

0:00

Markus Brunnermeier: So, welcome back everybody and thanks for joining us today for a conversation with Martin Wolf. Martin, welcome back. It's good to have you here.

Martin Wolf: Pleasure to be with you. Thanks.

Markus Brunnermeier: Today we will talk about Martin's recent book, *The Crisis of Democratic Capitalism*, and we will learn more about this topic. So before I give the floor to Martin, let me give a few opening remarks and then we will talk more about more details. So one question is, you know, is the middle class key for democratic capitalism? And the argument is essentially what we will make is that the middle class, each individual cannot really manipulate the democracies or care to maintain democracies, while oligarchs would actually manipulate the democracy or the society directly because they have more power, so that's why it's important to have the middle class. It is also important that they have a fair share, so the inequalities are kept. And there's a saying, which some middle-income countries say, "oh, we are a middle-income country without the middle class." Or perhaps it's more true that perhaps there's a reason for that, that the middle-income countries, because they don't have a middle class, and the middle class might push up a country further. That's a hypothesis. Another argument is that there's a fair shot. Instead of having a fair share, you should have a fair shot. And so in terms of social mobility, there should be the potential to move up to the upper class. But this also means if some people move up, others move down, so there's a status anxiety. So do we want to have a lot of social mobility, but it also leads to some status anxiety? Or we want something where we do not have so much resilience inequality. That means when you face a negative shock and you move down, you can bounce back easily. So there's this bouncing back. So there's no inequality, who is able to bounce back and who is not able to bounce back? But more generally, there's the question also and it is often argued that capitalism actually needs growth. Without growth, there can be no capitalism. And Bob Solow gave a famous podcast recently where he said, "no, that's not really needed." So for an economy to work, you don't really need growth. You can just think of a totally stationary economy where nothing is changing. Everything is just done every year the same way. There's the same output, same products, no innovation. There's only a glitch if people suddenly want to save more, then the government has to intervene. But this can be handled as well, in particular, if you hit the zero lower bound issues. But the bigger challenge, in his opinion, is social mobility. If you have a very stationary economy, then nobody can move up and nobody will move down. And if somebody moves up and somebody else has to move down, it's a zero-sum game. And that actually calls for the design of the zero-sum game, which is very tricky. And it, again, might lead to status anxiety. So if the economy is growing as a whole, then even if you move down in relative ranks, in absolute terms, you might still move up and that might make the society more stable. The second question is, so today I'll just throw out a number of questions. The second one is, when we talk about democratic capitalism, there's democracy and capitalism, but what's about the third pillar of a liberal society, the rule of law? So that to protect, essentially, each individual citizen from the arbitrariness of the government or the majority, but the whole thing of the rule of law started, of course, with the Glorious Revolution, 1688 in the United Kingdom.

3:45

And what role do social norms play for tolerance, that the majority, essentially, is not ruling everything? And how to balance these three elements all together? Now, another question is, what's the role of trust and technology? Do the citizens trust the democratic society because it has fair rules and social norms are designed this way. And it's the trust of the government in its citizens. So if the government takes on all the control and wants to design everything, it doesn't outsource some decision-making to the citizens, then you could call this a lack of trust by the government into its own citizens. And of course, new technologies might limit what individual freedoms citizens have because of surveillance technologies and other elements. Another thing is trust is also related to property rights. So capitalism really needs property rights to overcome frictions, so that it can trade, essentially contingent trade, pollution property rights or whatever property rights you have. This can be legally enforced through the government or the legal system, but these days it can also be technologically enforced. You can just have very good fences. You don't need somebody to enforce it legally, or through digital fences in the form of crypto technologies. And there might be a shift in how much legal enforcement of property rights we need, given we might have more technological ways to enforce property rights. Finally, there might also be a tension, because democracies are essentially national, while more of our problems become more and more international challenges. So we have spillovers across the globe. We have global public goods. Everything in society is challenged, everybody is challenged from global aspects. Historically, you might think, what mattered to me in my life is mostly within the country or in my own region. Now what matters, if somebody does something in a different continent, it has huge implications on me as well, while we have the governance structure from nation to nation. Is this because potentially democracies are challenged, because the democracies are still set up in the form of national boundaries? But it could also... argue that the same would be the tools of autocracies, they also focused very much on national boundaries. So I'm very grateful to all of you for submitting the answers, for the poll questions. And the first poll question was, is being part of a democracy, is this part of your core identity or not? And not really, 5% really said. And people said, yes, that's part of my core identity, 62% said. And the third part is, yes, and also actively contribute to this core identity, that's what 33% said. So essentially, 95% say it's really part of the core identity, which is encouraging, let's put it this way. The second question was about economic growth. And you could pick more than one answer. Do you think capitalism needs growth or not? That's what 53% thought. Does democracy need growth in order to get away from zero-sum games complications? 27% thought this way. And both can survive without growth. That's only 29% thought this way. And finally, I didn't mention this complexity – people might argue that we live through this huge shift or huge transformation. We have a green transformation. We have artificial intelligence. A lot of challenges and social norms will change in the upcoming years. And people feel anxiety and uncertainty about this. Is this the reason that complexity leads to populism or not? So the complexity people – 68% thought that's the case. And 32% thought, no, the world was always complex. It's not really more complex than it was earlier. So with these poll questions, I would like to conclude my opening remarks. And then I pass on the mic to Martin, who tells us more about the challenges we are facing. And hopefully, we can avoid, overcome the crisis of democratic capitalism. Martin, the floor is yours.

