The End of American Capitalism?

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October 10, 2008 – The Washington Post

The worst financial crisis since the Great Depression is claiming another casualty: American-style capitalism.

Since the 1930s, U.S. banks were the flagships of American economic might, and emulation by other nations of the fiercely free-market financial system in the United States was expected and encouraged. But the market turmoil that is draining the nation's wealth and has upended Wall Street now threatens to put the banks at the heart of the U.S. financial system at least partly in the hands of the government.

The Bush administration is considering a partial nationalization of some banks, buying up a portion of their shares to shore them up and restore confidence as part of the $700 billion government bailout. The notion of government ownership in the financial sector, even as a minority stakeholder, goes against what market purists say they see as the foundation of the American system.

Yet the administration may feel it has no choice. Credit, the lifeblood of capitalism, ceased to flow. An economy based on the free market cannot function that way.

The government's about-face goes beyond the banking industry. It is reasserting itself in the lives of citizens in ways that were unthinkable in the era of market-knows-best thinking. With the recent takeovers of major lenders Fannie Mae and Freddie Mac and the bailout of AIG, the U.S. government is now effectively responsible for providing home mortgages and life insurance to tens of millions of Americans. Many economists are asking whether it remains a free market if the government is so deeply enmeshed in the financial system.

Given that the United States has held itself up as a global economic model, the change could shift the balance of how governments around the globe conduct free enterprise. Over the past three decades, the United States led the crusade to persuade much of the world, especially developing countries, to lift the heavy hand of government from finance and industry.

But the hands-off brand of capitalism in the United States is now being blamed for the easy credit that sickened the housing market and allowed a freewheeling Wall Street to create a pool of toxic investments that has infected the global financial system. Heavy intervention by the government, critics say, is further robbing Washington of the moral authority to spread the gospel of laissez-faire capitalism.

The government could launch a targeted program in which it takes a minority stake in troubled banks, or a broader program aimed at the larger banking system. In either case, however, the move could be seen as evidence that Washington remains a slave to Wall Street. The plan, for instance, may not compel participating firms to give their chief executives the salary haircuts that some in Congress intended. But if the plan didn't work, the government might have to take bigger stakes.

"People around the world once admired us for our economy, and we told them if you wanted to be like us, here's what you have to do — hand over power to the market," said Joseph Stiglitz, the Nobel Prize-winning economist at Columbia University. "The point now is that no one has respect for that kind of model anymore given this crisis. And of course it raises questions about our credibility.

Everyone feels they are suffering now because of us."

In Seoul, many see American excess as a warning. At the same time, anger is mounting over the global spillover effect of the U.S. crisis. The Korean currency, the won, has fallen sharply in recent days as corporations there struggle to find dollars in the heat of a global credit crunch.

"Derivatives and hedge funds are like casino gambling," said South Korean Finance Minister Kang Man-soo. "A lot of Koreans are asking, how can the United States be so weak?"

Other than a few fringe heads of state and quixotic headlines, no one is talking about the death of capitalism. The embrace of free-market theories, particularly in Asia, has helped lift hundreds of millions out of poverty in recent decades. But resentment is growing over America's brand of capitalism, which in contrast to, say, Germany's, spurns regulations and venerates risk.

In South Korea, rising criticism that the government is sticking too close to the U.S. model has roused opposition to privatizing the massive, state-owned Korea Development Bank. South Korea is among those countries that have benefited the most from adopting free-market principles, emerging from the ashes of the Korean War to become one of the world's biggest economies. It has distinguished itself from North Korea, an impoverished country hobbled by an outdated communist system and authoritarian leadership.

But the repercussions of crisis that began in the United States are global. In Britain, where Prime Minister Margaret Thatcher joined with President Ronald Reagan in the 1980s to herald capitalism's promise, the government this week moved to partly nationalize the ailing banking system. Across the English Channel, European leaders who are no strangers to regulation are piling on Washington for gradually pulling the government watchdogs off the world's largest financial sector. Led by French President Nicolas Sarkozy, they are calling for broad new international codes to impose scrutiny on global finance.

To some degree, those calls are even being echoed by the International Monetary Fund, an institution charged with the promotion of free markets overseas and that preached that less government was good government during the economic crises in Asia and Latin America in the 1990s. Now, it is talking about the need for regulation and oversight.

"Obviously the crisis comes from an important regulatory and supervisory failure in advanced countries . . . and a failure in market discipline mechanisms," Dominique Strauss-Kahn, the IMF's managing director, said yesterday before the Fund's annual meeting in Washington.

In a slideshow presentation, Strauss-Kahn illustrated the global impact of the financial crisis. Countries in Africa, including many of those with some of the lowest levels of market and financial integration and openness, are now set to weather the crisis with the least amount of turbulence.

Shortly afterward, World Bank President Robert Zoellick was questioned by reporters about the "confusion" in the developing world over whether to continue embracing the free-market model. He replied, "I think people have been confused not only in developing countries, but in developed countries, by these shocking events."

In much of the developing world, financial systems still remain far more governed by the state, despite pressure from the United States for those countries to shift power to the private sector and create freer financial markets. They may stay that way for some time.

China had been resisting calls from Washington and Wall Street to introduce a broad range of exotic investments, including many of the once-red-hot derivatives now being blamed for magnifying the crisis in the West. In recent weeks, Beijing has made that position more clear, saying it would not permit an expansion of complex financial instruments.

With the U.S. government's current push toward intervention and the soul-searching over the role of deregulation in the crisis, the stage appears to be at least temporarily set for a more restrained model of free enterprise, particularly in financial markets.

"If you look around the world, China is doing pretty good right now, and the U.S. isn't," said C. Fred Bergsten, director of the Peterson Institute for International Economics. "You may see a push back from globalization in the financial markets."

Staff writers Blaine Harden in Seoul and Ariana Cha in Washington contributed to this report.