits hardly at all from this wealth. The Swiss tax authorities recently collected all of 864 million Swiss francs (€715 million) in inheritance tax, and this revenue source is unlikely to increase anytime soon. To attract wealthy individuals, the cantons have reduced their tax rates to such low levels that even estates worth billions can be left to the next generation without being subject to any taxation at all.

In the past, the Swiss were fond of their quirky high society, whose lives of luxury in places like Lugano were as spectacular as their bankruptcies. But now, a large share of the super-rich comes from the financial industry, and even an upright window manufacturer like Markus Wenger is often unsure what to make of the demands coming from his high-end customers.

A homeowner recently asked Wenger if he could gold-plate his window fittings. And when he was standing in an older couple's 500-square-meter (5,380-square-foot) apartment not long ago, he found himself wondering: How do they heat this?

A Dangerous Path

Wenger is no revolutionary. He likes the market economy and says: "Performance must be rewarded." His support for a higher inheritance tax is not as much the result of his sense of justice, but rather a cost calculation that he explains as soberly as the installation plan for his windows.

This is how Wenger's calculation works: Today he pays about €8,000 a year in social security contributions for a carpenter who makes 65,000 Swiss francs (€54,000). But the Swiss population is aging, so contributions to pension insurance threaten to increase drastically soon. Doesn't it make sense, he asks, to exact an additional, small contribution from those Swiss citizens who hardly pay any taxes at all today on their rapidly growing fortunes?

For Wenger, the answer is obvious. But he also knows that most of his fellow business owners see things differently. They are worried about an "attack by the left" and prefer to support their supposed champion, Christoph Blocher, the billionaire spiritual head of the Swiss People's Party. Only recently, Blocher convinced the Swiss to limit immigration by workers from other European countries. Now Wenger expects Blocher to launch a new campaign under the motto: "Are you trying to drive our business owners out of the country?"

There is more at stake than a few million francs for the national pension fund. The real question is whether wealthy countries like Switzerland should become playthings for their elites. Wenger sees the industrialized countries embarking on a dangerous path, the path of greed and self-indulgence, and he believes Blocher's party is the most visible expression of that. Blocher is pursuing a "policy for high finance," says Wenger. "He is fighting on behalf of money."

The entrepreneur from the Bern Highlands has no illusions over his prospects in the upcoming conflict with the country's great scaremonger. The Swiss are likely to vote on the inheritance tax initiative next year. "In the end," Wenger predicts, "the vote will be 60 to 40 against us."

The Deformation of Capitalism

He was the face of the Reagan revolution, a young man with large, horn-rimmed glasses and thick hair, wearing a suit that was too big for him as he sat next to the hero of conservative America. As former President Ronald Reagan's budget director, David Stockman was the architect of the biggest tax cut in US history and the propagandist of the "trickle-down" theory, the Republican tenet whereby profits earned by the rich eventually benefit the poorer classes.

Thirty years later, Stockman is sitting on a Chesterfield sofa in his enormous mansion in Greenwich, Connecticut, an affluent suburb of New York, where the stars of the hedge fund industry conceal their tasteless mansions behind red brick walls and jeeps owned by private security companies are parked on every street corner.

Stockman is wearing a green baseball cap and a black T-shirt. It's a sunny early fall morning, but the mood in the brightly lit rooms is strangely somber. The rooms are empty, there are boxes stacked in the corners and a servant is wrapping the silverware in the dining room.

Stockman is moving to New York, into an apartment he has already rented in Manhattan. But it isn't entirely clear whether he is only moving to be closer to TV studios and newspaper editors, or if the move signifies a departure from his previous life. It was a life that took him through the executive suites of Washington politics and the US financial industry, a life that has placed Stockman in an almost unparalleled position to recount the aberrations of American capitalism in the last three decades. "We have a financialized, central-bank dominated casino," he says, "that is undermining the fundamentals of a healthy growing capitalist economy," he says.

Ironically, Stockman was the one who wanted to reshape that society, back in the 1980s, when Reagan made him the organizer of his shift to so-called supply-side economics. Like the actor-turned-president from California, Stockman believed in free markets, low taxes and reducing the role of government.