8:00

Martin Wolf: Thank you very much. It's wonderful to be talking with you. And it's also quite daunting. This is, I think, an immensely important topic and also a very difficult one. But I was very encouraged to see that 95% of the audience agree this is quite an important issue, and that they identify as a convinced Democrats. I would have hoped that would be the case, I must say. And I'm wondering about the other 5%. But I will leave that, leave that aside. It's a great honor and a pleasure. And I will start and I hope that you will be able to see my presentation. And well, it looks as though you can. So let me start at once. So I'm going to start with the book, which has already been shown in the American version. And then I will start with a, wait a second, why is it continuing? I will continue, I will start with some quotations, which I think set out a sort of fairly important part of my argument in making this book. And the first quotation is from, I suppose, one of the two fathers of political science, the other one being Plato with his Republic, that is Aristotle. And he wrote this in his politics, and it's his answer to Markus's question at the beginning. And it is clear then that the best partnership in a state is the one which operates through the middle people, by which he meant the middle class, and also that those states in which the middle class or middle element is large and stronger if possible than the other two together, by which he meant the very rich and the very poor, or any rate stronger than either of them alone, have every chance of having a well-run democratic constitution. This is the basic argument for the idea that you need middle people who are independent and are sufficiently able to make views of their own, but recognize that only together can they have weight. That is what you need. That's what you need for a democracy. Otherwise, you have a problem. I hope that I can move on. The second quotation is very, very much more recent and very, very different. It comes from Donald Trump, of course, who said on the 4th of March, 2023, "in 2016, I declared, I am your voice. Today, I add, I'm your warrior, I'm your justice. And for those who have been wronged and betrayed, I am your retribution." And I think that's a pretty clear statement of a view of politics, which terrifies the wits out of me. I don't know what you all feel about it, but it seems to me a pretty clear sort of program for the government. And the last quotation is a very short one and it is in a way the motto of my book, if you like. And it comes from the Temple of Delphi in Apollo, Apollo's Temple at Delphi. And it is a very famous Greek saying, it's μηδὲν ἄγαν, which means nothing in excess. That is to say, the way I take this is that a complex civilized society based on democracy and the market, I'll come to this in a moment, requires a balance between different elements. And if one dominates the other, either democracy dominates the economy or the market economy dominates politics, you will not have democratic capitalism, which is essentially a system based on the idea of balance. Now, this talk is based on my book, as I've mentioned, The Crisis of Democratic Capitalism, which was published in February. Now, I don't know whether it's to my shame or not, but I started work on this book in 2016. It took a long time. And it was of course started, or at least planned in the summer after Trump won the nomination for the U.S. presidency and Boris Johnson won his Brexit referendum. And it was pretty clear that something to me was very big and somewhat unexpected, not completely unexpected, because I prefigured this to some degree in my earlier book, The Shifts and the Shocks, which was about the financial crisis. I suggested that this could lead to big upheavals in politics, but I was surprised how quickly and how big they were.

13:40

It took me quite a long time to sort out what I thought, and it's still very much a working process in my mind, because I was basically required to think about political economy in a way I had not done since my days as an undergraduate in Oxford. Now, I think I should be clear about what my personal motivation is. I think this sort of thing is quite personal. It's not just analytical, not for me anyway. This is very much sort of a book written with the hope that it would influence the future, though it probably won't. And I just wrote this in my preface and I think it's of some interest. So in 1937, my father left Vienna for England and he did so on his own. His immediate family managed by a miracle to escape to Palestine in 1939. You can work out where they are now. Their wider family remained in Poland and apart from one young woman whom I got to know quite well, they all perished in the Holocaust. In May, 1940, my mother's family, father, sorry, a self-made Jewish fish merchant hijacked a trawler in order to take his family to England. As German armies poured across the Dutch frontier. He was one of nine. He asked all his brothers and sisters to join him with their families, none came. Their families also all perished in the Holocaust. I'm not certain of these numbers, but roughly between 40 and 50, my parents, aunts, uncles, and cousins were slaughtered. And this reality has, of course, shadowed my life from the beginning. And this event was, of course, the result of the collapse of civilization in Europe. There were many reasons for that collapse, but in my view, and I explained why I hold this view, crucial among them was economic failure and, above all, the Great Depression. It was that event which was, as it were, the trigger for bringing Hitler to power. And I concluded, and it's a complicated thing to work out precisely what we mean, but if people cannot gain a decent standard of living, and a reasonably stable position in society, both relatively and absolutely, a peaceful and stable democratic order becomes hard, if not impossible, to sustain. And that's why the theme of this book, which I began as Donald Trump became president of the U.S. and the Brexit campaign won in my country, sees me. I am, to be clear, not saying that what happened then will happen again, at least not precisely, but I'm saying that one cannot assume the stability of a civilized democracy. So with that, let me turn to what political scientists call the democratic recession, where we are now. Remember this, in a liberal democracy, a democracy characterized by individual civil rights, the rule of law, and respect for both the rights of the losers and the legitimacy of the winners, that's what I think of as a liberal democracy, fair elections determine who holds power. Attempts by a head of government and state to subvert the election or overturn the votes are, in my view, treasonous. Yet that is quite clearly, in my view, what Donald Trump attempted to do, both before and after the last presidential elections. He failed, of course. Decent and brave people ensure that. But to this day, Trump continues to hold the absolute loyalty of his party's base. And of course, as we know as things stand today, he could very well be the next president of the United States. So let me just give me – before I continue with that, I should have said this, this is the outline of what I got to say. I apologize that I didn't show you that before. Sorry. So I've just discussed it. That's what motivates me to write the book. I'm talking about the democratic recession. Now I'm gonna talk about, then I'm gonna talk about how democratic capitalism was born, the state of high-income democracies today, where democratic capitalism fits into the world. And I'm gonna finally conclude with, is it already too late to save democratic capitalism? I apologize, I didn't say this before. Oh, dear.

18:30

So let's talk about the democratic recession. And I've already just mentioned Trump. So here is my first chart. And it shows, it actually comes from a column of mine, the state of public opinion in the United States on what happened in the last election. And the key point is that. the perception of the legitimacy of the election, which is, as I've said, the most fundamental attribute of the democratic system, that fair elections create legitimate winners and losers, which both sides accept, that the view of what happened in the last election is stupendously polarized with roughly 70% of Republicans continuing to claim that the election was a fraud and therefore Joe Biden is an illegitimate president, and essentially zero Democrats having the same view and with the independents and the totals converging around 30% thinking it's illegitimate. So this is a real, it seems to me, a sort of knife in the heart of the legitimacy of the democratic system within the world's most important democracy. I don't think there's any real doubt.

Markus Brunnermeier: Do you think that's a specific US phenomenon? There's nothing like this in the UK or?

