‘Authoritative and compelling’
Economist

The Crisis of Democratic Capitalism

Martin Wolf

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THE CRISIS OF DEMOCRATIC CAPITALISM

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ABOUT THE AUTHOR

Martin Wolf is Chief Economics Commentator at the *Financial Times*. He was a member of the UK's Vickers Commission on Banking, which reported in 2011. He holds an honorary doctorate at the London School of Economics and is an honorary Fellow of Nuffield College, Oxford. He is a member of the International Media Council of the World Economic Forum. In 2000, he was awarded the CBE for services to financial journalism and in 2019 won the Lifetime Achievement Award at the Gerald Loeb Awards. His books include *The Shifts and the Shocks*, *Fixing Global Finance* and *Why Globalization Works*.

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THE CRISIS OF DEMOCRATIC CAPITALISM

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For my beloved grandchildren, Zach, Rebecca,
Alexander, Anna, Abigail, and Eden.

May their generation do a better job than mine has.

ΜΗΔΕΝ ΑΓΑΝ

(Nothing in excess)

—This famous text appears
at the shrine of Apollo at Delphi.

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PREFACE

Why I Wrote This Book

History does not repeat itself, but it rhymes.

—*Attributed to Mark Twain*[1]

My opinions have altered as the world has unfolded. I make no apologies for this. Those who have not changed their opinions over a lifetime do not think. But my values have not altered. I inherited them from my parents, both refugees from Hitler's Europe. I believe in democracy and so in the obligations of citizenship, in individual liberty and so in the freedom of opinion, and in the Enlightenment and so in the primacy of truth. The role of the fourth estate is, in my view, to serve these great causes. I am proud to have been one of its servants."[2]

I made these remarks in New York on June 27, 2019, when I received the Gerald Loeb Lifetime Achievement Award for business journalism. They are my credo. This book is witness to where those unchanging values and evolving opinions have brought me at the beginning of the third decade of the twenty-first century.

In the middle of the eighth decade of my life, I see a long historical circle—a circle that includes not just my life but also those of my parents. This story of two generations began on April 23, 1910, with the birth of my father, Edmund Wolf, in the Polish city of

Rzeszów, then part of the Austro-Hungarian Empire. By then the potent nineteenth-century mixture of industrialization, urbanization, class conflict, nationalism, imperialism, racism, and great-power rivalry had been at work for a long time. Four years later, the First World War, the conflict that was to demolish European stability, began. My grandfather, Ignatz, fearful of the arrival of Russian armies, moved his family to Vienna, where my father grew up. My mother, Rebecca Wolf (née Wijnschenk), was born in Amsterdam on August 30, 1918, just over two months before the First World War ended, although the Netherlands itself remained neutral. The Bolshevik revolution was just over nine months old when she was born.

Monarchs fled. European empires fell. A new world was born. But the hopes that it would be a better one proved a fantasy. In its place came the chaos of the interwar years: in the 1920s, hyperinflations, a fragile and unbalanced economic recovery, and battles among democrats, communists, and fascists; in the 1930s, the Great Depression, the collapse of the gold standard, the rise to power of Adolf Hitler in Germany and Franklin Delano Roosevelt in the US, Japanese militarism, Stalin's show trials, the Spanish civil war, appeasement, and at the end of the decade, the Second World War. This surely had been a time of trouble.

My father, rightly fearful of what Hitler's Germany intended, left Austria in 1937. My mother fled the Netherlands with her parents and siblings in May 1940, as the Nazis invaded. My parents met in wartime London in the autumn of 1942, at a party given by Dutch Jewish friends of my mother to celebrate the return from internment of my father's closest friend, who had been interned in Australia as an "enemy alien," while my father had been similarly interned in Canada. My parents' marriage on October 21, 1943, led to my birth on August 16, 1946, and so to my life as a man brought up and educated in Britain. I have also spent all but sixteen years of this life as a Londoner.

Without the Second World War and the genocidal anti-Semitism of the Third Reich, my Austrian-Jewish father and my Dutch-Jewish mother would never have met. I and my brother, born in 1948, are, like many millions of others, children of catastrophe. My parents and their immediate families escaped the wreck. My father's family (his parents, brother, sister, and his brother's wife and daughter) did so by managing, with difficulty, to reach Palestine in 1939. My mother's family did so by reaching an English fishing port on a trawler in May 1940. Their wider families of aunts, uncles, and cousins were murdered almost to the last individual. My mother's family had been large: her father, born poor in Amsterdam, was one of nine siblings. She told me that about thirty of her close relatives died during the Shoah, or Holocaust, as it is more usually known. She almost never spoke of this catastrophe. But I was aware that my parents' history was not like that of the other adults I knew, except for my parents' closest friends, who shared similar histories as refugees.

Not infrequently, people who read or hear me complain of my pessimism. To this criticism, I give three responses. The first is that my pessimism has made most of the surprises I have experienced pleasant ones. The second is that my biggest mistakes have come from overoptimism, most recently over the wisdom of finance and the good sense of electorates. The third and probably most important response is that my existence is due to the decisions of two pessimistic men: my father and my mother's father. My father took the opportunity afforded by the royalties he earned from early successes as a playwright in Vienna to leave for London on the way, he hoped, to America. My grandfather, who had left school in Amsterdam as a child and became a successful fish merchant in Ijmuiden on the coast of North Holland, was not only realistic, but also able to make quick decisions. As soon as the Germans invaded his country, he obtained a trawler and a captain (being a well-known fish merchant, he presumably found this not too difficult) and invited his relatives to join him and his family. He waited for some hours, but none of them came. In the end, the captain told him they had to go, presumably because of the speed of the German advance. My grandfather's combination of pessimism with quick wits saved his own family. But almost all their relatives perished. Pessimism saved him.

Yet these answers, while true, are not the whole story. My family history makes me aware of the fragility of civilization. Any moderately well-informed Jew should know this. But the connection to the Shoah reinforces it. Homo sapiens is prone to orgies of stupidity, brutality, and destruction. Humans naturally separate people into those who belong to "their" tribe and outsiders. They slaughter the latter gleefully. They have always done so. I have never taken peace, stability, or freedom for granted and regard those who do as fools.

My childhood was, nevertheless, secure. I loved and trusted my parents—and rightly so. Postwar England was shabby: I still remember the bomb sites in the City of London. But the country felt to me stable, peaceful, democratic, and free. The Cold War was a shadow upon us and at some points, notably the Cuban missile crisis of 1962, was even terrifying. Yet the world seemed solid as I grew up.

