Crisis of democratic capitalism

“[D]emocracy, national sovereignty and global economic integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full.” Dani Rodrik
The crisis of democratic capitalism

- Democracy and capitalism
- Revolution of global capitalism
- Breakdown of trust
- Rise of zombie ideas
- What might lie ahead
- Challenge before us
Democracy and capitalism

“... the best partnership in a state is the one which operates through the middle people.” Aristotle, Politics
1. Democracy and capitalism

● What is the relation between our economic and political systems?
● My response is that it is a difficult marriage:
  ○ The two are mutually supportive:
    ■ Democracy prevents capitalism from becoming too predatory;
    ■ Capitalism prevents democracy from becoming too oppressive.
  ○ The two are also in conflict:
    ■ Capitalists threaten democratic stability
    ■ Democracy threatens property rights
1. Democracy and capitalism

- Historically, the rise of capitalism brought forth the demand for democracy. Why?
  - Rising wealth
  - Rising education levels
  - Rising urbanisation
  - Rising unionisation
  - Rising demands on the population
  - So “no taxation without representation”
1. Democracy and capitalism

- The underlying idea of capitalism is that individuals are entitled to do “truck barter and exchange”, free of the cage of status
- Similarly, democracy holds that everybody has a right to be a citizen and share in public life, again free of the cage of status
- In principle, both systems recognise the equal value of people
- But capitalism generates inequality and tends to be global
- While democratic politics assumes equality and is inherently local
- This creates tensions that can be managed, but not eliminated
1. Democracy and capitalism

GLOBALISATION AND DEMOCRACY
(Source: "Our World in Data" and Center for Systemic Peace)

Klasing and Milionis (2014) Penn World Tables Version 8.1
Democratisation (Polity IV)
Revolution of global capitalism

“Economic globalization has powered global growth and facilitated movement of goods and capital, advances in science, technology and civilization, and interactions among peoples.”

2. Revolution of global capitalism

REAL GDP PER HEAD AT 2011 US$s (at PPP)(Maddison project)
2. Revolution of global capitalism

The US and its allies still have bigger economies than China and Russia

% of global gross domestic product at purchasing power parity

Source: IMF
© FT
2. Revolution of global capitalism

The US and its allies still also do much more trade than China

Exports and imports of goods as a % of world total

<table>
<thead>
<tr>
<th>Year</th>
<th>US</th>
<th>Allies*</th>
<th>China</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>25</td>
<td>30</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>2018</td>
<td>30</td>
<td>35</td>
<td>20</td>
<td>7</td>
</tr>
</tbody>
</table>

* South Korea, Australia, New Zealand, European Union and rest of G7

Source: IMF
© FT
2. Revolution of global capitalism

"ELEPHANT CURVE" OF GLOBAL INEQUALITY AND GROWTH, 1980-2016 (Source: World Inequality Database)
3. Breakdown of trust

“How did you go bankrupt?”

“Two ways. Gradually, then suddenly.”

Ernest Hemingway, *The Sun also Rises*. 
3. Breakdown of trust

• The world is in a “democratic recession”:
  • According to Freedom House 2018 Annual Report, “Democracy is in crisis. The values it embodies — particularly the right to choose leaders in free and fair elections, freedom of the press, and the rule of law — are under assault and in retreat globally.
  • “Political rights and civil liberties around the world deteriorated to their lowest point in more than a decade in 2017, extending a period characterized by emboldened autocrats, beleaguered democracies, and the United States’ withdrawal from its leadership role in the global struggle for human freedom.”
3. Breakdown of trust

• According to Roberto Foa and Yascha Mounck, “Over the last three decades, trust in political institutions such as parliaments or the courts has precipitously declined across the established democracies of North America and Western Europe.”

• Trust has been lost in both the democratic (political) and capitalist (economic) systems

• There is a big debate on whether the resulting “populism” (of the left or right) has economic or cultural roots

• The answer is: both
3. Breakdown of trust

• The breakdown of trust in political, administrative and business elites reflects declining status and thwarted aspirations.

• Absolute rises in prosperity have also slowed dramatically

• Moreover, important groups in our societies have suffered long-term declines in relative economic positions: those without a college degree, men especially; and those living in provincial towns.