Martin Wolf: No, this is very interesting. As far as I can see, and I haven't looked at this rigorously, but I haven't been able to find any case, any country, at least a significant country, where the doubt about the legitimacy of a core election was so fundamental. For example, to take a pretty contentious election in Britain, the referendum on Brexit, nobody has questioned to my knowledge the legitimacy of the outcome. There's a little bit of talk of voter fraud here, but it's, I mean, incomparably different from the American situation. There've been very vexed elections recently in, for instance, Spain and the Netherlands, but again, I don't detect any sign, at least from my knowledge, that people are saying the whole process is corrupt. And that's pretty significant, to put it mildly. Sorry, I must go back. Sorry, I need to go back. OK. This is a very recent statement of job approval and disapproval over Biden. And while I'm certainly not sure what the outcome will be, we can safely say that the president is not currently very popular. He's not been very popular for a very long time. I don't have time to go into why. And that certainly makes it a realistic proposition that Mr. Trump will be the next president of the United States with unknowable consequences. But clearly, ones that, given the history I've just discussed, and I could, of course, discuss many other things, are very, very significant. We should add in addition, when we think about the politics of the Republican Party, that of course, people, Liz Cheney was probably the most famous case who was about as conservative as you can imagine, was thrown overboard because she may have the great crime of stating that Trump's big lie, that the outcome of the election was a big lie, is itself a big lie. So basically, the fate of those who have denied what Trump has claimed has been pretty grim. Basically, they've all been driven out of the party and that's why the party remains essentially, as far as I can see, at his feet. Now, one has to stress this, a democracy in which people take their perception of reality from their leader, and there are other examples here, but this is the most important, is a pretty sick democracy. One would have to agree, it seems to me, that democracy has some pretty fundamental moral underpinnings if it's going to survive.

23:17

That we are all citizens, we all share the duties and rights of citizenship, we govern through debate, we argue at least reasonably, honestly, based on what we understand to be the truth,

and with these values gone, how do you decide who is legitimate other than with violence? With that, let me then go on to the next chart, which is really fascinating, it seems to me, because it goes into this question of how people see reality, again, in the United States, because the – sorry – so these are charts I've taken from one of my colleagues, again, very recent, which show the divergence cyclic, you know, the electorally connected divergence between the perceptions of economic reality of Republicans and Democrats over their overall consumer sentiment, is it a good time to make a big purchases, the twelve month outlook for business conditions, and the outlook for their own families finances. And what is, I think, fascinating, is how Republicans are very optimistic when they've got a Republican president, and they're very, very pessimistic when there's a Democrat president and pretty well vice versa. The only thing where this doesn't seem to apply, which I find intriguing, is whether it's a good time to make big purchases. Maybe the money involved is so large that people actually approach reality, then I don't quite know what to make of it. But it's clear that the very sense people have of reality has been affected by partisanship to a quite extraordinary degree. Now, let me move on.

Markus Brunnemeier: And this was much less pronounced in earlier decades. Sorry? Yes.

Martin Wolf: Again, I've never seen anything as striking as that for other countries. Again, I'm not saying there isn't some of it. But my colleague looked at this for the US precisely in detail, because it was so, so amazing. Or at least it seemed amazing to me. Now, let me just move on. While the U.S. is an extreme case in some of the points I've just made about the role of President Trump, his claims about the election, the support he's getting, and the partisanship, it is true that the Democratic recession, so-called, is quite worldwide. It's not just unique to it, to the US. Larry Diamond noted this concept of the Democratic recession more than one and a half decades ago. And Freedom House has talked about that in all its reports, really, in the last 15, 16 years (well-known think tank on democracy). And what it concludes is that we can see very large declines in many democracies. Most of them are the fragile democracies that emerged after the Cold War, but there have been very significant declines in Freedom House rankings in the functioning of democracy in two particularly important democracies. The U.S. is one, I'm just going to show you this from their perspective. And the other, which is I think also globally very important given its size and potential, economically, is India. So let me just tell you here. So these are the countries which have shown the largest declines. And this is, I'm trying to put a global context on this in the functioning of a democracy in the last ten years up to 2023. And you can see right at the bottom, there are only a few developed countries, basically the US is the only one that is dramatic apart from Poland, which we hope is about to reverse. But you can see right at the bottom, India and the United States have experienced really very steep declines in their ratings. And so there is a global recession, democratic recession. It seems to be particularly striking in these two very important democracies. And India is no longer rated by Freedom House as a free country in their categories, which are of course always rough and ready.

28:35

Let me move on then to my third section, which is my thinking about democratic capitalism: What is it and how did we get to it? And for that purpose, I'm going to just show, having another

chart, which I'll come to in a second, so according to the Polity 4 database, which provides a comparative database of whether countries are democratic or not, it goes back to the beginning of the 19th century. It's, of course, rough and ready because this is very difficult to define precisely. But they basically argue that there were no democracies at all in any real sense two centuries ago. There were countries where there were elections but the franchises was so limited and constrained that we couldn't possibly describe them as democratic. And even where, and the basic point is that the franchise was just too restricted on the grounds of sex, race and wealth to be called democratic. But in the 19th century franchises in those countries that were independent there were many countries in empire, what are now countries in empires were widened, universal suffrage democracy emerged and spread in fits and starts to cover about half of the world's countries after 1990 or before recently stabilizing. And then in the last 10 years, which I don't have here, declining once again. And this spread of democracy was a very remarkable phenomenon. This chart, which is sort of designed to show a bit the, in one way, the link between the market economy and democracy, basically has two sets of data. The brown line, which can be read off the right-hand side, is the proportion of the world's countries that Polity defined as democracies. And you can see there was a real upsurge in the 19th century, and then a big jump after the First World War, which the Western allies won. Then there was a big decline to the trough in the Second World War, the rise of fascism and all the rest of it. It was a big rise, after the war of democratization, then stabilized as a lot of the new newly independent countries became dictatorships, and then after 1980, and particularly after 1990, there was a massive surge in the proportion of countries that were democratic, reaching a little over 55%. I don't have more recent data from Polity but I'm sure it would show a decline since 2010. The other chart shows a very simple index of the health of the capitalist system which is simply the share of world trade over world GDP. How open was the world economy? How globalized was it? How much did people rely on globalization on the market? And this very simple indicator shows quite a close coincidence in the 19th century, late 19th century globalization, then the collapse in the interwar years and the Second World War, and then a recovery with this very strong upsurge in globalization from 1990, which coincided with the 1990 to 2010 upsurge in democratization. Do I wish to claim that this is cause and effect? That will be very bold, but I think the link is quite interesting. Periods of buoyant capitalism when people are confident in the future, open, seem to be also periods when democratization is relatively strong. But let me go back to the fundamentals, not just talking about these statistical relationships for what they're worth. Remember that throughout human history, at least since the agricultural revolution, as far as we know, the most common way to structure economies and politics has been for power to accrue to wealth and wealth to accrue to power, effectively the most powerful people in society were the richest and vice versa. And of course, absolute monarchs claimed effectively to own everything. When Louis XIV said, "L'État, c'est moi," he effectively said that everybody owned things ultimately at his discretion. And then the question obviously arrives, and this is a fundamental one, I think, is why did this revolutionary change that I've described of the last two centuries towards democracy occur?