My parents died in the 1990s, my mother in 1993 and my father in 1997. The world in which they died was far better than that of their youth and early adulthood. Their belief in a democratic and largely peaceful world seemed vindicated. The totalitarian shadows over Europe had vanished. Democracy was triumphant. Communist central and eastern Europe had emerged from behind the Iron Curtain. Europe was on its way to reunification. It even seemed conceivable that Russia was moving toward integration into a world of democracy and individual freedom. The great schisms—ideological, political, and economic—of the twentieth century and indeed back to the French Revolution seemed over.

Subsequent events have shown that this confidence was built on fragile foundations. Liberalized finance proved unstable. I realized this during the Asian financial crisis, as I explained in my book *Why Globalization Works*.[3] But the concern became even more compelling after the global financial crisis and Great Recession of 2007–09, which were the focus of a subsequent book, *The Shifts and the Shocks*. Moreover, the world economy was generating destabilizing macroeconomic imbalances. This was the theme of my *Fixing Global Finance*, written before *The Shifts and the Shocks*.[4] The financial instability we were seeing resulted, I argued, from the inability of the international monetary system to handle large net (and gross) cross-border capital flows in a reasonably safe manner. Moreover, financial instability was only one of the failings of Western economies. Also important were rising inequality, increasing personal insecurity, and slowing economic growth, especially after the Great Recession. Finally, largely as a result of all these calamities, partly brought about by their own moral and intellectual failings, ruling elites—commercial, cultural, intellectual, political, and administrative—lost credibility in the eyes of the public.

Equally large shifts occurred in politics. The first big shock was the attacks on the US on September 11, 2001, which were followed by wars in Iraq and Afghanistan. The biggest change of all was a counterpart of the economic success of globalization, namely, the rise of China and, to a much lesser extent, India. This created a shift in the balance of global economic and so political power, away from the US and the liberal West toward China and its system of bureaucratic absolutism. Yet this was far from the only way in which global politics changed. As the twenty-first century progressed, we saw a shift away from liberal democracy toward systems that some have called "illiberal democracy" but might be better described as "demagogic autocracy." In a recent book, the Russian economist Sergei Guriev and the American political scientist Daniel Treisman call these systems "spin dictatorships," to distinguish them from the "fear dictatorships" of old.[5] Alas, the shift toward demagogic or "spin" systems is to be seen—so far, in nascent form—not only in new democracies, but also in some of the world's most established democracies, notably the US, where Donald Trump remained an embodiment of the aspiration for arbitrary power even after his defeat in 2020.[6] The rise of Trump, along with that of Boris Johnson in the UK, undermined the international credibility of the two countries and weakened Western cohesion.

Above all, their demagogic approach to politics undermined the rule of law, the commitment to truth, and the credibility of international agreements, all fundamental underpinnings of liberal democracy. Outright despotism is the probable end point.

Today's challenges are beginning to look as significant as those of the first half of the twentieth century. We see fundamental shifts in global power—then from the UK and France toward Germany and the US, now from the US to China. We see huge crises—then the world wars, Spanish flu, the hyperinflations of central Europe in the early 1920s and the Great Depression of the 1930s, now the Great Recession, COVID-19, and Russia's invasion of Ukraine in February 2022. We see a collapse of democracies and rise of authoritarianism—then in Germany, Italy, Spain, and other continental countries, now in the fragile democracies of developing countries and postcommunist countries in central and eastern Europe (including Russia). But this time, liberal democracy has been shaken even in Trump's US and Brexit Britain, countries that carried the banner of liberal democracy throughout the twentieth century.[7] Above all, we confront the risks of nuclear war and runaway climate change, the former largely unimagined before the 1940s and the latter barely considered before the 1980s.

We might have avoided the biggest mistakes of the first half of the twentieth century. But my parents would surely have heard loud echoes of their past. Not least among these has been Putin's determination to restore the Russian empire by force, so painfully reminiscent of Hitler's desire to bring the German-speaking peoples of Europe together under his totalitarian rule. Even war between Russia and NATO has become less inconceivable.

This book is a response to this new and troubling era. Its central argument is simple: when we look closely at what is happening in our economies and our polities, we must recognize the need for substantial change if core Western values of freedom, democracy, and the Enlightenment are to survive. But in so doing, we must also remember that reform is not revolution, but its opposite. It is not just impossible, but wrong, to try to re-create a society from scratch, as if its history counted for nothing. The outcome of such attempts has always been destruction and despotism. Only unbridled power can deliver a revolutionary overthrow of the existing order. But unbridled power is by its nature destructive: it shatters the security on which productive human relations can be based and decent lives lived. As Edmund Burke wrote in his response to the French Revolution, society is a "partnership not only between those who are living, but between those who are living, those who are dead, and those who are to be born."[8] Change is essential, both at home and abroad, but it must build on what is. Indeed, one cannot start anywhere else.

The motto of this book is "Never too much," as the ancient Greeks used to say.[9] The health of our societies depends on sustaining a delicate balance between the economic and the political, the individual and the collective, the national and the global. But that balance is broken. Our economy has destabilized our politics and vice versa. We are no longer able to combine the operations of the market economy with stable liberal democracy. A big part of the reason for this is that the economy is not delivering the security and widely shared prosperity expected by large parts of our societies. One symptom of this disappointment is a widespread loss of confidence in elites. Another is rising populism and authoritarianism. Another is the rise of identity politics of both left and right. Yet another is loss of trust in the notion of truth. Once this last happens, the possibility of informed and rational debate among citizens, the very foundation of democracy, has evaporated. In *The Great Transformation*, published in 1944, the same year as Friedrich Hayek's *The Road to Serfdom*, Karl Polanyi argued that human beings would not long tolerate living under a truly free market system.[10] Experience of the past four decades has vindicated this point of view.

This need to reform the relationship between democratic politics and the market economy is not driven purely by domestic tensions, important though they are. It is made more urgent by the rise of autocracy worldwide and, above all, by the apparent success of China's despotic capitalism. Western nations must improve their economic, social, and political performance in response.