The First Mistake

But Stockman also believed in healthy finances, which placed him at odds with the California contingent on Reagan's team who saw themselves as lobbyists for industry and the military. When Reagan's chief of staff, Donald Regan, declared the phrase "tax increase" to be taboo after the 1984 election, Stockman knew that he had lost. But it was more than a personal defeat. It was a triumph of irrationality, one that led Stockman to permanently disassociate himself from his party's fiscal policies. "The Republican concept of starving the beast is the worst thing in terms of fiscal rectitude that you can imagine," Stockman says today. "It's even worse than the Keynesian models of the Democrats."

The debt policy of the Reagan years was the first mistake of America's conservative revolutionaries, but not the only one. There is another fallacy, one that Stockman also participated in when he went to work for the investment bank Salomon Brothers and later the private equity firm Blackstone after his ouster from the White House.

It was the time when it had become politically fashionable to unfetter the financial industry; a time when then-Fed Chairman Alan Greenspan, Stockman's old acquaintance from the Reagan team, was inventing a new monetary policy: Whenever the economy and the markets showed signs of weakness, he reduced interest rates, and when a large financial institution ran into trouble, it was bailed out with the help of the central bank.

Greenspan's policy of cheap money became a sweet poison for Wall Street, the chief ingredient of the dangerous debt cocktails brewed up by the wizards at London and New York investment banks, with Stockman front and center. The former politician became a virtuoso of the leveraged buyout, a complex financial deal in which in investor buys companies with borrowed money, restructures them or carves them up, and then sells them at a profit.

The deals made Stockman rich, but they also turned him into a junkie. His projects became increasingly risky and the towers of credit he constructed became taller and taller. "I was an addict," he says. "I got caught up in the process."

A Debt Republic

Disaster struck in 2007, when one of his highly leveraged companies went bankrupt. He was indicted on fraud charges, and the bankruptcy cost him millions and damaged his reputation. It became his "road to Damascus experience," as he calls it, when the financial crisis erupted a short time later. He concluded that the same mistakes that had destroyed his company also took the United States to the brink of an abyss: cheap credit, excessively high debt and a false sense of security that everything would ultimately work out for the best.

Stockman again became the rebel he had been at the beginning of his career. He gave up his position in the financial industry, started a blog in which he settled scores with both policymakers in Washington and the financial oligarchy on Wall Street and he wrote an almost 800-page analysis of the "Great Deformation" of US capitalism.

The conservative is furious over his country's transformation into a debt republic of the sort the Western world has never before seen in times of peace. A republic in which going to college is paid for with borrowed funds, as is the next military campaign. A country which hasn't actually dismantled its gigantic pile of debt since the crisis -- $60 trillion -- but has merely redistributed it. While the banks were allowed to pass on a large share of their bad loans to taxpayers, the government is in more debt than ever before.

The mountain of debt appears smaller than it is because the Fed keeps interest rates low. At the same time, though, all this cheap money is driving the United States into a risky race against time, one in which no one knows what will happen first: the hoped-for economic boom or the next crash. Experts, like former Treasury Secretary Robert Rubin, believe the current rally in the markets is in fact the precursor to the next crash.

The primary beneficiaries of the market rally seen in recent months are the 10 percent of top earners who own more than 90 percent of financial assets. But for average Americans, the policies instituted in response to the crisis have been poverty inducing. After the crash, millions of US citizens first lost their homes and then their jobs -- and now the social divide in the country is as big as it was in the 1920s. While wealth has grown at the top of the income scale, the median household, or the household that lies statistically at the exact middle of the scale, has become $50,000 poorer since 2007.

In the past, part of the promise of the American dream was that anyone who worked hard enough could eventually improve his or her situation. Today the wealthy enjoy most of the fruits of US capitalism and the most salient feature of the system is the fear of fear. No one knows what might happen if the Fed raises interest rates next year as planned. Will pressure from rising costs cause the government deficit to explode? Will the stock market bubble burst and will financial institutions collapse? Will the economy crash?

Only one thing is certain: In the seventh year of the financial crisis, the US economy is still addicted to debt and cheap money. Worst of all, the withdrawal phase hasn't even begun.

"There is no possibility of a soft landing (with the) markets as completely distorted and disabled as they are today," Stockman says in parting. "There will be some great conflagration. It's just the question of when."

Michael Klaus flips open his mobile phone, which he has been doing a lot of these days. He taps the screen with his finger to display the current yields on 10-year German government bonds. "Germany 10 Year: 0.80," the screen reads, using the abbreviated terminology of the Bloomberg market service. "You see," he says, "yields are down again. They were at 0.84 yesterday."