33:39

And the answer I suggest in my book, not at all original, of course, lies with the emergence of a new system, a marriage between a liberal economy and a democratic polity. I argue in my book

that market capitalism and democracy are complementary opposites. So they're complimentary in the following sense – reasons, both logically and historically. A market economy and a universal suffrage democracy both reject ascribed as hereditary status. They embrace the idea that people are entitled to decide important things for themselves. These are pretty radical liberal ideas. Market capitalism, of course, rests on ideals of free labor, individual effort, reward for merit, and the rule of law. In fact, without the rule of law, there can't really be market capitalism. Democracy rests on ideals of free discussion and debate among citizens when making those laws. These are, I think, important complementarities. Historically, and this is where the positive sum element that Markus was talking about seems to me so important, the market economy brought urbanization, some slow, difficult, but nonetheless ultimately radical increases in prosperity. It brought about a need for a more educated workforce. People realized they needed educated workforces. They created industrialization and with it, the possibility, I'll give this at length, for organizing the working class as a political force through trades unions and then through political parties. And this, at the bottom, created through the positive sum economy, also a positive sum form of politics. One could start giving more to everybody while not taking away enormous amounts from anybody. It made politics so much less fraught. I argue in addition that democracies rest on the existence of an economically independent citizenry. And that, I think, was basically Aristotle's point. A fully socialist society is, I argue, not a new idea, inevitably, a dictatorship, since the ownership of productive assets is vested in the state. In the absence of coordination through competitive and open markets, that state is itself directly responsible for the allocation of those valuable resources. This inevitably creates both a huge centralization of power and a huge incentive not to lose control of that power, because then essentially you lose access to the resources that you controlled when you were in power.

Markus Brunnermeier: Can I come to this figure just to figure out, so you argue that forcefully that the middle class is really essential for democracy to flourish, but if I look at the 19th century, democracy was going up at the same time there was the robber barons and there was inequality was probably rising quite a bit in the 19th century as well. Would you say that's not a problem if the whole economy is growing fast enough, then it could be that inequality is going up and democracy is still flourishing?

Martin Wolf: Well, I'm going to come a bit to inequality. My view is that this was a very complicated process in the 19th century and society started from very different points. So if I just compare the U.K. and the U.S., my view is that the U.K. almost certainly became less unequal in the 19th century because it started off as a society with unbelievably concentrated ownership of the most valuable asset in society, which was land. And it was exceptional. Capitalism was highly egalitarian, and it also created, by creating the industrial working class, a very powerful mobilizing force for greater democracy.

38:16

In addition to that, very important in Britain, of course, there was a rise in a very significant independent commercial middle class, small businessmen, small traders and so forth in this more prosperous country as it became increasingly a market society. And they were the big source of demand for more open, responsible democratic institutions in the middle of the 19th



century, the second and third reform acts in the British case. So I think in the British case, it's clearly more equalizing, and it did create a very much bigger independent commercial middle-class, and they did. They were the people who supported the liberals, people like Gladstone, they really did demand democracy and the industrial working class followed them. The U.S. seems to me a somewhat different story, but I think it's very important though there was clearly a rise in, I would have thought in the robber baron period, there must have been a rise in inequality. There was also, because the U.S. had easy access to land and a very thriving and emerging small business, small to medium-sized business society in an economy that was growing quite dynamically, I would have thought that the commercial middle-class, the independent middle-class in the United States too, and the independent working class, what people working in industry was also growing very rapidly at that time. And they were a very important source of the desire for greater democracy and even interesting for the abolition of slavery. So I think the extreme wealth inequalities might be less important than the fact that very many more people were acquiring the means to live independently, to earn enough to support themselves comfortably and to demand an increasing say in public life. So that's a big, very big...

Markus Brunnermeier: So when you measure inequality you would not focus on the top 1%, you focus much more on a Gini coefficient in a sense.

Martin Wolf: Yes, I think the overall Gini coefficient is better and I tend to think that, though this is difficult, but I actually tend to think income from this point of view, from the point of view of people's independence and ability to engage in politics, income may well be much more important than wealth. I don't know enough about that and it may well be that somebody has done wonderful economic analysis on this and I'm not aware of.

Markus Brunnermeier: Actually, there's a comment that Carlos Bosch, my colleague here at Princeton, has worked on that. But let me just say, you made this very forceful argument that it was a transformation from an agricultural economy to an industrial economy, which allowed that. Do you think now we go through a shift again where we move from an industrial economy much to a service-oriented economy? Do you think this is very different, the second shift, because the first shift or the transformation from agricultural to industrial led the middle class to grow? Is this also the case for the next shift or the next transformation we are facing now? That's a little bit-

Martin Wolf: I think that I'm gonna raise that question. I've come to the view, and this is very controversial, I don't think there's any certainty here, that deindustrialization has been quite important in atomizing the working class.