Even though domestic reform is essential, if we are to strengthen the solidarity on which the health of all societies depends, reform cannot be limited to the domestic. No country is an island. Indeed, never before in history have we so clearly shared a common destiny on our fragile planet. This tribal species has created problems that its tribalism will only make worse. Any insistence on a narrow and exclusive national sovereignty, democratic or not, will fail to protect citizens. COVID-19 has demonstrated this. Trump declared "America First." But the pandemic has demonstrated that even a country as powerful as America cannot fix its problems on its own. The same is true, to a far greater extent, of climate.

We should want democracy, the market economy, and the spirit of free inquiry to thrive in a new age. Currently, they are not. In trying to decide what we must do, I can only distill lessons from the events of my lifetime and those that came before it. But the aim is clear: we must resolve, as Abraham Lincoln stated in the Gettysburg Address, that "government of the people, by the people, for the people, shall not perish from the earth." Democracy is always imperfect. But tyranny is never the answer. It is up to each generation to resist its siren song. This is not happening to the extent I once took for granted. On the contrary, many are succumbing.

I have dedicated this book to my six grandchildren, Zach, Rebecca, Alexander, Anna, Abigail, and Eden. Now in my seventy-sixth year, I cannot have many left. But the children can reasonably hope to see the twenty-second century. I fear for what the world might then look like. I recognize the dangers of environmental catastrophe and thermonuclear war. But I fear just as much that they will end up in an Orwellian world of lies and oppression. This is the world emerging in China and in many other countries, even in leading democracies.

The twentieth was a century of monstrous dictators. The dictators have returned, if not ones as monstrous as the worst of the previous century. But Xi Jinping is one, as is Vladimir Putin. Donald Trump, Narendra Modi, and Jair Bolsonaro are would-be dictators. Given the size of their populations and economies, these are five of the world's most important countries. With such leaders comes nightfall, for their goal is unbridled power. States that serve only power are a dead end. Humanity escaped that destiny in the twentieth century. But it was a close-run thing. Will it escape once again in the twenty-first?

CHAPTER ONE

The Fire This Time[1]

What we may be witnessing is not just the end of the Cold War, or the passing of a particular period of post-war history, but the end of history as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government.

—*Francis Fukuyama*[2]

When Francis Fukuyama wrote his essay "The End of History?," published as the Cold War ended, in 1989, many agreed with him that the Western synthesis of liberal democracy with the free market had won a decisive victory over its ideological enemies. The end of the last totalitarian ideology seemed to many not just an extraordinary and surprising event, but one that promised a better future for humanity. The era of totalitarian coercion and mass murder was over. Freedom—political and economic—had won.

Neither liberal democracy nor free-market capitalism seems at all triumphant today. This is true not just in developing, emerging, or former communist countries, but even in established Western democracies. Economic failings have shaken faith in global capitalism. Political failings have undermined trust in liberal democracy. The ascent of China, whose ruling communist party has rejected the link between capitalism and democracy, has also shaken the confidence *of* the West and confidence *in* the West.

Liberal democracy and free-market capitalism are both now in question. On the nationalist right, Donald Trump in the US, Nigel Farage in the UK, Marine Le Pen in France, Matteo Salvini in Italy, Geert Wilders in the Netherlands, and Heinz-Christian Strache in Austria are shaping—or have shaped—political debate, even when not in power. Self-proclaimed "illiberal democrats"—a euphemism for authoritarians—have come to power in Hungary and Poland, two of the countries that benefited from the fall of the Soviet empire and the opportunity to enter the EU.[3] Following the political example of Vladimir Putin in Russia, Hungary's Viktor Orban and Poland's Jaroslaw Kaczynski set their embattled nations against the world and a purported "will of the people" against individual rights. These various leaders also object to at least one aspect (and frequently more than one) of contemporary global capitalism, be it free trade, free flows of capital, or relatively free movement of people. Inevitably, opposition to those things has also turned into suspicion of the European Union.

Crucially, the US possessed in Donald Trump a president who admired "strong men" and the politics of strong men, hated the free press, was indifferent to the survival of the Western alliance, intensely disliked the EU, was fiercely protectionist, and was happy to intervene arbitrarily in the decisions of individual businesses.[4] He had no ideological attachments to liberal democracy or free-market capitalism. He was populist, instinctively authoritarian, and nationalist. Worst of all, he promulgated the "big lie" that he won the November 2020 presidential election, which he lost by a large margin, thereby undermining the foundations of American democracy. Moreover, the US is not just any country: it is the creator of the post–Second World War liberal world order. Trump lacked the character, intellect, and knowledge needed to be president of a great democratic republic. His rise to power in 2016 and continuing influence over the Republican Party after his defeat in 2020 was (and remains) a worrying failure of the world's most important democracy.

This book will argue that economic disappointment is one of the chief explanations for the rise of left- and right-wing populism in high-income democracies.[5] Many point instead to cultural factors: status anxiety, religious belief, or outright racism. These are indeed important background conditions. But they would not have affected societies so deeply if the economy had performed better. Furthermore, many of these supposedly cultural changes are also related to what has been happening economically: the impact of deindustrialization on the labor force and the pressures of economic migration on established populations are among the important examples. People expect the economy to deliver reasonable levels of prosperity and opportunity to themselves and their children. When it does not, relative to those expectations, they become frustrated and resentful. That is what has happened. Many people in high-income countries condemn the global capitalism of the past three of four decades for these disappointing outcomes. Instead of delivering prosperity and steady progress, it has generated soaring inequality, dead-end jobs, and macroeconomic instability. Predictably, they frequently blame this disappointment on outsiders—minorities at home and foreigners. Thus, one of the points on which populists of both left and right agree is the need to limit international trade. Many also see a need to restrict the movement of capital and workers.

In short, the liberal democracy and global capitalism that were triumphant three decades ago have lost legitimacy. This matters, because these are respectively the political and economic operating systems of today's West. Democracy vests sovereignty in electorates defined by citizenship. Capitalism vests decision-making in owners and managers of private businesses engaged in global competition. The potential for conflict between these political and economic systems is self-evident: democratic politics are national, while market economics are global; and democratic politics are based on the egalitarian idea of one person, one vote, while market economics is founded on the inegalitarian idea that successful competitors reap the rewards.

