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The unsettling zeitgeist of state capitalism

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How can it be that Merrill Lynch, Citigroup, Morgan Stanley, Bear Stearns, UBS and other big banks have been turning to foreign governments for financial lifelines with so little public controversy? Perhaps it is because the dangerous broader context of what is happening – the rise of “state capitalism” – is not sufficiently recognised. Indeed, the reality may be that the era of free markets unleashed by Margaret Thatcher and reinforced by Ronald Reagan in the 1980s is fading away. In place of deregulation and privatisation are government efforts to reassert control over their economies and to use this to enhance their global influence. It is an ill wind that blows.

Exhibit A is a quantum increase of regulation nationally and globally. The issues of product and food safety will spawn new and highly complex trade regulations in the US, the European Union, China and the World Trade Organisation. The blizzard of energy and environmental legislation in a number of countries is mind-boggling. The subprime debacle will probably lead to new rules for every type of

institution that securitises debt.

Evidence of the rise of state capitalism can also be found in increasing public sector ownership of natural resources. Government-run energy companies from Saudi Arabia, China, India and Brazil now own more than 80 per cent of the world's reserves. Their reach is growing. Russian and Chinese government entities also look poised to make a run for global domination of aluminium and iron ore.

Finance is being taken over too. Beijing's state-controlled banks are now moving into the US and taking large stakes in important banks such as South Africa's Standard Bank. Last year sovereign wealth funds in the Gulf and east Asia invested more than \$60bn in foreign financial institutions and the amounts are rising rapidly. Assets in these funds will, in the years ahead, exceed the combined capital in private equity and hedge funds.

We should not be surprised by these trends. Since the mid-1980s the world economy has been on steroids, resulting in exceptional growth and wealth creation. Now governments are reacting against the excesses of free markets. A lot of people were left behind as soaring income inequality accompanied the boom. In trade, product quality went unsupervised. In finance, risk

management was neglected by bankers, regulators and credit agencies. The 27-nation EU, being more prone to intervention in markets than the US, has taken the lead in reasserting a robust role for regulation. China and India, neither of which has any deregulatory DNA, have also become influential in changing the global *gestalt*.

Government officials also turned a blind eye towards dangerous financial

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imbalances. The very countries that had little history of free markets accumulated massive reserves, while the US accepted large deficits and became hungry for money from anywhere it could find it. In a world economy where power has become highly decentralised and in which international institutions are weak, governments backed by huge reserves have discovered they have significant leverage in global markets. That is especially

true in downturns, such as now.

The implications are worrying. While prudent regulation in selected areas can be justified, the new zeitgeist is likely to produce too much government intervention, too fast. We can expect less productivity, less innovation and less growth, since governments have many goals that the private sector does not. These include employment generation, income redistribution and the aggrandisement of political power. The expansion of regulation will also open up new possibilities for trade disruption. For example, countries may block the importation of goods that do not meet their precise national environmental standards.

Beyond that, trade and finance will become more politicised as governments leverage the companies they control as instruments of their foreign policies. Russia's president, Vladimir Putin, has used Gazprom's natural gas to influence his neighbours' economic and political directions. China has provided aid to repressive regimes to open up opportunities for companies such as Sinopec. President Nicolas Sarkozy seems poised to use the combination of France's Atomic Energy Commission, the state-controlled nuclear power company Areva and the national engineering champion Alstom to sell civilian

nuclear power in the Gulf and China.

Unfortunately, the trend is unstoppable. But officials from market-friendly finance ministries could acknowledge the momentum behind the rise of state capitalism to demand their own governments produce impact statements that spell out all the costs of new laws and regulations. They could commission reviews in the International Monetary Fund and the WTO of all the implications of growing government intervention. Think tanks and universities should gear more research to the costs and benefits of state capitalism.

When it comes to foreign investment by state-owned companies or from sovereign wealth funds, the US and the EU need to set common standards for transparency, ownership and reciprocity. The rules should be enforceable – not milk-toast, voluntary guidelines.

In the late 18th century, capitalism was replacing feudalism. In the 20th century freer markets won the day. Now the world is flirting with another big transformation in the philosophy and rules of global commerce. Unlike the changes of the past, this new trajectory does not represent progress.

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