42:05

And it has also tended to make them less effective in politics and feel significantly more vulnerable and insecure. And that has been a very important part of the rise – these have been with other people, a very important force in creating a new working class support for right-wing populism and breaking the, what I think of, it's very European thing, the social democratic center-left political structures that emerged in the early part and early to middle part of the 20th

century. So I think deindustrialization is very important. What the shift to the service sector has been done in terms of people's attachment to democracy is very interesting, but I think this is partly linked to one of the most interesting things I will raise in a minute, which if we ever get there, which will be the other big shift in our economy, which I think is associated with a very big part of the splits we're now seeing in our societies, which is the emergence of an enormous graduate class. This is a new class in my view, which dominates the more sophisticated services and of course the IT sector has very different values, I think, from the old working class and has shattered, that is to my mind at core, what has shattered the center-left coalitions and has created the possibility of a form of right-wing populism, which we saw in the Brexit campaign and I think we see with Trump. In which plutocrats, very wealthy people, some parts of the commercial class ally with the old industrial working class and particularly people who've lost jobs in the industry to create the bedrock of contemporary right-wing populism. That at least is my theory, what I argue in my book. And I have, I think, some fairly lengthy discussions of that, which I won't be able to go through in detail now, but you can all disagree violently later. Shall I go on? So I've discussed the way in which capitalism and democracy are complementary in my perception, both theoretically and historically, but there are also, and I think Markus has already discussed that, there are also opposites in important ways. Capitalism is inherently cosmopolitan. The democratic state is by its nature territorial. The market is the domain of exit. And democracy is the voice of the domain, a voice in Hirschman's famous dichotomy. And the market economy is ultimately, it has the potential for high levels of inequality. Ultimately, power rests in one's command over economic resources that are valuable. Democracy is inherently, at least in principle, egalitarian. The principle of one person, one vote. And so we're going to find tensions between capitalism and democracy. They're just inevitable. And I argue that if the economy fails to serve what the majority think of as their interests, the sense of shared citizenship will fray, and there is a high likelihood that populist demagogues will emerge. And I think populism is a meaningful concept, and I will discuss what I mean by that in a minute. And Plato himself, interestingly, in his discussion of demagogues, he was the first to talk about this idea in *The Republic*, calls these demagogues protectors, people who offer to the majority, the great majority, particularly the majority who feel, who are anxious about their situation, he calls these people protectors. And Trump is a characteristic protector in that sense. Indeed, that is precisely what my opening quotation suggests he is stating of himself. Populism is not necessarily lethal to democracy because it's, to my mind, the essential characteristic of populism as a political form is that it expresses hostility to elites. The elites it expresses hostility to may change, but the core idea of a populist politician is to say, you, the honest, honorable people are being sacrificed to the interests of elites who are indifferent to your fate. But as Ian Werner-Muller has argued, I think quite persuasively, this idea of hostility to elites often morphs, indeed frequently it's morphed, into the form of hostility to pluralism.

47:21

It basically says, you, the people who support me, are real members of the people, and we can take you seriously, and the people who don't support me, aren't really part of the people at all, and so they have no legitimacy. And there are extreme versions of this, about most populist politicians, and Trump is certainly one, who has expressed exactly that view at various stages. And if you get that sort of populism, and the populist wins, it starts to become a plebiscitary

dictatorship, and ultimately, I think, a dictatorship. Alternatively, the concentration of wealth may lead to plutocracy as wealth is once again transmuted into power. Both possibilities exist and indeed it is possible and quite easy in my view to have both a predatory autocracy and a corrupt plutocracy in uneasy tension. I won't give any contemporary examples, but there is a wonderful historical example of such a system because it was the governing system of the Roman Empire. Now that said, let me just move to where I think the high income democracies are today and how we got here. I argue that rises in inequality and the deteriorating prospects of the old respectable working and middle classes in core democracies have weakened the legitimacy of democracy. In particular, a fear of downward mobility and risk associated with that has created status anxiety. These anxieties have been diverted by successful propagandists into cultural and racial resentments. And that's been particularly easy in ethnically diverse societies. And that's not – and a lot of it is focused on immigration as in Britain, it was in the Brexit campaign. This is of course, not a new political phenomenon. It was a core aspect of the political culture of the American South. And of course it was a core aspect of European fascism in the early 20th centuries. I argue, in addition, that these resentments which are cultural as well as economic have been greatly aggravated by the emergence of a large and discontented class, a self discontented class, of university educated clerics dedicated to a very different sort of cultural politics. And what we then see increasingly is an identity army of the left clashing with the identity army of the right as cultural symbols become increasingly important. And that clash is the core of contemporary politics. I would argue in addition that the emergence of the new media has facilitated all these trends, but they did not, in my view, create them. And after all, as I know, old media created right-wing populism, including fascism, a hundred years ago. It's not clear that we needed the new media to do this. So what created – what were the sources of this status anxiety, especially people who did not go to college and the resentments they feel to the people who did go to college who are constantly lecturing them about how barbaric they are? And well, I'm just going to give a few charts which indicate some of the things that seem to me quite intriguing about the world. I'm not suggesting anything completely coherent. So this chart shows the ratio of mean family income to median house family income in the United States from 1984. And the blue line shows the ratio of the median to mean. It seems to me quite a simple way of thinking about where the median is relative to the average, which is obviously being influenced by what's going on in the top 10, 20 percent of the distribution. And as you can see, there's been a steady and pretty substantial fall in the median relative to the mean over this period. The second chart, this is global. Again, I don't want to push this too far, but I think it's quite intriguing. This is Milanovic's famous elephant curve, updated, the trunk of the elephant, the head is here with the red, the beginning.

52:14

Basically, this shows the percentile of global income distributions and the vertical axis shows the increase in real incomes percent between 1980 and 2016. And you can see very big real income increases between the 20th and the 50th percentile, 20th and 40th percentile, which is basically the developing, the high growth emerging countries, particularly in Asia. And then you get these long middle income parts, which are South America and then the middle and lower middle of the developed world. And then we get started heading, this is of course not to scale because it's not to scale. You start looking at the very, very rich and they have experienced