Today, the synthesis of democracy and capitalism—"democratic capitalism"—is in crisis.[6] The nature of that crisis and what should be done in response to it are the central themes of this book. The discussion focuses on the fate of democratic capitalism in the West, though it is not limited to that, since the future of the West cannot be separated from what is happening in the rest of the world. But the West is the heartland of democratic capitalism. Meanwhile, China, the world's rising superpower, stands for a very different way of managing the links between political power and wealth generation, one we might call "authoritarian capitalism" or "bureaucratic capitalism." Elsewhere, we see the emergence in countries like Brazil, India, Turkey, or even Russia of what might be called "demagogic capitalism" or "demagogic autocratic capitalism." The Western system of democratic capitalism does, however, remain the world's most successful political and economic system, in terms of its proven ability to generate prosperity, freedom, and measured happiness. It has also survived great challenges in the past, notably in the 1930s and 1940s, and then again during the Cold War. But it now needs to change again. It must, above all, find a new equilibrium between the market economy and democratic politics. If it does not do so, liberal democracy may collapse.

What do I mean by the terms *democracy* and *capitalism*? By *democracy*, I mean its dominant contemporary form—universal suffrage, representative democracy.[7] Thus, those who want to limit or narrow suffrage are acting antidemocratically.

To be more complete, I mean by *democracy* what Fukuyama called "liberal democracy." The distinguished political scientist Larry Diamond, of the Hoover Institution, argues that liberal democracy has four individually necessary and collectively sufficient elements: free and fair elections; active participation of people, as citizens, in civic life; protection of the civil and human rights of all citizens equally; and a rule of law that binds all citizens equally.[8] All these elements are necessary and, in combination, sufficient to make a democracy liberal. Note the emphasis above on "citizens." A liberal democracy is exclusive: it includes citizens, but excludes noncitizens. This does not mean noncitizens—foreigners and immigrants—lack all rights; far from it. It means they lack the political rights of citizens.

Crucially, liberal democracy is *not* just a way of deciding who runs the state, though it is that: the term also defines the sort of state it is. As John Stuart Mill insisted in his *Considerations on Representative Government*, democracy is, or should be, characterized by "liberty of discussion, whereby not merely a few individuals in succession, but the whole public, are made, to a certain extent, participants in the government, and sharers in the instruction and mental exercise derived from it."[9] For a liberal democracy to work, then, citizens must be entitled to express their opinions, and fellow citizens must be prepared to tolerate opinions they disagree with and the people who hold them. In the terminology of Isaiah Berlin, as citizens, people enjoy *negative liberty*—the right to make up their own minds, free from coercion—and *positive liberty*—the right to participate in public life, including by voting.[10] Such a political system is inherently pluralist.[11] It cares about the political rights of minorities because it cares about the political rights of *all* citizens.

In essence, a liberal democracy is a competition for power between parties that accept the legitimacy of defeat. It is a "civilized civil war." Force is not permitted. But this means that winners do not seek to destroy the losers. A system in which gangsters seek to kill their opponents, trample on the rights of individuals, suppress the free press, and benefit financially from office, yet go through the motions of running rigged elections, is *not* liberal democracy. Nor is "illiberal democracy" democracy either.[12] Such a system should be called what it is: at best, a dictatorship of the majority, and at worst, "plebiscitary dictatorship." Putin's rule over Russia is a plebiscitary dictatorship, as is Erdogan's over Turkey and Orban's over Hungary. Indeed, increasingly these are just dictatorships, without qualification.

By *capitalism*, I mean an economy in which markets, competition, private economic initiative, and private property play central roles. This system is "market capitalism." The size, scope, and nature of government, with respect to regulatory intervention, taxation, and spending, vary across capitalist countries. Government intervention has also tended to intensify over time as societies became more democratic. This was inevitable, as the franchise widened to include people without significant assets. But it also reflected the growing complexity of economic life and the pervasiveness of what economists call "market imperfections"—situations in which market incentives may lead to socially or economically damaging results.

Yet, as was the case with "liberal democracy," the state, be it large and relatively intrusive or not, must be law-governed. Without the rule of law, there can be no market capitalism, just larceny. Moreover, capitalist economies, thus defined, are also (and have always been) open to global trade and capital flows, at least to some degree. Capitalism is never entirely national, because the wider world offers a host of opportunities for profitable exchange.

More narrowly, by *market capitalism* I mean the form of market economy that has emerged over the past seventy years and particularly over the past forty, for which the word *globalization* provides a shorthand description.[13] In their economic lives, just as in their political ones, people should possess *freedom from* arbitrary coercion, especially but not exclusively, from the state, and *freedom to* buy and sell their labor and anything else they may legitimately own. Again, as is also true in political life, such freedoms are not absolute, but must be bounded by regulatory, legislative, and constitutional limits.

The rule of law is an essential shared underpinning of democracy and capitalism because it protects the freedoms essential to both. This means that "all persons and authorities within the state, whether public or private, should be bound by and entitled to the benefit of laws publicly made, taking effect (generally) in the future and publicly administered in the courts."[14] If some individuals or institutions are above the law, nobody without such privileges can be secure in exercising their freedoms. The law must be universally binding and protecting if liberal democracy and market capitalism are to thrive.

Both liberal democracy and market capitalism share a core value: a belief in the value and legitimacy of human agency, in political and economic life. In these respects, both systems rest on "liberal" ideas. But the workability of democratic capitalism also depends on the presence of certain virtues in the population at large and especially in elites. Neither politics nor the economy will function without a substantial degree of honesty, trustworthiness, self-restraint, truthfulness, and loyalty to shared political, legal, and other institutions. In the absence of these virtues, a cycle of mistrust will corrode social, political, and economic relations.

In short, the political and economic systems depend for their success on the prevalence of fundamental norms of behavior or, as they are sometimes called, "social capital." Today, however, liberal democracy and market capitalism are individually sick, and the balance between them has broken. The last chapter of my previous book, *The Shifts and the Shocks*, on the global financial crisis, bore the title "The Fire Next Time."[15] The penultimate paragraph of that book argued that "the loss of confidence in the competence and probity of elites inevitably reduces trust in democratic legitimacy. People feel even more than before that the country is not being governed for them, but for a narrow segment of well-connected insiders who reap most of the gains and, when things go wrong, are not just shielded from loss but impose massive costs on everybody else. This creates outraged populism, on both the left and the right. Yet willingness to accept shared sacrifice is likely to be still more important in the years ahead than it was before the crisis. The economies of the Western world are poorer than they imagined ten years ago. They must look forward to a long period of retrenchment. Making that both be and appear fair matters."[16]

I was wrong: the fire is not next time; it is now. Moreover, COVID and the impact of Russia's war on Ukraine has made it burn even hotter. The fire is in substantial part the ignition of the slow-burning anger left by the last financial and economic crisis, coming, as that did, after a long period of mediocre performance and wrenching social changes in Western countries. Trump was a product of this process. He promised to drain the swamp, but, inevitably, made it an even worse quagmire. By his actions, his cynicism justified itself. It is conceivable that, as economies recover from the financial crisis and the pandemic, the fire will burn out. But that now seems almost inconceivable. Democratic global capitalism is caught between an unsatisfactory present and an even less satisfactory future of protectionism, populism, and plutocracy, culminating, possibly soon, in autocracy, most significantly in the US.

