

Demise of the Anglo-American Model of Capitalism

By Wonhyuk Lim

THOUGH COINED IN GEOGRAPHICAL TERMS, “the Anglo-American model of capitalism” does not represent some permanent model of capitalism prevailing in Britain and America. Rather, it refers to the brand of capitalism that has essentially sought to dismantle the postwar welfare state through privatization, deregulation, and regressive tax and social policies in the name of promoting economic efficiency. Its neo-liberal philosophy is characterized by a strong distrust of the government and an equally strong faith in the market, and its ambitious liberalization program extends beyond real markets to financial markets, where herd behavior and systemic risks pose significant challenges. This brand of capitalism takes an aggressively hostile approach toward labor unions and subscribes to “supply-side economics,” or the “trickle-down” theory of income generation and distribution.

Initially popularized by Margaret Thatcher and Ronald Reagan, the Anglo-American model of capitalism enjoyed its heyday right after the collapse of the Soviet Bloc in the early 1990s, but widening income disparities and repeated economic crises over the past decade have reduced its appeal around the world. Although it successfully eliminated the excesses of the postwar welfare state, its attack on the government and worship of the market failed to deliver broad-based, sustained growth. The current global financial crisis, combined with the resurgence of progressive politics, is likely to hasten its demise and usher in a new era of expanded role for the government and strengthened financial supervision on a global scale. Although the advocates of the Anglo-American

model of capitalism have tended to present it as an embodiment of irrefutable economic principles, it was actually a product of political and commercial calculations. Understanding its rise and fall would shed light on the new balance that is likely to be reached between the government and the market in the wake of the current crisis.

The intellectual underpinning of the Anglo-American model of capitalism initially began as a critique of totalitarianism but soon evolved into a revolt against state intervention in general. Criticizing John Maynard Keynes as well as Karl Marx in the 1930s and 1940s, Friedrich von Hayek asserted that state intervention would threaten human liberty and place society on the “Road to Serfdom”— even if this state intervention was supported and demanded by a free democratic political process. Hayek also argued that due to information and incentive problems, planning would prove inferior to market mechanisms in coordinating economic production. His claim stood in contrast to the theory of the firm advanced by Ronald Coase, who took a much more balanced view on the merits and demerits of markets versus hierarchies based on the concept of transaction costs. The implicit anti-democratic bias and intellectual extremism inherent in Hayek’s writings prevented him from gaining a great deal of popularity for a long time.

In fact, the guiding economic principle for western nations after the Great Depression and World War II was, in many ways, the opposite of what Hayek prescribed. It was probably a surprise to Hayek that the welfare state model based on social democracy ushered in a remarkable period of broad-based growth. In the United States, for instance, annual productivity growth averaged 2.8 percent from 1948 to 1973, and progressive taxation and pro-labor policy significantly reduced income disparities and created a robust middle class in what is commonly called “the Great Compression.”

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However, the very success of the postwar welfare state sowed its own demise. As Michael Kalecki foresaw, full employment greatly strengthened labor unions’ hands and led to excessive welfare demands and practices that alienated not only the rich but eventually the middle class as well. The stagflation of the 1970s amplified the public’s disenchantment with these excesses, even though they continued to value the social safety net provided by the state. Conservative politicians such as Thatcher and Reagan saw an opportunity to dismantle the welfare state, and adroitly combined the rhetoric of individual liberty and free enterprise with thinly veiled appeals to not-so-lofty instincts of the elec-

torate such as racism. It is in this context that the Anglo-American model of capitalism was born and Hayek's theory gained popularity.

Although the actual economic records of Thatcher and Reagan left much to be desired, the collapse of the Soviet Bloc ushered in a triumphant era for the Anglo-American model of capitalism. To a critical observer, it was “[a]n era of unbridled deregulation, wealth-enhancing perks for the already well-off, and miserly indifference to the poor and middle class; of the recasting of greed as goodness, the equation of bellicose provincialism with patriotism, the reframing of bigotry as small-town decency.” (Judith Warner blog, Nov. 6, 2008, *New York Times*) In development economics, this brand of capitalism found its expression in the Washington Consensus, which preached privatization, market liberalization, and macroeconomic stabilization. Its advocates typically missed the irony of huge macroeconomic imbalances in the United States and aggressively pushed for financial globalization, whether emerging markets — and for that matter, advanced industrial nations — were prepared for it or not.

Had the Anglo-American model of capitalism produced broad-based, sustained growth, its appeal might have lasted. Unfortunately, it could not. In the developing world, the Washington Consensus failed to deliver tangible benefits. By comparison, East Asian countries that judiciously combined market mechanisms with selective state intervention generated “rapid, shared growth.” In advanced industrial nations, the Anglo-American model of capitalism increasingly produced social disparities and economic insecurity, even as it yielded solid productivity gains. In the United States, for instance, annual productivity growth averaged 2.5 percent between 2000 and 2007, but the median income declined by \$2,010 in the same period. The portrayal of the government as an embodiment of corruption and incompetence

became a self-fulfilling prophecy as key posts were filled with corrupt and incompetent people and essential services were privatized with little oversight. The faith in the self-regulating capability of the market suffered a heavy blow as the current global financial crisis revealed the corruption and incompetence of those who were entrusted with other people's money. In addition, the swift propagation of shocks and rapid rise in systemic risks confirmed that financial markets are different from real markets and demonstrated the need to establish a global financial supervision framework commensurate with the global reach of financial institutions. The intellectual and philosophical premises of the Anglo-American model of capitalism were never as solid as its advocates claimed, and after a generation of political dominance, reality finally caught up with it.

Wonhyuk Lim is Director, Office for Development Cooperation, the Korea Development Institute (KDI).