It's Wednesday of last week. The Frankfurt banker is walking down Friedrichstrasse in Berlin on his way to a meeting with fellow members of the Confederation of German Employers' Associations. The latest labor agreement is on the agenda, but Klaus is still thinking about the number on the screen of his mobile phone, yet another reaction to the most recent plans of Mario Draghi, the president of the European Central Bank (ECB).

Such rates are almost always a reaction to Draghi, at least they have been since the euro crisis got going. According to economics textbooks, security prices are determined by supply and demand. But in the reality of the monetary union, they usually follow the rates set by the top monetary watchdog in Frankfurt. In Klaus's assessment of the situation, "to put it in somewhat exaggerated terms, we live in a central-bank-administration economy."

The ECB's Contribution

For the last quarter of a century, Klaus, a management expert, has been working for Metzler, a traditional, private bank based in Frankfurt. He is now a partner and exudes the self-confident nonchalance of a man who knows that his customers need to show up with at least €3 million to become his clients. His biggest asset is reliability. Unlike the large, powerful banks, his bank would be unable to count on government assistance in a crisis. It is not big enough to be too big to fail.

Partly for that reason, Klaus is particularly bothered by the ECB's development in recent years. He sees it as a kind of hedge fund a kind of ministerial administration. Because Europe's major banks are ailing and national governments are at odds, the ECB has developed into the most powerful bureaucracy on the Continent. It controls interest rates and the money supply, drives prices on the exchanges and financial markets, supervises financial institutions and audits governments. According to Klaus, the European Central Bank has all but "replaced" the European bond market.

It made sense at the time, because it protected the monetary union from breaking apart. But now emergency aid has turned into long-term assistance. The effects of ECB measures are subsiding, and financial experts aren't the only ones to notice that their programs have recently done more harm than good.

That was the case with Draghi's latest package last month. To stimulate lending to small and mid-sized companies, the ECB announced its intention to begin large-scale buying of special debt instruments known as asset-backed securities, or ABS. The only problem is that far too few of these securities exist in Europe.

This leads many experts to worry that lenders will simply fill the gap by transforming bad debt from their portfolios into ABSs and pass them on to the ECB. The investment effect would be next to nothing.

Draghi's plan to provide long-term funds to banks if they can demonstrate that they passed it on in the form of loans to companies or households could also prove harmful. They must only offer proof in 2016, meaning they could first invest the money in government bonds, a surer bet these days than corporate bonds.

Achieving the Opposite

Another recent Draghi measure is particularly dangerous: the "negative deposit interest rate." It means that banks no longer earn anything when they park their money with the ECB. On the contrary, they are required to pay for the privilege.

This too is meant to encourage banks to lend. In reality, however, the measure makes the situation even more difficult for financial institutions like savings banks and cooperative banks, which are dependent on customer deposits. Because of the current low interest rates, these banks already earn almost nothing from the spread between savings and lending rates. If interest rates are pushed down even further, profits will continue to decline. "Ironically, this torpedoes the business model of savings banks and cooperative banks, which have thus far managed to survive the crisis in relatively good shape," says Klaus.

Many experts are worried that with measures like these, the ECB is achieving precisely the opposite of what it wants to achieve. Instead of being strengthened, the credit sector is weakened. Instead of reducing risks, new ones are being created. Instead of liquidating ailing banks, they are kept alive artificially.

The economy has had little experience thus far with the new crisis capitalism, with its miniature growth, miniature inflation and miniature interest rates. But economists learned one thing after large credit bubbles burst in recent years, in Japan and Scandinavia, for example: After a financial and banking crisis, the first order of business is to clean up the banks, and to do it quickly and radically. Institutions that are not viable need to be shut down while the others should be provided with capital.

'Substantial Turbulence'

In Europe, however, this process has dragged on for years, under pressure from the financial lobby. The condition of the industry is now so dismal that experts are using metaphors from the world of horror films to describe it. "Zombie banks" are those that are being kept alive artificially with government bailouts and, like the zombies in Hollywood films, are wreaking havoc throughout Europe. They are too sick to lend money to the real economy but healthy enough to speculate with financial investments. Many banks today, says Bonn economist Martin Hellwig, can only "survive in the market by speculating."

What distinguishes the current situation from the wild years before the financial crisis is that speculators were once driven by greed but have since turned into speculators motivated by need.