Restoring health to the Western system is among our biggest challenges. We may not succeed. But nothing good will be achieved if nothing is attempted. The rest of the book elaborates this argument. Part I analyzes the relationship between politics and economics and especially between democracy and capitalism, as I have defined them, in both theory and history. Part II goes on to examine what has gone wrong in the capitalist economy and the democratic polity, as a result of the closely connected rise of predatory capitalism and demagogic politics. Part III analyzes the reforms needed if we are to create a more inclusive and successful economy and healthier democracies. Part IV then looks at how a reinvigorated alliance of democratic capitalist states should engage in the world to defend themselves, promote their core values, and protect global peace, prosperity, and the planet. Finally, the Conclusion returns to the core issue, namely, the responsibility of elites for safeguarding the fragile achievements of democratic capitalism, before they disappear in an incoming tide of plutocratic populism and tyranny.

Part I

ON CAPITALISM AND DEMOCRACY

Prologue to Part I

Democracy and the market have something fundamental in common: the idea of equality of status. In a democracy, everybody has the right to a voice in public affairs. In a free market, everybody has the right to buy and sell what they own. Market economies, with supportive governments, have created enormous increases in wealth and economic opportunity. They have also transformed economic and political systems.

In premodern agrarian economies, it was usually straightforward to exclude the greater part of the population from any role in guiding the polity. Indeed, anything else was usually considered unthinkable. In a modern market economy, the reverse became the case. It became necessary or at least highly advisable to share power. This, then, is why the evolution of wealthy market economies has brought with it, albeit slowly and painfully, greater political inclusion, culminating in universal adult suffrage.

In the past four decades, democracy went global. Never before had there been as many democracies and never before had the proportion of states that were democratic been as high as in the early 2000s. Unfortunately, this progress has subsequently stalled, partially even gone into reverse, in what is sometimes called "a democratic recession."

Chapter 2 looks at the underlying relationship between democracy and the market economy. Chapter 3 examines what has happened over the past two centuries in practice.

CHAPTER TWO

Symbiotic Twins: Politics and Economics in Human History

Man is by nature a political animal in a sense in which a bee is not, or any other gregarious animal.

—*Aristotle*[1]

Economics provides the principal rationale for human cooperation. Politics provides the framework within which that cooperation works. Economics and politics are necessarily symbiotic. What, then, is the relationship between market capitalism and liberal democracy? The answer is that capitalism cannot survive in the long run without a democratic polity, and democracy cannot survive in the long run without a market economy. We might then think of market capitalism and liberal democracy as the "complementary opposites"—the "yin and yang"—of the world created by the market economy and modern science and technology. They are married to each other. But theirs is also a difficult marriage. Managing this productive, yet fraught, relationship requires awareness of these realities. Why and how this is so is the topic of this chapter.

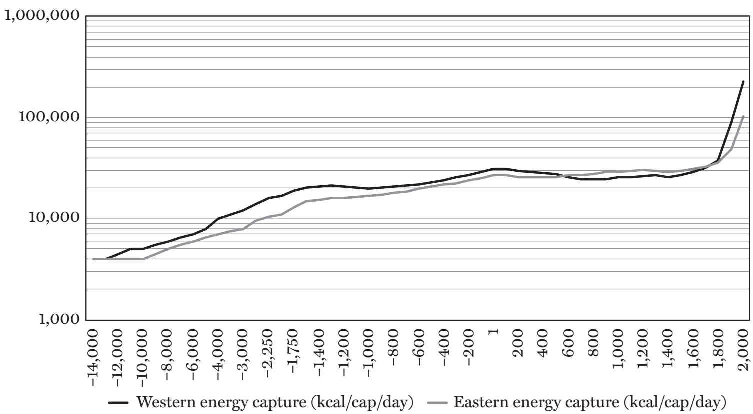
How Economics and Politics Intertwine

The economy human beings have created is complex, adaptable, and innovative. Yet it exists to do something simple: provide the resources people need to thrive. We talk of "earning our living" for good reason. Since humans are imaginative, they also constantly redefine what a "living" is. It always means thriving within one's society. But today that no longer just means sufficient food, shelter, clothing, and heating. In the high-income economies of today, it includes a range of goods and services unimaginable to anybody born two centuries ago. One estimate suggests that today we have access to something of the order of ten billion different goods and services.[2]

All the resources on which the human economy depends come from our planet and sun: the economy is embedded in nature, a truth that economists foolishly forgot. Yet the economy is also embedded in human society. By cooperating, human beings can support themselves and their families vastly better than they would be able to do on their own. That has been true since our hunter-gatherer ancestors. Cooperation allowed humans to create a complex division of labor and outcompete other animals far stronger and faster than they are.

The historian Ian Morris of Stanford University has provided estimates of "energy capture" per head for advanced societies.[3] His data suggest that two economic revolutions have occurred since Homo sapiens emerged in Africa some 200,000–300,000 years ago.[4] The first was the slow shift from hunter-gatherer to agricultural economies. The second was the far swifter shift from predominantly agricultural to industrial economies. The agricultural revolution increased energy capture per head roughly sevenfold at its peak, relative to preagrarian societies. By 2000, the industrial revolution had raised energy capture per head another sevenfold relative to the agrarian past (see figure 1). In 2022, the human economy supported 7.9 billion people (and rising), up from roughly 1 billion in 1800 at the dawn of the industrial revolution, and maybe just 4 million 10,000 years ago at the dawn of the agricultural revolution. The recent increase in energy capture, driven by our extraction of fossilized sunlight, as opposed to the incident sunlight that drove preindustrial economies, is also why we now have a climate problem.

