

Opinion

## US Capitalism Has Been Shattered

The coronavirus response is paving a path to government control of the economy

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American capitalism is rapidly disappearing. Its demise has been under way for some time and the economic devastation wrought by the Covid-19 pandemic is the latest blow to our political economy.

Adam Smith remains a useful guide to the hallmarks of capitalism. In 1776's *The Wealth of Nations*, he argued that humans innately strive for material progress and the best way to get there is through unfettered competition, the division of labour and free trade.

Smith wrote that the state should play a limited role in economic affairs. For him, governments should be properly confined to national security, the rule of law — including the protection of private property — and the provision of a few public goods such as education. He also cautioned against sharp class divisions that might idle rich people and exploit workers. "No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable," he warned. Smith hoped that whole societies could be enriched through the striving of individual members.

This kind of capitalism has been shattered. Free trade is being dismantled as treaties are being abrogated. The free movement of labour is constrained by walls

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and edicts. Competition enforcement in business and finance is lagging and tardy. The anti-monopoly trustbusting that thrived under US president Theodore Roosevelt is long gone. Concentration of non-financial corporations has increased sharply. Many businesses now enjoy a global reach, allowing them to post non-competitive prices.

In financial markets, concentration is even more glaring. Today, a shrinking number of financial conglomerates hold a tight grip on investment management and the underwriting and trading of securities. The enormous underlying conflicts of interest are tolerated by the authorities. In truly competitive economies, those who do well should prosper while those who offer inferior goods and services should fail. Increasingly, that doesn't happen.

Rather, capitalism is being rapidly replaced by statism — a form of political economy in which the state exercises substantial centralised control over social and economic affairs.

In the US, the federal government and the Federal Reserve sit atop statism. The government has a vast capacity to tax, borrow and reallocate funds. Federal debt owed to the public currently stands at \$20tn and much more can be borrowed. For some time to come, the US dollar will remain the key reserve currency, and overseas investors continue to prefer US government bonds over most other securities.

In contrast, the creditworthiness of state and local governments has come under acute pressure because of the coronavirus pandemic, forcing many of them to seek federal help. States and localities will be financially beholden to the federal

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government, weakening their independence while strengthening the central authority. That is not what the US system of federalism envisions.

Historically, the Fed has been viewed as somewhat independent from immediate political interests. But the central bank's response to the onset of the pandemic-related recession shows that its quasi-independence is quickly evaporating, contributing to the emerging statism.

The Fed was helpfully supportive in previous crises. During the second world war, it stabilised yields on government securities. In the 2008 financial crisis, it bailed out prominent financial institutions, engaged in quantitative easing, forced large banks to accept government capital and lowered interest rates sharply.

But the Fed's response to the pandemic is far more open-ended. It is buying not only government bonds but also corporate bonds — including low-quality issues, mortgage obligations, municipal bonds and exchange traded funds. The central bank also is working with the Treasury to get loans to small and medium-sized businesses. Its balance sheet has already swollen by an astonishing \$3tn to more than \$7tn since the start of this year. And financial markets have come to expect the Fed to intervene in response to any sharp decline in equity prices.

Before the pandemic, the Fed had made considerable progress in reducing the size of its balance sheet. But now we can expect an even more significant increase in the size of its intervention as long as there remains no clear resolution to the pandemic, such as a mass-produced vaccine. Markets will probably remain quite skittish as well.

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With the federal government and the Fed firmly joined at the hip, the transformation of capitalism into statism is gaining momentum, perhaps irreversibly. This is a great departure not only from the vision of the US founders but also, I suspect, it is not the kind of economic system most Americans living today want to leave for future generations.