Capitalism, Socialism and Democracy: Old Visions, New Realities

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For a while late last century, democratic capitalism was triumphant. Struggles that had dominated global politics through the first half of the twentieth century passed into history. Real existing versions of socialism had failed. The hard capitalism of earlier times had been tamed by democracy.

At times it seems that the tragic history of the old struggle is returning as farce. Fox News. Corbyn and Sanders. Boris Johnson and Trump. The new Australian Senate. The French National Front and the Alternative for Germany.

This evening I want us to lift our eyes from the awkward contemporary realities to visions of what might be.

There is a chance this century to bring most of the world’s people into the material standards of living now enjoyed in the developed world. I call that condition the maturation of global development. As all of the world’s people would live in high income countries, all would have been through the demographic transition to fertility levels below replacement and the labour force would be shrinking. Capital would be abundant and cheap. Great wealth would bring family security but not high incomes. High incomes would have to be earned by application of new ideas and entrepreneurship. No people would be poor simply because they had not inherited wealth, as labour would be scarce and valuable. Globalisation would involve exchange of goods and services among countries based on special strengths and knowledge and capacities, as it is among developed countries today. There would be no rush of people to secure residence in the richest countries, because all would provide reasonable living standards for their people. If democratic capitalism had survived till then, it would do well, free of today’s stresses from inequality and downward pressures on incomes from the global economy.

With the maturation of global development, there is a chance, but no certainty, that most people would live in successful democracies. In the democracies, policy would be developed and applied in a disciplined way to advance some conception of the public interest in which the maintenance of high standards of living of most citizens is the dominant objective.

Yet we can’t rule out the possibility that many or most people would live in authoritarian capitalist systems. Authoritarian capitalism would only have survived to the maturation of global development it had been able to sustain commitment to equitable distribution and to control the desire for greater personal influence over affairs of state as incomes and wealth rise. History suggests that that is not possible, but we don’t really know.

With the maturation of global development, most economic exchange would be strongly affected by global markets. However, the nation state would still exist—it is hard to envisage it withering away without a catastrophic breakdown of order in war or chaotic response to a failure of climate change mitigation. And it is hard to see the maturation of global development emerging this century from such a catastrophe. There would be mechanisms to coordinate those government decisions that require collective decisions on a global scale, but it is likely that national governments have been persuaded by their electorates to be cautious about how far to go.

Today, a seventh of humanity’s 7 billion live in developed countries which enjoy high material living standards. Today, with quibbles at the margin, all of these live in democracies.

Authoritarian China is home for nearly a fifth of the world’s people. On the more modest trajectories of the new model of economic growth, China will join the ranks of the high income countries within a couple of decades. China’s announced policy goals today gives high priority to securing transition from upper middle income to high income status. That requires difficult reform and structural
change. It would seem to require political reform, of a kind that no Leninist regime has accepted. The necessary structural reform is also difficult for more prosaic economic reasons. It might or might not succeed. If China were to succeed in this structural change, most people in the developed countries would probably live in an authoritarian capitalist economic system with Chinese socialist characteristics at some time in the 2030s. Today’s correlation between democracy and developed economy status would have been blown apart. Probably and not certainly, because we don’t know for sure how the Chinese political system would change once high incomes were achieved.

Today, the developed countries and China together are home to about a third of the world’s people.

A bit more than half of the world’s people live in developing countries other than China in which modern economic growth is well established. While most are behind China, they are catching up with the developed world over time. The huge democracies of India and Indonesia, accounting for a quarter of the world’s people, have continued strong growth through troubles in the developed world since the Great Crash of 2008. There are setbacks in some countries from time to time—as today in Russia, Brazil, Nigeria and South Africa and other resource exporters after the end of the China boom.

There is one last seventh of humanity to account for—a group that has only recently or has not yet entered sustained modern economic growth. These people mostly live in Sub-Saharan Africa. A small number of them, but of large importance to Australia, inhabit the island countries in Australia’s immediate neighbourhood. The good news here is that some of the countries of Sub-Saharan Africa, including Ethiopia, Tanzania and Kenya in East Africa, seem to be on a path of sustained growth—Ethiopia, with the second largest population in Africa, at a sustained rate close to the highest in the world (Johnston 2015).

In the top six sevenths, global fertility is close to replacement levels, and heading down. If this were the whole world, the global labour force would soon be shrinking, bringing forward the prospect of global scarcity of labour.

Fertility remains high and population growth rapid in Sub-Saharan Africa. Absent sustained strong growth leading to demographic transition in Africa along the lines of the rest of the world, Africa alone will keep the global labour force growing at a considerable rate. Under any scenario, Africa will contribute more than the whole of the growth in the global labour force through the twenty first century. Under the most pessimistic of the United Nations projections for fertility, Africa will account for more than half the global labour force by the end of the century. Under these projections, Africa’s population grows from under a billion today to more than 2 billion by mid-century, and in worst case to 5 billion by 2100. A failure of development and demographic transition in Africa would block the global demographic transition and maturation of global development.