Private banker Klaus has seen enough on his market app. He closes the phone with a worried look on his face, and then he utters a sentence in the typically convoluted idiom of the financial industry: "If Europe slips into a recession, it could lead to substantial turbulence in the financial markets."

The man who introduced the concept of "inclusion" into the political debate is sitting in his office in Boston. There are mountains of papers on the round conference table: academic papers, pages of statistics from the International Monetary Fund, and the latest issue of the *Anarcho-Syndicalist Review.*

Daron Acemoglu is currently considered one of the 10 most influential economists in the world, but the native of Istanbul doesn't think much of titles and formalities. He prefers the relaxed look of the web community: a plaid shirt and jeans, and a Starbucks cup in his hand.

He became famous two years ago when he and colleague James Robinson published a deeply researched study on the rise of Western industrial societies. Their central thesis was that the key to their success was not climate or religion, but the development of social institutions that included as many citizens as possible: a market economy that encourages progress and entrepreneurship, and a parliamentary democracy that serves to balance interests.

The only problem is that such institutions do not arise automatically. They have to be promoted and defended, especially against those social classes and interest groups that use power to seal themselves off from competitors, secure their own benefits and seek to influence lawmakers accordingly.

Extremely well read, Acemoglu can cite dozens of such cases. One is 14th century Venice, where a small patrician caste monopolized maritime trade. Another is Egypt under former President Hosni Mubarak, whose officer friends divided up key economic posts among themselves but were complete failures as businessmen. These are what Acemoglu calls "extractive processes," which lead to economic and social decline.

A Process of Extraction?

The question today is: Are Western industrial societies currently undergoing a similar process of extraction?

Acemoglu leans back in his chair. He isn't one to make snap judgments, and he understands the contradictions of social trends, in the United States, for example. On the one hand, the US is more inclusive today than in the 1960s, because it has abolished racial segregation. On the other hand, says Acemoglu, he has noticed the growing influence of powerful interest groups: the pharmaceutical industry, insurance companies and, most of all, Wall Street. "The problem of money in politics," says Acemoglu, "is particularly acute in the case of the financial industry."

US politicians spend up to 70 percent of their time raising money for their campaigns, and Wall Street is one of their most important sources. Experts have calculated that Bill and Hillary Clinton alone have garnered at least $300 million in donations from the financial industry since the early 1990s.

In addition, money is no longer the only factor shaping the connections between Wall Street and Washington, as Acemoglu demonstrated in a recent study about former US Treasury Secretary Timothy Geithner. The stock prices of financial firms, with which he maintained close relationships, climbed significantly after his nomination. "The fact that some companies had the ear of the Secretary of the Treasury," Acemoglu concludes, "was, at least by the market view, very valuable."

It has nothing to do with bribery, Acemoglu clarifies. Still, the process highlights the dangerous closeness between the financial industry and the political world, a phenomenon which can be seen elsewhere in the world as well. In Germany, for example, Chancellor Angela Merkel took steps to prevent a Greek insolvency at least partly out of consideration for German banks invested there. The London financial industry, to cite another example, was instrumental in blocking EU plans for the introduction of a financial transaction tax. In Switzerland, billionaire Blocher finances referendum campaigns via his political party. "The rich are extremely powerful," Acemoglu says, "and that is a concern."

Not Enough

Limiting that influence is of the utmost importance, Acemoglu believes, so that today's upper-class, high-finance capitalism can once again revert to being a capitalism of the real economy and the societal center. The necessary economic reforms are not Acemoglu's primary focus, even if the relevant proposals have existed for a long time: a fiscal policy that doesn't just benefit the rich; a monetary policy that knows its limits; a reform of the financial and banking industry that separates the traditional savings and lending business from risky investment banking.

That won't be enough, Acemoglu believes. What is needed, he argues, is a new political alliance that takes a stand against the power of the financial industry and its lobby. He sees the anti-trust movement from the beginning of the last century in the United States as a model. It was a broad coalition from the center of society and finally achieved its great victory after decades of struggle: the breakup of major corporations like Standard Oil.

Will something comparable happen with the big international banks? Acemoglu doesn't know, but he is convinced of one thing: Elitist conferences, at which bankers and fiscal policy experts hold sophisticated conversations about "inclusion," will not bring about change.

The organizers of the World Economic Forum once again sent him an invitation to Davos recently. But Acemoglu declined, as he has done several times in the past. "Solutions to the world's problems are not produced in a meeting between Bill Gates and George Soros," he says. "Renewal has to come from below."