

ECONOMIC NEWS UPDATE

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A Touch of Xenophobia in the Night?

If you think our current economic difficulties are all about subprime mortgages, securitization, the drying up of credit, falling house prices and the like, think again. That's not how the rest of the world sees it. Yes, all of these problems are on the list. But more important, foreigners see this as the end of what Henry Luce memorably called the American century. America caused the world's economic problems; America will pay a terrible price.

"Everything happening now in the economic and financial sphere began in the United States. This is not the irresponsibility of

specific individuals but the irresponsibility of the system that claims leadership," gloats Vladimir Putin. Well, he would say that rather than blame the collapse of his country's stock market and the flight of capital on his confiscation of foreign investment and invasion of Georgia.

But Putin is not alone in pillorying the US. "The origin and center of gravity of the problem is clearly in the USA," German finance minister Peer Steinbrück pronounced. And Gordon Brown, the Prime Minister of America's putative ally, Great Britain, says that his nation's economic problems were imported from

America. Name an economic problem, and its origin is George Bush's USA, and the radical deregulation policies of the neoconservatives. That gets the local politicians off the hook.

There is worse. The failure of America's politicians to agree immediately on a \$700 billion bailout package shows that its squabbling politicians are irresponsible, interested only in getting re-elected. Never mind that Treasury Secretary Hank Paulson and Fed chairman Ben Bernanke have been loosening credit while the Bank of England and the European Central Bank keep interest rates high, and that we will have a rescue package in place before the Europeans even meet this weekend to discuss just what to do. The French want a coordinated Euro-wide bailout; the Germans fear that will end up as a raid on their Treasury; the British worry that Ireland's guarantee of all bank deposits is draining funds from the UK, and anyhow took longer to decide what to do about a single bust bank (Northern Rock) than our politicians took to decide on an industry-wide, massive bank rescue effort.

Gleeful European leaders are agreeing with French president Nicolas Sarkozy that the failure of the American model shows that the "idea of an all-powerful market without any rules

and any political intervention is mad ... [and that] self-regulation is finished. Laissez faire is finished. The all-powerful market which is always right is finished." That no American politician or policy maker ever proposed that the financial system operate "without any rules" matters not to America's critics. Nor are these same critics embarrassed to have spent years criticizing Sarbanes-Oxley as an example of American over-regulation, before switching to calls that we tighten the rules.

The important thing is that the American model is dead. Or so they think -- hope, to be precise. No longer can America recommend its version of capitalism to the developing world, or turn its collective nose up at the alternative models of authoritarian capitalism offered by China and Russia. Or at France's protection of vital infrastructure companies, which group includes Danone, maker of the yogurt that adorns the shelves of the world's supermarkets.

There's more. The burgeoning federal deficit marks the end of the dollar as a reserve currency. And good riddance to it. Its status as a reserve currency only served to shore up America's prestige and allow it to borrow to support military expenditures and unwise adventures such as those

in which America is now bogged down in Iraq and Afghanistan.

I'm not making this up. As an American here in London who happens to be an economist, and who is known as a conservative believer in democratic capitalism, I seem to be the guest-of-choice on television programs hunting desperately for someone willing to support the American system. The critics to whom I find myself responding range from left to right, from politicians on the left who are delighted that capitalism has run into difficulties, to those on the right who blame the loss of their friends' jobs in the City -- London's financial district -- on American policies. Some complain that by bailing out Bear Stearns we are losing the force of moral hazard on the world, encouraging sinners to sin again without consequence. Others complain that by failing to bail out Lehman Brothers we have cost thousands of well-paid Brits their jobs. Some complain that the Paulson rescue plan rewards the greedy bankers who unleashed the American disease on Europe; others complain that by not passing the Paulson plan on the first try we have exacerbated the problems of European financial institutions.

Clearly, the best response is to ignore the caviling and caterwauling. Foreigners won't love us again unless we elect

Barack Obama. Let's just remember the critics when foreign banks try to deal themselves in on the Paulson rescue plan.

And get on with the job of reforming the regulatory system. Brokers who sold mortgages to families with no hope of bearing the interest cost, and then flogged them off to investors, should henceforth be required to bear some of the risk of default. Rating agencies that sanctified dicey securities with triple-A ratings should have their fees geared to the performance of those securities. Executive compensation should be based on long-term profit performance. This might make capitalism, described by the great economist Joseph Schumpeter as a force for creative destruction, a bit less destructive and probably a bit less creative, alas. But it will nevertheless get on with its historic task of delivering and fairly distributing steady improvements in material well-being.

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