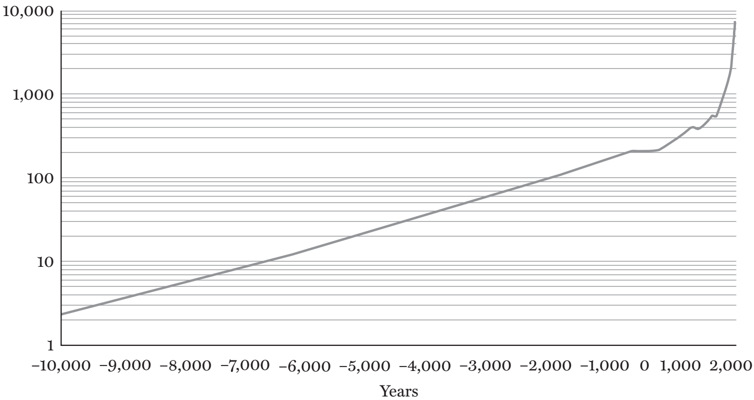
Figure 1. Energy capture per head and per day (kilocalories)
(Source: Ian Morris)



Humans have prospered mightily, while other primates have not: the planet contains fewer than 300,000 chimpanzees, 200,000 western gorillas, and 70,000 orangutans.[5] Human beings and the livestock they rear make up 96 percent of the mass of all mammals on the planet.[6] Life on earth, it is argued, has entered a "sixth extinction," with extinction rates thought to be 100 to 1,000 times higher than their background rate over the past tens of millions of years.[7] We can even think of the human economy as a giant cuckoo's hatchling now crowding many other species out of the planetary nest, while also fouling the nest itself, via climate change.

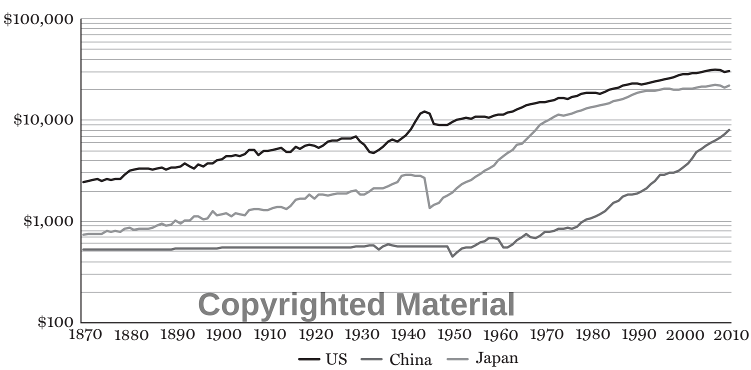
In its own terms, the modern human economy has been an astounding success. It has not only supported an ever-rising population (figure 2), but has given individual humans a far higher average standard of living than ever before (figure 3).[8] Between 1820 and 2008,

FIGURE 2. WORLD POPULATION (MILLIONS; SPLINE INTERPOLATION UNTIL 1950)
(Source: Our World in Numbers)



the human economy expanded more than seventyfold, in real terms.[9] This expansion in human economic activity also brought enormous increases in inequality among countries: some prospered; others did not. In 1820, the average real income of the richest country in the world was about five times that of the poorest. By 2017, the ratio of average real income in the richest large country (the US) to the poorest (the Democratic Republic of the Congo) was 70 to 1.[10]

FIGURE 3. GDP PER HEAD
(PURCHASING POWER PARITY; 1990 INTERNATIONAL DOLLARS)
(Source: Maddison Project; Conference Board)



The three epochs of the human economy have come with distinct forms of social organization. The essential characteristic of the ancestral hunter-gatherer bands was cooperation through custom and personal relationships, that of the most powerful agrarian states was cooperation through coercion and hierarchy, and that of the most successful modern economies is cooperation through decentralized competition and democratic consent.

In a hunter-gatherer band, politics and economics fused. It was a large family. In this world, territory was readily available and access to it was either uncontrolled or managed by sanctified custom. Little permanent or fixed property existed and most property was personal (tools, weapons, clothing, and ornaments). Decision-making was informal and fluid, though some—the wiser, the more intelligent, the braver, and the more skilled—had more authority and influence than others. Such a band worked because everybody knew who belonged, was entitled to its protection, and could be trusted. The primary group was an extended family, including those taken in through marriage. To break the band's rules and customs was to risk banishment—a terrifying sanction.

Humanity's most remarkable characteristic is the ability to turn what it has imagined—gods, tribes, states, nations, money, companies—into social reality.[11] Our world is full of entities that are both real and invisible. "France" is an idea or, more precisely, many ideas. So is "God," "the gods," "the law," "the dollar," "the president," "Exxon," and "the Treaty of Rome." Humans may live in the physical world, like other animals, but their imagination gives the social world that controls our interaction with the physical world its form and movement. The first such imagined social and political entities were the tribes into which hunter-gatherer bands merged. A tribe was thought of as a family writ large. To give the tribe reality, people imagined the presence of long-dead ancestors.[12] These, then, were the first of humanity's "imagined communities." Nation-states are the predominant contemporary exemplars.[13]

Agriculture brought a far more complex division of labor and more sophisticated ideas, roles, and institutions. The details depended on the technology, terrain, reliance on trade, nature of warfare, and religious ideas. Behind the diversity, however, a remorseless logic drove the development of these new states: valuable and relatively immovable resources—workers, land, crops, irrigation systems, and stores of food—needed to be protected from bandits, external and internal. Agriculture also generated the resources needed to support the people providing that security, who inevitably became both protectors and predators.[14] The bigger and richer the states they created, the greater the power, wealth, and glory of these predatory protectors. Even if a state had no desire for expansion, it was vulnerable to others who did. War became a semipermanent activity of agrarian states. Not surprisingly, their leaders were also often warriors.

■ ■ ■

The late S. E. Finer suggested there are four potential players in the resulting games of domestic power: "the palace" (the royal house and its servants); "the nobility" (generally both landowners and warriors); "the church" in some form (as a source of religious legitimacy); and, finally, "the forum" (the body of citizens).[15] The palace polity was the predominant form. The great empires—the Persian, Chinese, and Roman—became the pinnacles of monarchical power. Agrarian states were also mostly "patrimonial": they were thought of as the property of the ruler and his family.[16] Wealth was concentrated in the hands of the royal family, though senior officials, priests, soldiers, and noble landowners often shared in the spoils. The most important of the nobles were also often close relatives of the monarch.

