

Can American Capitalism Survive?

By **Robert Samuelson**

"Can capitalism survive? No. I do not think it can."

-- *Joseph Schumpeter, 1942*

WASHINGTON -- The story of American capitalism is, among other things, a love-hate relationship. We go through cycles of self-congratulation, revulsion and revision. Just when the latest onset of revulsion and revision began is unclear. Was it when Lehman Brothers collapsed? Or when General Motors pleaded for federal subsidies? Or now, when AIG's bonuses stir outrage? No matter. Capitalism is under siege, its future unclear.

Schumpeter, one of the 20th century's eminent economists, believed that capitalism sowed the seeds of its own destruction. Its chief virtue was long-term -- the capacity to increase wealth and living standards. But short-term politics would fixate on its flaws -- instability, unemployment, inequality. Capitalist prosperity also created an oppositional class of "intellectuals" who would nurture popular discontents and disparage values (self-enrichment, risk-taking) necessary for economic success.

Almost everything about Schumpeter's diagnosis rings true with the glaring exception of his conclusion. American capitalism has flourished despite being subjected to repeated restrictions by disgruntled legislators. Consider the transformation. In 1889, there was no anti-trust law (1890), no corporate income tax (1909), no Securities and Exchange Commission (1934) and no Environmental Protection Agency (1970).

We have subordinated unrestrained profit-seeking to other values. "We've gradually taken into account the external effects (of business) and brought them under control," says economist Robert Frank of Cornell University. External costs include: worker injuries from industrial accidents; monopoly power; financial manipulation; pollution.

Great reform waves often proceed from scandals and hard times. The first discredits business; the second raises a clamor for action. Parallels with the past are eerie. "No one in 1928 thought that the head of the New York Stock Exchange would end up in Sing Sing (prison) in 1938," says historian Richard Tedlow of the Harvard Business School. That was Richard Whitney, convicted of defrauding his clients. Flash forward: Bernie Madoff, once head of NASDAQ and also a member of the financial establishment, goes to the slammer, a confessed swindler.

Some guesses about capitalism's evolution seem plausible. The financial industry -- banks, investment banks, hedge funds -- will shrink in significance. Regulation will tighten; required capital will rise. Profitability will fall. (Until recently, finance represented 30 percent or more of corporate profits, up from about 20 percent in the late 1970s.) More of the best and brightest will go elsewhere.

But Schumpeter's question remains. Will capitalism lose its vitality? Successful capitalism presupposes three conditions: first, the legitimacy of the profit motive -- the ability to do well, even fabulously; second, widespread markets that mediate success and failure; and finally, a legal and political system that, aside from establishing property and contractual rights, also creates public acceptance. Note that the last condition modifies the first two, because government can -- through taxes, laws and regulations -- weaken the profit motive and interfere with markets.

The central reason why Schumpeter's prophecy remains unfulfilled is that U.S. capitalism -- not just companies, but a broader political process -- is enormously adaptable. It adjusts to evolving public values while maintaining adequate private incentives. Meanwhile, the ambitious, striving character of American society supports an entrepreneurial culture and work ethic -- capitalism's building blocks. As for new regulations, many don't depress profitability because costs are passed along to consumers in higher prices.

It's also wrong to pit government as always oppressing business. Just the opposite often holds. Government boosts business.

Some New Deal reforms helped "by making risk more manageable," says Stanford historian David Kennedy. Deposit insurance ended old-fashioned bank panics. Mortgage guarantees aided a post-World War II housing boom. Homeownership skyrocketed from 44 percent in 1940 to 62 percent in 1960. Earlier, the federal government distributed 131 million acres of land grants from 1850 to 1872 to encourage railroads. Land, as well as bank charters and government contracts, often went to the well-connected. Cronyism is sometimes capitalism's first cousin.

Still, the present populist backlash may not end well. The parade of big companies to Washington for rescues, as well as the high-profile examples of unvarnished greed, has spawned understandable anger that could veer into destructive retribution. Congressmen love extravagant and televised displays of self-righteous indignation. The AIG hearing last week often seemed a political gang beating.

If companies need to be rescued from "the market," then why shouldn't Washington permanently run the market? That's a dangerous mindset. It justifies punitive taxes, widespread corporate mandates, selective subsidies and meddling in companies' everyday operations (think the present anti-bonus tax bill). Older and politically powerful companies may benefit at the expense of newer firms. Innovation and investment may be funneled into fashionable, though economically dubious, projects (think ethanol).

Greater government is an inevitable reaction to today's economic breakdown. But there is a thin line between "saving capitalism" from itself and vindicating Schumpeter's long-ago prediction.

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