according to these from the World Inequality Database, extraordinary rises in real income. And a lot of the more discontented people are in this sort of 70th, 80th, 90th percentile in this chart. The next chart is, and this gets to the question that Markus started with, which is social mobility which I agree with him. It's double-edged because in a slow growing society, slow growth mobility looks very zero sum, but it is quite interesting. I think that this is income inequality. The X-axis shows the Gini coefficient of household disposable incomes in the mid 1980s to early 1990s. The vertical axis shows – this is the so-called Great Gatsby curve, the intergenerational elasticity, earnings in elasticity, in other words, how far were you distant from where your father was? And basically the point of the curve, the correlation is modest, but it's certainly not very far from zero, is that the more unequal the society, the less the intergenerational mobility tends to be. The U.K. and the U.S. and Italy are relatively immobile. The children tend to stay more where their parents were. There are several reasons for that, but I think it's arguable at least that this is one reason why people might, particularly in a slow-growing world begin to feel if you're at the bottom of the bottom to the middle of the curve, that maybe your chances of doing well, of your children doing well, aren't so good. The next chart shows what I really think is a very important social phenomenon because of its direct effect on the working classes and that's deindustrialization. So I started in 1970 and the chart ends in 2019. It shows the share of industry and civilian employment ranked by the decline in the share. The UK has far and away the biggest than France; interestingly Germany also from a very high level, but essentially there has been a very large decline over the last 40 years or so in the proportion of the labor force employed in industry and of course the significance therefore of industrial jobs, which were by and large the best jobs that people without university degrees in large were likely to get in our societies. They could organize, they had usually considerable market power and that allowed them to earn really very, very good wages in a fairly stable way and that has gone. Britain has suffered this considerably and the consequences for our society I think have been pretty serious and then I think I've got two or three more and then I've sort of come to the end. This shows decadal average growth rates of output per hour in the major developed countries starting in the '50s then to the '60s to the 2010s and you can see in general there's been a dramatic decline in growth rates, least so actually in the U.K. and the U.S. because they didn't do so well in the early period but in general the 2010s, in terms of output per hour (things seem to be improving in the U.S. more recently) were really miserable. And this is ranked by the 2010s average productivity, particularly low, slow growth at that point in the U.S., U.K., and of course, Italy, which is far at the bottom. But generally, the growth dynamism as measured here has clearly been generally falling, which I think has made our politics much more zero sum.

57:28

And I think this is the final one, well, there's one more, which I think is to me, one of the crucial things, which is what happened after the financial crisis. So a lot of what I've talked about here is this long period of slow growth and disruption as it affected people in the middle, at the bottom of the income distribution, and rising inequality, which is of course a controversial issue. I couldn't go into that in depth. And then came, along came, and I think it was crucial, the financial crisis. It was a crucial moment, I think, affecting particularly, well, the U.S. and U.K., which I know particularly well. And I argue that the scale and visibility of the crisis and the rescue of the banks and bankers convinced many ordinary people that the elites were both corrupt and

incompetent. And I think it was one of the reasons that the conservative establishment and the Republican establishment were effectively overthrown by outsiders. The confidence in the people who'd orchestrated this, which is both the center-left and the center-right, was lost, but the right-wing populists were much more effective. I think there are reasons for this, which I won't be able to go into, in picking up the anger. But this chart, I think, brings out something very remarkable, which is how big the real income losses have been since the financial crisis. So basically, what I've done is taken all these countries, and I've shown how far GDP per head between 2007 and 2021 has fallen below what would have happened if the pre-crisis trend had continued. And the only countries which have done pretty well relative to the pre-crisis trend, not too badly anyway, are Germany and Japan. They are short of it, but not massively. Then you start getting some absolutely enormous declines relative to the pre-crisis trend. In the U.S., it's about 20%. In the U.K., GDP per head is now about 37% below what it would have been if the pre-crisis trend had continued. I wrote about this this week. a massive decline in the growth rate. Spain, of course, has suffered a massive decline because of the big financial crisis. Italy is less of a collapse because it was already growing very slowly. But basically, the underlying dynamism of our economies has been unbelievably poor since the financial crisis.

Markus Brunnermeire: I think before that might be misleading because, you know, Spain was growing on overheating artificially. There was a bubble pushing it up.

Martin Wolf: I think myself that, by the way, that if you go into that, most of them were a bubble. The problem is the bubble went on, in my view, so long that people started thinking that was reality. So the correction of the bubble into near stagnation has been a colossal shock and it's taken people – I think it's created an enormous amount of anger. I agree with you. Indeed, I discussed this in the case of the U.K. I think it's also true in the U.S. The big financial bubble, housing boom, and all the rest of it before 2008 gave people an illusory view of the increases in their wealth, but the burst of such a bubble, as it also happened in the 1930s, nonetheless, of course, is a tremendous disappointment to people who think that they're going to enjoy it. And the final thing I just wanted to show, I think it's the last chart. I'm not quite sure, maybe one or the other, which shows for Europe, where a friend of mine, Roberto Farr, did a quite detailed analysis of, sorry, of support for what he calls populist parties. I think it's pretty obvious what sort of parties they are. You can see, as soon as the financial crisis hit. And then you've got the Eurozone financial crisis, 2010, 2013, up to 2016.

1:02:05

You saw a dramatic rise in populist parties, and that's far less true in Northern Europe. So again, I would argue, and do argue, that the impact of the financial crisis on populism was very, very important.

Markus Brunnermeier: But how do you explain that, you know, in the U.S., at least the Republicans are closer to Wall Street, and Trump is actually not known for being against Wall Street?

Martin Wolf: Yeah, I think this is probably the thing I understand least about America. I think, I

mean, my view of this tends to be that when the crisis hit, the disappointment became politically actual, people had sort of a choice in the U.S. and to some extent, the same was true in the U.K. between a center left dominated by what I call the graduate class increasingly dominated, which had shown itself pretty indifferent from the perception of many ordinary people to their interests, economic and cultural and the had shifted away from them. This is partly why the Labour Party lost the support of so many working class people, so it's a similar phenomenon. Why did they all vote for Boris? Similar sort of thing. And in that situation, when you've given up in believing that the government was going to do anything good for you economically, you are attracted at least to support people who will say or emphasize your cultural and ethnic identity as valuable, as something that they feel is, or they project as being valuable to society, to them. In other words, who empathize with their situation. That doesn't necessarily mean doing anything for them economically. It is interesting to me, and I haven't been able to work this out sufficiently, why you get this divergence across the world between right-wing populists who are strong on welfare and are very happy to support public spending: Poland is an example. And right-wing populists who emphasize culture, cultural identity successfully, but don't emphasize the economy. And what makes one successful in one case and one successful in the other is not something I have to say I fully understand. But in the American case, it seems to me this – and that's what I said earlier – that this attraction to the racial ethnic interpretation of what's gone wrong is, I think, quite deeply rooted, and that's particularly so in the South, which is a very large part of the basis of support of the modern Republican Party. Whether that's a good enough answer, I honestly don't know, but I haven't seen any other really good ones.

Markus Brunnermeier: I have another question, and so Uttam Kumar, he, she wants to ask, do you think if China underperforms going forward, it's an autocratic society or some socialism with Chinese characters, will this actually help the democratic societies? Because you can point to something or will this be totally disconnected, it will be disregarded?