Human and animal labor provided the motive power for the economy. Thus, those at the top of society lived off the forced labor of those below them, the heavily taxed peasants, serfs tied to the soil, and slaves. Slavery was not an invention of European colonizers, as some seem to imagine. It was a nigh on universal institution. Stanford's Walter

Scheidel argues that such "pre-modern states generated unprecedented opportunities for the accumulation and concentration of material resources in the hands of the few, both by providing a measure of protection for commercial activities and by opening up new sources of personal gain for those most closely associated with the exercise of political power."[17] The degree of inequality frequently reached the limit set by the need to leave the laboring poor with a subsistence income.[18]

These societies, then, were often almost as unequal as it was possible for them to be. Given these inequalities, the shift from the hunter-gatherer band to the agrarian state probably led to a lower standard of living and more cramped lives for the great mass of the people. But it also led to the survival of far more people. Once the agrarian revolution had occurred, there was no way back. Traditional hunter-gatherers were driven onto marginal land, conquered, or wiped out. Mounted nomads, in contrast, were able to develop effective predation on agrarian societies. Think of the Scythians, Huns, and Mongols, who descended on their horses from the Eurasian grasslands onto the settled populations to their south and west.

As Finer notes, the states of the agrarian societies were not identical. In some cases, their army consisted of the entire body of adult freemen (as in some of the city-states of ancient Greece and republican Rome). Such armies could constrain the centralization of power, at least for a while, and so create the "forum polities." A merchant class (notably in the prosperous "free cities" of Italy and northern Europe) was another potential constraint, particularly if the state depended on the taxes it could raise from these wealth creators and the latter operated across frontiers. Religious authority (such as that of the Roman Catholic Church) could provide yet another barrier to absolute power, particularly if the priests determined the monarch's legitimacy. Not coincidentally, the Western democracies originated out of medieval polities characterized by a complex balance of power among the palace, church, nobility, and free cities, with no ruler able to establish a centralized empire similar to the old Roman Empire.[19]

Any legal constraint imposed on the king could benefit ordinary people (in principle and, to some extent, even in practice), as well as the aristocrats. The Roman Republic—the paradigmatic forum polity—had elected officials and a precise division of power, with two holders of each magistracy, except in extreme crises, when an all-powerful "dictator" was chosen. A different version of the idea of representation emerged from a rebellion against the English king Henry III, led by Simon de Montfort. This resulted in the summoning of a parliament, which included not just the nobility, but representatives of "the commons" (two knights from each shire and two burgesses from each borough), in 1264.[20] In the seventeenth century, that parliament was strong and legitimate enough to defeat the monarchy in a civil war and execute the king. The representative parliament created the foundations on which modern representative democracies could ultimately be built.

England's subsequent role as world-girdling imperial power and first industrial country turned these developments in a small island on the western edge of Eurasia into events of global significance. They contributed to the birth of modern forms of democratic governance. Parliaments and the political parties that accompany them professionalized politics. They also facilitated the emergence of democratic rule in large and populous states. On these foundations—professional government, a rule of law, and electoral politics—today's liberal democracies were ultimately built.

How Market Capitalism Succeeded

The driving force behind the transformation in prosperity over the past two centuries was an economy that rewarded people for developing new commercial ideas in competition with one another. This was the system of "creative destruction" described by the Austrian economist Joseph Schumpeter.[21] A crucial element was the emergence of a fully monetized economy. The contemporary notion of an "industrious revolution" that preceded the industrial revolution is founded on the idea that households increasingly participated in market transactions for the sale of their labor in return for money, which then allowed them to purchase the commodities they needed. The existence of such markets made possible a reduction in the self-sufficiency of households, encouraging specialization and so creating ever greater market demand.[22] Policy makers also consciously created some particularly important markets, notably those in land and labor.[23]

As these markets developed, the old practices of forced labor became increasingly redundant. After long struggles, serfdom and slavery were both abolished. This was a huge and undeniable advance in human freedom, though in places where slavery coincided with a color bar, the liberation remained incomplete, as in the southern states of the US, where it was transformed into a division of caste. In time, even the age-old subordination of women began to erode, as they gained economic independence and political rights.

A large part of the debate on what began the rapid growth of the modern era is of the "how many angels can dance on the head of a pin?" variety. Some, for example, emphasize the availability of resources.[24] Others emphasize institutions.[25] Others emphasize ideas about what people are entitled to do as well as about what works.[26] Yet others emphasize changing prices of factors of production, notably of labor.[27] Others again point to racialized slavery, as both an institution and an extreme form of exploitation. Yet the notion that there should be just one cause seems absurd. Ideas animate institutions. They also show people how to exploit resources, including human resources. This said, the marriage of the market to technology was crucial. The industrial transformation it caused was a great turning point in human economic history.

The socially and economically destabilizing rise of the market

economy brought forth, in reaction, an alternative ideology, that of the socialist planned economy. The twentieth century delivered a decisive test of the merits of the market economy against the planned socialist alternative. It was not a test of some form of "pure" market capitalism against a planned alternative. On the contrary, capitalism had itself evolved, with the rise of welfare states and active developmental states. But the contrast between the economic performances of West Germany and East Germany, North Korea and South Korea, western Europe and eastern Europe, Taiwan and Maoist China proved decisive. It even persuaded the Soviet and Chinese communists themselves. Mikhail Gorbachev's "perestroika" and Deng Xiaoping's "reform and opening up" were the result. Deng knew well what he was doing and why. He looked at Hong Kong, Singapore, South Korea, and Taiwan and realized that this was the path China itself needed to follow.

History proved him spectacularly correct. Without the market, economies can generate neither the information nor the incentives needed to be dynamic. It was, accordingly, only after Deng's reforms that China began its staggering economic progress (see figure 3). Much the same is true of India's slow reforms in the 1980s and far faster reforms in the 1990s. In neither case did a competitive domestic economy exist prior to the reforms—in China not at all and in India only to a limited extent, given the stifling restrictions on business activity (the so-called Permit Raj, or License Raj).[28] The dynamic market economy, increasingly open to the world, proved a remarkable engine for sustained advance.

In sum, market capitalism drove economic growth. It started in countries that supplied enough of the basic preconditions for such a revolution: stable property rights; a commitment to scientific and technical progress; and a belief in the right of everybody in the country (initially only white men, but ultimately everybody) to make their way in the world on their merits.[29] This, then, began a process of rising output per head, unequally shared but still shared quite widely in the countries where that revolution began. This was an economic and social revolution that unfolded and spread over the succeeding centuries. It was brutal and exploitative. It was also transformative.