A number of other possible developments could block global development. War between major states in the nuclear age, and weakly mitigated climate change, are obvious possibilities. Failure of political order or development policy in major developing countries or regions. In particular, failure or long delay in growth and demographic transition in Africa. Or unravelling of open global trade and investment led by political response to popular revolt against globalisation in the rich countries.

Blockage would deny most people the material prosperity currently enjoyed in the developed world. It would also block the release of ordinary people in rich countries from downward pressure on their living standards from the globalisation of economic activity.
This glance at what might be possible encourages us to think about how to make good use of remarkable opportunities.

Capitalism regulated by democratic polities brought economic and political success in the developed countries for half a century after the second world war. Wise application of economic analysis guided democratic intervention to greatly reduce the instability and inequality that Marxist and other critics predicted would destroy capitalism. Abundant employment, incomes growth and reasonably equitable distribution underpinned political support for increasingly open markets, which reinforced rising productivity and living standards. Democratic capitalism and the socialist Soviet Union defeated authoritarian capitalism in war, and then democratic socialism outperformed Soviet socialism in peace.

In the last quarter of the twentieth century, deepening links between the developed core of the world economy and the developing countries placed most of humanity on a path towards the living standards of the developed countries.

To fit some large and complex ideas into a single lecture I am going to have to do some simplifying this evening. I invite those of you who wish to explore the subtleties and test the detail to wait for a book on which I am working at the University of Melbourne, with Reuben Finighan.

Tonight, I use the term capitalism to describe the economic system that evolved in Britain and adjacent continental Europe in the first half of the nineteenth century before the building of a democratic constitution in the late nineteenth and early twentieth centuries. I use the term socialism to describe the system of pervasive state ownership of property coordinated by central planning and nominally associated with Marxism. It would be more precise to speak of Leninist Socialism, but I will use the shorter term to avoid tedious repetition. Socialism emerged in the former Soviet Union from 1917 and its East European satellites after the second world war. Socialism so defined was absorbed from the former Soviet Union into three Asian countries after the collapse of Japanese Imperialism—China under and immediately after Mao, Vietnam up to the collapse of the Soviet system in 1991, and North Korea.

I use the term democratic capitalism to describe a system in which private ownership and market exchange play major roles in the economy, and democratic processes drive policies to modify distributional and other outcomes to maximise welfare according to some conception of the public interest. Others may prefer the term social democracy. An effective democracy drives capitalism towards social democracy. The democratic political contest defines the public interest and redefines it from time to time. In this, democratic capitalism is different from capitalism, which has no public interest goal. Socialism also sought to promote a conception of the public interest, notionally the maximisation of material living standards of the general run of citizens. Socialism was different because the goal was defined by a ruling elite rather than a democratic electorate—at its ideal, by Platonic Guardians—Plato’s “philosopher kings”; at its worst by Stalin and Mao.

Democratic capitalism can embrace a wide range of preferences and outcomes on equity in income distribution, state provision of public goods, fiscal and monetary intervention to stabilise economic conditions, and proportionate size of state economic activity. The democratic process tends towards a high degree of equity. It embodies a pragmatic approach to assessing the case for state intervention case by case. At its best, policy choice within democratic capitalism is guided by economic analysis on how to implement democratic preferences most effectively. At its worst, it descends into arbitrary decisions on resource allocation in response to pressure from vested interests, that lead to inferior outcomes when measured by the objectives and values of any authentic expression of the democratic will.
Both capitalism and socialism existed as a vision, and separately and differently as a reality.

The capitalist vision was of an unrestrained market economy, in which sanctity of property and contract, free exchange of goods, services, capital and labour were expected to produce stronger economic growth than any alternative. Any individual with energy and talent who applied himself would have opportunities for material comfort and eventually for wealth. Attempts by Government to vary the natural outcomes of the operation of a market economy to reduce inequality, to improve the prospects for some disadvantaged groups within society (for example, women, or ethnic minorities), or to reduce economic instability would reduce the welfare of all, including the poor.

Capitalism into the early twentieth century was strongest in parts of continental Europe which had not experienced the evolution to democracy. It flourished under Emperor Franz Joseph’s government in Austro-Hungary in the several decades prior to the first world war. Vienna was a glittering capital of world culture and intellect as well as business. It was enriched by contributions of people from many ethnic backgrounds and religions. State intervention for equity or stability or improved resource allocation was rejected as counterproductive.

The Viennese efflorescence of culture, intellect and private wealth had a weak political base. The extreme inequality that came from capitalism without democracy contributed to social tension and revolutionary ferment. Ethnic tensions undermined the cohesion of a multi-racial empire. The Empire’s final collapse in military defeat in 1918 was notable for the complete absence of interest in restoration of any elements of the old political system. Vienna before and after the old regime’s collapse nurtured the fantasies of a young Adolph Hitler.