Martin Wolf: Yes. Let me come to let me stop talking because I've said enough. I mean, there's more in the presentation, but that's not really important. I've covered everything that matters. I, but I do then ask, have a section which I don't want to go into detail with democratic capitalism in the world. Essentially, if you look at democratic capitalism in recession, there are two rivals out there.

1:06:46

One is authoritarian capitalism. And by this, I mean systems in which a demagogue, could be many different people, Modi, Erdogan, Trump, succeed in taking over power, and they hollow out the democracy from within, they turn it into what I call what I have, have called a plebiscitary dictatorship – that's an exaggeration, but that sort of system. And by and large, it seems to me, if you look around the world, these systems just don't work very well, because they tend inevitably to start becoming (there are exceptions) but basically, they become crony systems. They're in different ways, and crony systems are very problematic from the point of view of successful long term economic development, which is why democracies tend to do better. Now this is the Chinese option alternative. Vietnam is another and you might even put Singapore in this category, though it's slightly, obviously very different in size. But this is a system in which

you've got institutionalized, bureaucratic authoritarian capitalism, and not personal, and not a personal dictatorship with all the problems of it. And in China's case, this worked very, very well for about 35, 40 years. I argue, however, in my book, not at all originally, but I think it's very important that that system starts creating at least two, or has created two very big problems for China. One is a generalization of the problem of East Asian forced savings capitalism, which China is taking to extremes. Its forced savings are so massive that absorbing them in investment has become incredibly difficult. And that's what the huge property bubble was, and that's about, and that's over, and they haven't yet worked out an alternative way of absorbing the excess savings in the system, and it seems to be politically remarkably difficult for them to do so. But a second and more important point, that, perhaps, which I think is sort of an Acemoglu and Robinson point, is that if you have a massive market-led dynamo in your economy, when there are essentially no property rights and all allocations of property and resources are decisions made by executives on a discretionary basis, there is simply bound to be a colossal explosion of corruption. So when Xi Jinping said we've got a huge corruption problem and it is destroying the legitimacy of the Chinese communist system, he was right. The problem is the only way he can fix this is tightening discipline, reducing discretion, and putting lots of bureaucrats and the odd businessmen in prison, lots of them. And when that happens, everybody stops making decisions because it becomes very dangerous to make decisions. And the system they have depended on having people like this making decisions. And so I think that the very essence of Xi's attempt to re-legitimize the marketized communist system, sorry about the term, has inevitably undermined the dynamism of the communist system, the Chinese communist system. And there's no simple way of fixing that without changing the politics in quite a big way. And that means (I hope) that over the next 10 or 15 years, the democratic systems are gonna start looking better again. And people will be more confident that democracy actually is the least bad system except all the others, including the Chinese system. So that is my sense of what's going on and why, and I expressed this in the book. I have some real optimism on this front, if we can sustain our system successfully over the next 10 or 15 years.

Markus Brunnermeier: So one thing that you didn't mention, you mentioned a lot about the wealth inequality, but the ease with which you can buy political power with money. Is this something, if you could change one thing, would this be the first order thing to change or?

1:11:30

Martin Wolf: A huge part of my book is, I have a whole huge chapter about what I call rigged capitalism or rentier capitalism. There's an enormous amount of rentier activity in our democracy, democratic capitalism. It's pretty obvious if you start working on the financial system or the health system, on the way the government works and so forth, that there's an awful lot of this activity and quite a lot of it is related to the influence in different dimensions of money in the political system. Now, I know this too is somewhat controversial. I have friends who denies it's that important, but it seems to me looking at the literature and it's most striking obviously in the U.S., so it's very relevant too in the U.K., though the money involved is much smaller, that the influence of wealth and the perception of the influence of wealth on power is one form of the delegitimization of the establishment. It's why people start looking to outsiders. It doesn't answer why they go to outsiders who are essentially on the right, but it does indicate why they feel, it

seems to me that insiders are not to be trusted, but that doesn't prevent, of course, insiders from having an immense amount of influence if they're allowed to use their resources, because the law has allowed them to do so, allowed to use their resources in the way that they are currently in, for example, the U.S.

Markus Brunnermeier: Do you think there's a big difference between small countries and large countries because of scalability? Wealthy people can have more influence to grow in bigger countries?

Martin Wolf: There is an argument. There are many differences. I mean, one of the most important features of the U.S. is the role of its constitution and therefore the role of jurists and of the judicial system, which is sort of a fairly unique thing. And it seems to me their politicized judicial system does create some, from my perspective, pretty big problems. But on your point, I do think – so let's take an extreme example of an exceptionally successful small country like Denmark or Switzerland. The basic point about those societies, the most obvious, is that they're highly educated societies in which everybody knows what everybody's doing. It's complete, they just can't avoid it, and that means that if things are really too blatant; I may be being a bit naive, but if things are too blatant, they sort of become obvious. And relatively small groups of people acting in the political system, and we're talking about a political system which is smaller than almost most American states, it becomes transparent what's going on and people react to that. These are also countries with a highly educated and politically mobilized citizenry. In very, very large systems, the barriers to enter politically are ineluctably higher. It's very costly to make an impact on the American political system as a whole. I mean, it's obvious that that must be so. You have to organize across a large number of states, mobilize an awful lot of people. Ineluctably, the possession of very large resources becomes very important, it seems to me, in determining your effectiveness as a mobilizer. Thomas Philippon's book on competition, which I think very good, is very, very good, I think, on how politics is affected by money in different societies.

1:15:34

Markus Brunnermeier: So when you talked about social status, there was one question among the audience members. How would you differentiate between social status and economic status? So it doesn't necessarily be the case that if somebody has a lot of income, a lot of wealth, he has a high social status in the society. Perhaps we have to, you know, social norms can shape, essentially, who gets a high social status and who doesn't. And it doesn't need to depend only on dollars.