How Market Capitalism Married Liberal Democracy

In the more economically successful countries, the rise of the market economy generated growing pressures for universal suffrage democracy. It is impossible to believe so profound a political transformation, from the societies run by monarchs and aristocrats of the eighteenth century to the universal suffrage democracies of the twentieth, was a mere accident. So why did this happen? The answers come in terms of ideology, aspirations, empowerment, elite self-interest, and finally, influence.

First, *ideology*. However different they may seem from each other, market capitalism and liberal democracy rest on the same underlying philosophical values. As Larry Siedentop argues, "Western beliefs privilege the idea of equality—of a premise that excludes permanent inequalities of states and ascriptions of authoritative opinion to any person or group—which underpins the secular state and the idea of fundamental or 'natural' rights. Thus, the only birth-right recognized by the liberal tradition is individual freedom."[30] The core belief underpinning a market economy is the right of individuals to change jobs, create businesses, lend and borrow money, and spend how and where they wish. It is an individualistic creed.

Historically, most civilized states rejected this notion of equality of status. Those with power were held to be inherently superior to those without it, as white southerners believed in relation to their enslaved Africans. Moreover, access to power brought wealth, while the absence of power guaranteed poverty. Even if, occasionally, people without political power achieved wealth, perhaps as merchants, they were always at risk of having it seized by a monarch or lord. Power and wealth were intimately connected, and both were frequently the fruit of ascribed, not earned, status. This was particularly true when ownership of land (and so control over the people who worked it) was simultaneously the principal fruit of power and the chief source of wealth. The erosion of the idea of ascribed status in the modern society and economy changed all this. It took too long for that to become evident. But it did do so, in the end.

Crucially, once the notion of the equality of legal status had replaced the old one of the sanctity of inherited status, it became far more difficult to limit political rights. If all adult men (or, as was later understood, all adult men and women) had equal rights to read and learn, buy and sell, innovate and prosper and so benefit themselves, how could they not also have equal rights of political representation?[31] Attempts were long made to limit suffrage on grounds of wealth, race, or gender. But all of these demarcations came to seem arbitrary. Everybody should be entitled to a voice in politics because everybody is affected by political decisions, and everybody has interests to defend.

A limited franchise will always seem arbitrary and oppressive. What one would have is rule by the wealthiest or most powerful, not the "best," unless one accepts the beneficiaries' biased view of who are the best. Being arbitrary and unfair, the resulting franchise will fail to obtain the consent of the governed. The wider the franchise, the more oppressive the remaining restrictions become: how, for example, could one justify the denial of the vote to an educated woman when an uneducated man had it? How, similarly, could such rights be ascribed arbitrarily only to people of a certain skin color? That was transparently ridiculous. The obvious locus of sovereignty is *the adult population as a whole*, exercising its power either through direct votes or through indirect votes (via representative parliaments) or through lots (sortition).[32]

The shared idea underlying both the market and democracy is the right of people to shape their own lives wherever choices need to be made, individually and collectively. That does not guarantee equality of achievement or outcome. In a democratic political system, power is not distributed equally, and in a market economy, wealth is most certainly not distributed equally. Yet those with political power are *accountable to* citizens, not just (as the Chinese Communist Party and, before it, the Chinese imperial state believed) *responsible for* them. Similarly, those who participate in markets must respond to the decisions of customers. Thus, the market and democracy both rest on the proposition that people's choices have inherent value. This ideal of equality of status among all adult citizens is one of the great moral and practical achievements of democratic modernity.

Second, *aspirations*. As Benjamin Friedman of Harvard University has argued, "a rising standard of living fosters openness, tolerance and democracy."[33] With machines doing much of the physical labor, the age-old exploitation of the drudgery of others became increasingly unnecessary. Serfdom and slavery, being no longer economically necessary, as well as increasingly abhorrent, were ultimately abolished. This general rise in prosperity also created a more self-confident and better-educated population that was increasingly unwilling to be subject to the political whims of those with higher ascribed status or greater wealth. In the UK, for example, the resulting political changes began with the demands of the middle classes for parliamentary representation, which was largely achieved in the Great Reform Act of 1832.[34] In the US, property qualifications for white men started to be eliminated even earlier.[35] As people became better off, their aims also changed. Instead of a life concerned mainly with survival, they became increasingly interested in securing more rewarding lives for themselves and their families. This aspiration naturally included a desire for a voice in social and political life. The formation of social groups in which people increasingly had the time to participate also strengthened the political salience of such desires.

Third, *empowerment*. The social upheavals associated with the market revolution included mass urbanization, the development of factories, and the rise of an organized working class. The institutions

that emerged from this upheaval, notably trade unions, played a political role that had been impossible for the peasantry, who were scattered over the land and ceaselessly and brutally suppressed by the landowning warrior class and its parasitic descendants. The new groupings also acted to protect themselves from the injustice, and insecurity associated with the rise of the capitalist economy. They found much of that protection in democratic politics.[36]

Fourth, *elite self-interest*. Industrialized warfare was another fruit of the industrial revolution. States needed motivated and literate soldiers and, they discovered, also the labor of women, who became the "home front" in both world wars. The need for—and possibility of—full mobilization of the population dramatically accelerated the shift toward universal adult suffrage. In many countries, not coincidentally, female suffrage directly followed the First World War. The new economy also demanded an educated workforce. This meant not just education, but education in "national values." In this way, nationalism played a crucial role in the creation of a modern state and economy. Over time, the spread of education led to the widespread dissemination of newspapers and the creation of a politically engaged populace. The expansion of education could also be justified politically. Thus, Lord Sherbrooke, a British aristocratic politician of the nineteenth century, responded to the passing of the Reform Act of 1867, which greatly widened the franchise, by arguing that "it will be absolutely necessary that you should prevail on our future masters [the newly enfranchised] to learn their letters."[37] This notion was popularly summarized as "We must educate our masters." The education promoted for such reasons was, in turn, essential to rising prosperity.

Yet, elite self-interest could cut both ways. While there were indeed powerful forces working toward democratization in the industrializing economies of the nineteenth and early twentieth centuries, democratization was not the universal outcome; far from it. The contrast between the United Kingdom and Germany is particularly striking, though a similar contrast exists between northern and southern Europe. Harvard's Daniel Ziblatt notes the point that "the relationship between a pre-existing concentration of social power, on the one hand,