

After the big squeeze

This is not the New Depression, but we are on the way to discovering how the New Capitalism will operate, argues *Irwin Stelzer*

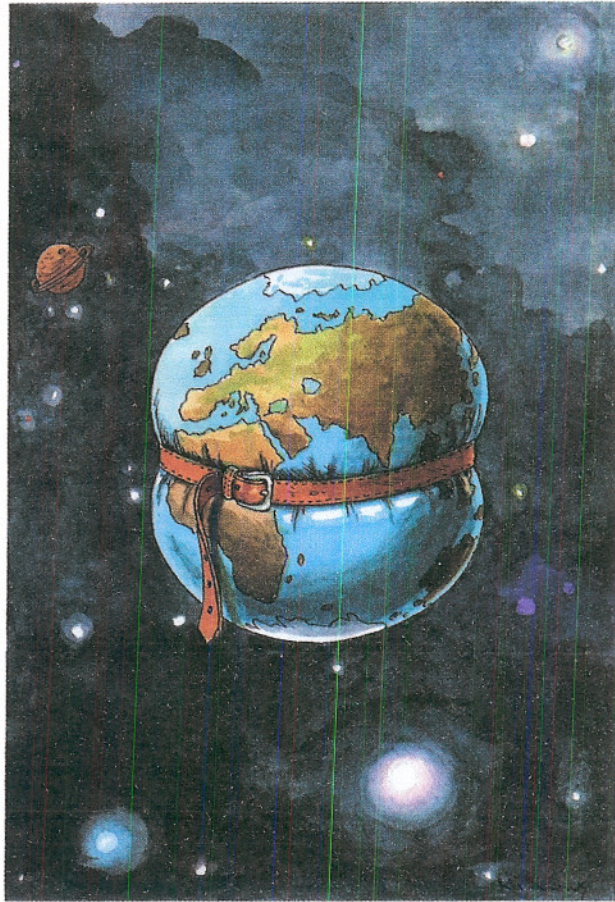
Students at Harvard's John F Kennedy School of Government succeed as policymakers if they take away only one message: "Ask the wrong question, and you get a useless answer." That message is too often ignored in the debate about the future structure of the British and American economies as they plough through the economic downturn. Ask whether this is a recession or, as Ed Balls argues, a depression, and you waste hours comparing our situation with the often-misremembered 1930s (Britain did quite well without much government intervention, and America suffered 25 per cent unemployment in spite of huge government intervention). Since our definitions of "recession" and "depression" have all the precision of a Gordon Brown response at PMQs, there is little point to the exercise that led Balls to the erroneous conclusion that we are suffering the worst economic malady in a hundred years.

Next wrong question: Have we seen the last of unfettered capitalism? But that red-in-tooth-and-claw model never existed. Market capitalism has always been characterised by rules, or fetters. Securities can be peddled only after meeting disclosure rules; houses can be built only after satisfying planning regulations; construction workers are protected by myriad safety regulations; the quality of the air we breathe is determined by government rules. There's more, but you get the idea.

The correct question is: will capitalism survive the downturn, and the increase in the reach of government that it has engendered, not only in Britain, where the Prime Minister has undertaken the task of saving the world, but in the United States, where President Barack Obama has accepted the more modest charge of reviving the national economy?

The answer to that question is an unequivocal "yes". We are not, as *Newsweek* recently argued, "all socialists now". Angry British subjects and US citizens do enjoy seeing their bankers serve as piñatas to parliamentary and congressional inquisitors, the silliness of whose questions is matched only by the vacuity of the bankers' responses. But Americans still vote for middle-of-the-road candidates, and there are no demonstrations in Britain demanding the restoration of Clause Four.

The alternatives are just too grim, and anyhow no more immune to the problems the capitalist economies face. Russia, despite or more likely because of the government grab of private property and confiscation of foreign investment, is in crisis as its rouble teeters on devaluation, unemployment rises, and the new commissars who studied economics while working in the security services prove no better managers than oligarchs who made off with a large portion of the nation's wealth.



