Martin Wolf

On Thursday, December 7, Martin Wolf joined Markus’ Academy for a discussion on his book “The Crisis of Democratic Capitalism”. Wolf is the associate editor and chief economics commentator at the Financial Times.

A few highlights from the discussion:

- **A summary in four bullets**
  - Aristotle emphasized that sustaining a democracy requires a middle class that is economically independent, that is able to form their own views, and that recognizes that only together can it have an impact on society.
  - Democratic capitalism requires a balance between the market economy and democracy. The two are often complementary. Both reject hereditary status, while the market ideals of reward for merit, free access to the labor market, limits by the rule of law complement the democratic ideals of free discussion and debate. Yet the two can also be in opposition: capitalism is cosmopolitan and generates inequality, while democracy is territorial and egalitarian.
  - In recent decades the rise in inequality, deindustrialization and the financial crisis have atomized the working class, making them feel vulnerable, fostering anxieties of downward mobility, and weakening the perceived legitimacy of democracy.
  - On a positive note, it seems that after seeing the instability and self-seeking behavior of populists voters realize it is not what they need. There are also some signs that oligarchs are beginning to realize that living in an autocratic world will be unpleasant also for them, even if taxes are lower.

- **[00:00] Markus’ introduction**
  - Having a middle class may be key for sustaining democratic capitalism. The middle class has a higher incentive to maintain democracy since individual members have no power to manipulate society directly. A strong middle class can also boost economic growth, where arguably some countries remain middle income countries because they lack a middle class.
  - Robert Solow has recently argued that an economy does not need growth to operate, but that without growth the economy becomes a zero sum game and social mobility becomes a challenge.

- **[8:00] The democratic recession**
  - Democratic backsliding over the last decades has been well documented (Diamond 2015, Freedom House 2023). The most worrying democratic recessions are in the US and in India. In the US we see a large fraction of the population questioning the legitimacy of elections, the fundamental non-violent mechanism with which we determine legitimate winners and losers.
  - Democratic capitalism requires a balance between the market economy and democracy. Aristotle emphasized that sustaining a democracy requires a middle class that is economically independent, that is able to form their own
views, and that recognizes that only together can it have an impact on society.
- Trump in contrast argued that he (and only he) was his voters “justice” and “retribution.” At the same time, general sentiments about the state of the economy are increasingly attributable to one’s political views. A democracy in which people take their perception of reality from their leader is a sick democracy.

- **[28:36] How democratic capitalism was born**
  - Democracies appeared on a large scale in the 19th century, and after WWII we saw a steady rise to cover ~55% of countries in 1990. There is a strong correlation between the share of GDP attributable to world trade and the number of democracies. Periods of buoyant and open capitalism are periods of strong democratization.
  - The market economy and democracy are often complementary. Both reject hereditary status, while the market ideals of reward for merit, free access to the labor market, limits by the rule of law complement the democratic ideals of free discussion and debate.
  - The market economy brought the prosperity required to have an economically independent citizenry. It also created the need for an educated workforce, while industrialization and trade unions brought the possibility of organizing the working class politically.
  - However the market economy and democracy can also be in opposition. Capitalism is cosmopolitan, while democracy is territorial. The market has the potential for high inequality, while democracy is egalitarian. In Hirschman’s terms, the market is often about Exit, while democracy is Voice.
  - Deindustrialization has atomized the working class, making them feel more vulnerable and less effective in politics. Coupled with the rise in inequality, these have led to growing fears of downward mobility, and a weakening of the perceived legitimacy of democracy.
  - The social democratic center-left political structures from the 20th century have been weakened, while plutocrats have allied with the old industrial working class to create contemporary populism.
  - Populism is not necessarily lethal for democracy. An essential character of democracy is a hostility to elites. As Jan-Werner Müller has highlighted, the problem is when this hostility against elites turns into hostility against pluralism. The polarization can be aggravated by the emergence of a discontented educated class committed to another kind of cultural politics.

- **[50:59] Unhappy high-income democracies**
  - Over the last few decades we have seen a decline in the ratio of the median to the average wage, while income growth has been restricted either to the global poor or the very rich. We see a correlation between a society’s inequality and a lack of intergenerational mobility.
  - We see a dramatic decline in productivity growth, which makes politics zero sum. We also see a decline in the share of the labor force in manufacturing, where workers have more bargaining power.
• The financial crisis destroyed people’s confidence in elites. The pre-crisis bubble went on so long that people started thinking it was reality, and after the correction they stopped believing the government was working for them.

• In this context, the disenfranchised will be attracted to leaders that emphasize people's cultural and ethnic identity.

• [1:06:36] Democratic capitalism in the world
  • The market economy has two rivals. First is authoritarian capitalism, where a demagogue tries to hollow out democracy from within; this model tends to fail because of cronyism.
  • Second are authoritarian regimes that are institutionalized and bureaucratic. In China this model worked well for 35-40 years, but it has two big problems. (1) It becomes difficult to absorb the excess savings the model imposes. (2) The allocation of resources is done on a discretionary basis by bureaucrats, but this fosters corruption. Taming corruption requires imprisoning bureaucrats and businessmen, but these are the people the system relied upon to make decisions, undermining its dynamism.
  • Countries like Denmark or Switzerland have successfully protected democracy because the population is highly educated and politically mobilized. However their small size makes it easy for small groups of people to act, while in large countries the barriers to entry into politics are higher.
  • Deindustrialization has not happened because of predatory trade policies from China. The biggest reason has been productivity growth with low elasticities in demand for industrial goods. Protectionism won't revive American industry and we must accept the shift to services. If unions can’t do so, we must address the fact that the shift has led to anxiety, insecurity, and a lack of attachment to society in the workforce.
  • The hope is that over the next 10 years democracy will start to be appealing again. It seems that, after seeing the instability and self-seeking behavior of populists, voters realize it is not what they need (e.g. the UK or Poland). At the same time, there are some signs that oligarchs are beginning to realize that living in an autocratic world will be unpleasant also for them, even if taxes are lower.

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