• And then came the shock of the financial crises

• Financial crises are politically brutal: they are visible; they have immediate consequences; they are an obvious failure; and they create unjust responses. They almost always have big political outcomes
3. Breakdown of trust

DECADAL AVERAGE GROWTH OF OUTPUT PER HOUR
(Conference Board)
3. Breakdown of trust

Levels of inequality vary

Shares of the top 10 per cent of income recipients in pre-tax national income (%)

- 1981
- 2008
- Difference

Countries ranked by difference
Source: World Inequality Database
© FT

Crisis of Democratic Capitalism
3. Breakdown of trust

SHARE OF INDUSTRY IN CIVILIAN EMPLOYMENT (per cent)(OECD)
3. Breakdown of trust

The great profit manipulation

Offshore profits of US multinationals in select jurisdictions (% of US GDP)

- Seven low-tax jurisdictions
- Six large economies

Low-tax = Luxembourg, Ireland, Netherlands, Switzerland, Singapore, Bermuda, UK Caribbean territories. Large economies = Germany, France, Italy, India, China, Japan

Sources: Brad Setser/Council on Foreign Relations, BEA, Haver Analytics

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3. Breakdown of trust

FOREIGN-BORN AS SHARE OF POPULATION (per cent)(OECD)
3. Breakdown of trust

DEVIATION FROM 1990-2007 GDP PER HEAD TREND

- Japan
- Canada
- US
- France
- Germany
- Italy
- Spain
- UK

21/11/2019

Crisis of Democratic Capitalism
3. Breakdown of trust

**PROPORTION OF HOUSEHOLDS WITH FLAT OR FALLING REAL INCOMES FROM WAGES AND CAPITAL**

*2005-14 (Source: McKinsey)*

- **Italy**: 100
- **US**: 80
- **UK**: 60
- **Netherlands**: 60
- **France**: 50
- **Sweden**: 10
- Weighted average of 25 advanced economies

Crisis of Democratic Capitalism
3. Breakdown of trust

VOTE SHARE OF POPULIST PARTIES IN WESTERN EUROPE
(population-weighted)(Roberto Foa)


Northern Europe  Southern Europe
4. Rise of zombie ideas

“People in this country have had enough of experts.”

Michael Gove, 2nd June 2016.
4. Rise of zombie ideas: populism

- Populism is distinct from calls for radical (and necessary) reform
- Even though reformers share hostility to elites with populists
- Populists employ a demagogic style and place a virtuous people against corrupt elites
- Populists of the right emphasise the nation, against cosmopolitan elites and racial minorities and immigrants
- Populists of the left emphasise working people and the poor against corrupt capitalists and businesses
4. Rise of zombie ideas: populism

- Populists reject the legitimacy of the constraining institutions – parliaments, courts, the bureaucracy, free media
- They do so for two reasons:
  - These institutions are staffed by elites and experts
  - These institutions are designed to thwart the “will of the people”
- Instead, they trust a charismatic leader, especially on the right
- The rejection of expertise creates a vicious circle in which populist failure is attributed to elite treachery
4. Rise of zombie ideas: sovereignty

• Sovereign autonomy is also a zombie idea
• The world has been brought together by technology
• and the impact of humanity has radically increased
• This necessitates global public goods: financial stability and open trade; security; and protection of the environment
• No state can deliver these things on its own, not even a superpower
• We must create supra-national regimes. These are inescapably technocratic or “expert” regimes
• Such regimes clash with simplistic ideas of sovereign autonomy
4. Rise of zombie ideas: economics

• Among zombie economic ideas are:
  • Protectionism
  • Marxism

• At the same time, our present fiscal and monetary arrangements are also built on zombie ideas:
  • That we can make the current financial system stable
  • That there is no need for an active fiscal policy
  • That inequality does not matter

• We need a new balance between markets and the state
4. Rise of zombie ideas: economics

“Protection will lead to great prosperity and strength.”

4. Rise of zombie ideas: economics

Tariff rate, applied weighted mean, all products in 2017

Source: World Bank, Justin Weidner, DB Global Research

New US tariffs introduced in 2018 (steel and aluminum / $250bn of imports from China)

All tariffs on China raised to 25% as threatened in May 2019 tweet

10% tariffs to go into effect Dec 15, 2019

10% tariffs to go into effect Sep 1, 2019

Raising existing tariffs on China to 25%

Retaliatory tariffs in 2019

Retaliatory tariffs in 2018

10% tariffs to go into effect Sep 1, 2019
4. What might lie ahead

• Erosion of democracy
• Erosion of global capitalism
• Fracturing of western co-operation (Trump, Brexit, intra-EU friction)
• China-US conflict across multiple domains
• Failure to deal with the challenge of the global commons
5. Challenge

• We are living in an era of transformation
• Post-war institutions and assumptions have become fragile
• The central characteristics of this new transitional era are:
  • Rise of populism, demagogy and nationalism and the “democratic recession”
  • Rise of China and the shift in world power
• We need to renew western capitalism and democracy
• We also need to create a stable, global and co-operative order based on multiple values and shared interests
• At the moment, this seems infeasible