China, its economy ruled by an authoritarian regime that controls the banking system and the major means of production, is not doing much better. Despite manipulating the renminbi to keep its value at export-subsidising levels, the regime is unable to prevent 20 million workers from disconsolately heading back to their rural homes after being cast adrift in the cities, adding to the reserve army of the unemployed. This is a combustible group of the kind that Marx envisioned would topple capitalism, not riot against its communist masters.

The final alternative to the US and UK models is typified by France, its hyperactive president an unrelenting critic of the American hyperpower, and now of Gordon Brown's decision to cut VAT, a move enthusiastically applauded by Ken Clarke, whose birdwatching skills are of little use when it comes to the hard work of analysing economic phenomena. The French electorate apparently is content to accept slow growth, protectionism and high levels of unemployment in good times to avoid some of the volatility of Anglo-Saxon capitalism. And instead of allowing market forces to correct excesses, France relies on the occasional riot to force governments to do what markets do in the US and UK to correct inflation, or wage discrepancies, or too-high tuition levels.

So we are back to the capitalism of Britain and the US, which, for the purposes of discussion, we can treat as broadly

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similar despite Britain's more comprehensive welfare state and greater taste for regulation. That capitalism will survive, not because it is perfect, but because it has the capacity to reform in response to the demands of a democratic electorate. Theodore Roosevelt attacked "malefactors of great wealth" and passed antitrust laws that reined in the cartels and monopolies. His cousin Franklin D Roosevelt later attacked the "practices of the unscrupulous money changers", and established the Securities and Exchange Commission to regulate their activities. Republican Teddy's Square Deal and Democrat FDR's New Deal reformed capitalism and restored faith in markets that had been stripped of their worst abuses. Not all abuses, nor all the future maladies that might be dreamed up by financial innovators run amok, but the worst of the day.

Which brings us to another sensible question: what form will the New Capitalism take? It is a good guess that the nationalisation of the banking systems will be reversed. Banks are eager to rid themselves of the need to trek to Downing Street or Washington in order to conduct their business, and have a huge financial incentive to buy back the preferred shares that governments have purchased and that eat up a large share of profits. The next generation of auto industry executives would rather decide just what vehicles their customers want than leave that decision to America's politicians or Lord Mandelson. And as much as the electorates in both countries are appalled by the behaviour of the captains of industry, they are at least equally inclined to deny their political leaders increased control over their lives and livelihoods.

What will emerge is a new capitalism, the contours of which are already visible. It will be a system in which high incomes will be unacceptable unless they are demonstrably related to economic performance. No more golden goodbyes for executives who have brought their companies to ruin; no more huge bonuses in return for short-run, illusory profits. Yet no rules against making large fortunes; Bill Gates, who has built a company that changed the way we live, Warren Buffett, who risked his and his shareholders' capital in pursuit of profit, and the entrepreneur show-off Richard Branson have all escaped public obloquy.

Financial institutions will operate under a new set of rules. The days of 50-to-1 leverage are over: banks will be required to rely more on shareholder capital in their businesses. But the present tendency to deploy armies of regulators to supervise banks' lending and other activities will soon prove feckless. Instead, there will be rules that align financial institutions' interest with the public interest. Lenders will have to keep what Wall Street calls "more skin in the game". No more mortgages and other loans to those who cannot repay, with the risk then passed on to others via securitisation. Mortgage lenders will have to retain some of the risk of non-payment. Rating agencies will not be allowed to dole out AAA ratings in return for fees. Bonuses will be geared to long-term profit performance.

It won't be capitalism as many of its current practitioners recognise it, any more than the oil-monopolist John D Rockefeller recognised the reformed system instituted by Teddy Roosevelt, or the money changers recognised the reformed temple FDR constructed to contain their activities. But it will be capitalism, a system in which men will be led by a slightly more visible hand... You know the rest. ●

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