Martin Wolf: I think this is, I think it's a very good question. And I think my argument would be, I do discuss it a bit, that in a modern Western society, economic status and social status are fairly highly correlated, not 100% for sure, and less so in societies, the way I think about this, is those societies which still, it's strangely enough, internalize pre-modern value systems, aristocratic and intellectual. Britain is – I take the contrast between Britain and the U.S., which are the two countries I know best. In Britain, we are still pretty uncomfortable, and this is probably one of the reasons our economy has worked in the way it has or hasn't. We are pretty uncomfortable with the idea that people who have made vast wealth should be decisive players in public life and



should have huge prestige because they are very rich. It's not that we don't accept it ultimately, but there are other value systems still at work which go back to pre-modern times. They're almost futile in some respects. And that's because Britain's a very old society by American standards, and we've never had a true social revolution. So in these cases, great wealth does for sure give you influence. It allows you to buy politicians. It allows you to contribute to parties and have a lot of influence in the political process, but it isn't decisive in quite the way in the U.S. that there has been acceptance of the revolution, the role of money in politics, and the role of the judiciary helps in that regard. And I think quite apart from that, in the United States, for a very long time, a new country, people have felt that the new billionaires are heroes and though there's obviously lots of controversy about that too, they are to be admired and their words are to be taken very seriously. So I think somebody like Elon Musk, for example, plays a role in America, obviously controversial, but still a role that the equivalents, if we had some, we don't, we only have two, to a much smaller extent, would never play within a society like Britain or France. But it's complicated. In Italy, Berlusconi was a dominant political figure for a generation. In the end, in all our societies, wealth does carry with it significant political influence.

Markus Brunnermeier: So let's conclude perhaps coming back to, you know, industrialization. So I see very much your argument that industrial, industries, workers in industries there can organize themselves and get a lot of more influence compared to the agricultural arrangement or as compared to the service economy. But would you go so far that we should slow down the shift from the industrial economy to a service oriented economy because essentially you just slow down your transformation which will happen no matter what?

Martin Wolf: No, I think that would – absolutely not. I mean, in my book, I make two arguments about this. First, if you look at it carefully and I do look at it quite carefully, it's very difficult to make the argument that seems very common in America that more in America than anywhere else, America's unique, that the biggest reason for this deindustrialization has been trade, and particularly illegitimate trade by predatory China. And that's, I think, unambiguously wrong. And so the idea that protectionism will recreate American industry is, I think, unambiguously wrong.

1:20:16

And that's important if you look at current policy in the United States. The biggest reason, unquestionably, has been very rapid growth of productivity in America and other industrial nations, combined with, of course, relatively low, relatively low elasticities of demand for manufacturers. By the time everybody has a car, everybody has a washing machine, everybody has a refrigerator, everybody, you don't need more steel plants. I mean, you just have run out of room. So we have to do this. It has to be, we have to accept the shift to services. But what we can, I think, do, maybe that's being optimistic, but what we can do is encourage ways of operating in the service sector that help people to have less precarious lives, better minimum incomes. Now that will mean a certain amount of regulation, but I do think, I do discuss this in my book, that the very precarious nature of some of the work in the, and I think that fits with your ideas, the precarious nature of some of the work in the service sector where it's been casualized or re-casualized is very, it creates anxiety and insecurity in the workforce, a lack of attachment to society, a difficulty of making plans for the future, which is highly undesirable. And

if it can't be done naturally through trades unions, then I think we need to be thinking quite carefully about the way how we can improve this so that people feel more plugged into and share the social and political life of their country. It's a big challenge, but I certainly don't believe we can end de-industrialization. Indeed on the contrary, my guess is that we're going to end up with a world that may take a long time in which basically nobody works in a factory because it's all going to be done by robots.

Markus Brunnermeier: So we always end up with a positive note, perhaps of one or two sentences, you know, about citizens or citizenship looking forward to how we actually can overcome the crisis of democratic capitalism with citizenship, with identification, with the country without going into a Nazi system.

Martin Wolf: Well, I argue that's where I end up and I haven't been able to go into any of this. I haven't been able to talk about immigration and many other issues which are in the book. I think this is my optimistic view. Although I think it's getting a bit late, and I'm very concerned about what would happen in another Trump term. I sort of share Bob Kagan's now notorious fears. But leave that aside. My optimistic view goes something like this. The shocks of the post-financial crisis period are fading. And with luck, with luck, the post-COVID period are also fading. So let's assume we get back to decent inflation and so forth. Then life starts feeling less hysterical. A crucial thing for me, and I'm beginning to see at least some signs. It's very encouraging for me that Charles Koch has decided to put his money behind Nikki Haley. Whether it will make a difference now, I don't know. But I want to persuade the oligarchs on the one hand, that living in a world dominated by an autocrat is going to be very, very unpleasant, even if taxes are a bit lower. And there are more important things than having the lowest possible taxes, like having a society in which people feel they all belong, and a society which is not riven by the sorts of conflicts we're now seeing. At the same time, I hope that we will find a way through this idea of citizenship for closing the gap which we're seeing culturally between graduates and non-graduates, and some sort of middle ground emerging in which people, and it's pretty clear, if you look at the statistics, there are an awful lot of people in the middle.

1:24:55

And the question is whether they can form, create a sufficient weight in the system to shift the extremes in their direction. I would say from this point of view, the US at the moment frightens me rather, but in the British case, I'm a bit happier because we've tried the extreme option of crazy populism, Brexit. It's obviously been a disaster. The people who did it didn't know what they were doing. The result for our country has been utterly terrible, and we seem to be returning to sane politicians because people have experienced the populist alternative and they really don't like it. We've seen that in Poland just now. We'll see how that works out. So it seems to me that when you look around the world, when people experience unstable, irresponsible, self-seeking, Pluto populism, as I call it, they decide, "well, that's actually not what we really want." And as long as the elections continue and they are allowed to be fair, that's crucial, then the people have the right and the ability to change their minds. And if we maintain that, I remain of the view that they will start to realize there are alternatives. But it will take some realization by elites, certainly in the U.S., that by maintaining a healthy and vital democracy is even in their

interest because it's a better society for everybody.

Markus Brunnermeier: Yeah, let's hope that the democratic capitalism is resilient and bounces back after all the setbacks recently. And as you said, everybody is taking their own little steps, including the elites, and everybody who is listening to it to help our democracies. Thanks again for the insightful talk and giving us a big picture on the big, big questions we are facing at the moment. Hope to see you soon. Bye-bye to everybody.

Martin Wolf: Enormous pleasure. Enormous and a great honor. Thank you.

Markus Brunnermeier: Thank you. Thanks Martin.