Capitalism evolved differently in Britain, its first home. In Britain, the early systematic attempts to comprehend modern economic development sought the right balance between collective goods and services and private economic activity. Here the towering contributions in a great tradition are those of Adam Smith and John Stuart Mill. Mill, especially, provided early intellectual support for democratic capitalism. This was influential in the English speaking countries as they responded to the democratisation of government through the late nineteenth and early twentieth centuries.

John Maynard Keynes in Britain, the most important public intellectual of the twentieth century, provided a policy framework for democratic capitalism that could manage the deep problems of the interwar period.

Frederick Hayek at the London School of Economics became the most persistent and effective opponent of Keynes’ influence on post-war trans-Atlantic economic thought. Hayek saw state intervention in economic activity as counterproductive, and as a first step on a path to authoritarian government. Schumpeter saw different but deep problems in capitalism within a democratic political system. These were articulated in Capitalism, Socialism and Democracy, published as continental Europe capitulated to Nazism in 1941.

Hayek and his mentor Mises, were the leading intellectual supporters of the old raw capitalism and opponents of democratic capitalism in Britain and the United States mid-century and following. They and Schumpeter grew up in property owning families in Vienna and adjacent parts of the Austro-Hungarian Empire in the years before 1914. Their sensitivity to authoritarian government can be sympathetically understood. Their judgement about democratic capitalism in practice was not grounded in observation of the reality of their time. Schumpeter’s warnings, in particular, ring more loudly today.
In a famous exchange with Hayek late in his own life, Keynes focusses on Hayek’s acceptance that there are some circumstances in which state intervention to correct market failure led to superior economic outcomes. He notes that once the concession in principle has been made, the question is where you draw the line. The drawing of the line requires pragmatic assessment in the circumstances of each decision.

Hayek’s *Road to Serfdom* was lionised by United States business. The influence of Viennese theorisation about capitalism reached its apogee sixty years after the collapse of the political, social and economic regime from which it emerged—a collapse at least partly due to the unresolvable tensions generated within this view of capitalism.

The capitalist reality never corresponded closely to the vision. The reality included influential use of state power to strengthen the position of established wealth—as Schumpeter recognised with concern. It included concentration of wealth and high incomes in relatively few hands; entrenched inequality of opportunity; recurring financial crisis and a business cycle that brought periodic recession and occasional depression. While the vision was said to be value neutral, it took sides with established wealth.

In well-established democratic polities, like Australia, the United Kingdom and in the United States more powerfully from 1932, pressures for state intervention modified outcomes from market exchange. As it turned out, democratic capitalism was a road not to serfdom, but to personal freedom to an extent unknown at least since the neo-lithic revolution. There was no systematic process driving a similar modification of capitalism in authoritarian systems, with Austro-Hungary the exemplar.

On occasion, authoritarian rulers have been able to moderate capitalism in the public interest without democratic institutions. The Germany of Bismarck and his successors stands out for acceptance by authoritarian rulers administering a market economy of a major role for the state in promotion of economic growth and to expand opportunity for many citizens. Bismarck shrewdly saw this as a protection against expansion of the influence of Marxist, democratic and other revolutionary ideas. China might turn out to be a twenty first century example of use of state power to moderate inequality in a market economy controlled by an authoritarian state. Current Chinese interventions of this kind are motivated by Communist Party concern for regime stability. Bismarck’s Germany and Xi Jinping’s China—and, it can be grimly acknowledged, Hitler’s Germany before the military overreach—should alert us to the force of authoritarian capitalism when it includes amongst its objectives the raising of living standards of most ordinary people.

Here I should note that widely shared values in some societies have sometimes caused state intervention to modify distributional consequences of capitalism independently of democratic pressure. For example, Christian values influenced policy in Bismarck’s Germany (Esping-Andersen, 1990).

What, then, of socialism? Socialism was a reaction to the harsh capitalist reality in Europe in the mid-nineteenth century. It promised a pathway to rule in the public interest, without the institutions of private property or market exchange. Its fatal weakness in understanding emerging reality was its denial that capitalist outcomes could be radically modified for the better in response to democratic pressures.

Economic failure and repression of human freedom destroyed the legitimacy of the socialist regimes.
Capitalism was invariably associated with tensions arising out of inequality. In the absence of mitigation by democracy, capitalism was also associated with profound constraints on freedom. The scapegoating of ethnic minorities was used by rulers to deflect popular anger with economic conditions away from governing elites.

None of the socialist systems evolved towards democracy. The European socialist states collapsed, and were replaced in crises by constitutionally democratic regimes whose character is still evolving. In Russia, there was subsequently swift movement from a nominally democratic constitution to authoritarian capitalism. China and Vietnam avoided state collapse and evolved quickly to their own hybrids of socialism and authoritarian capitalism.

But I am running ahead of myself.

DEMOCRATIC CAPITALISM AFTER THE SECOND WORLD WAR

The third quarter of the twentieth century saw the strongest, most stable and most equitable expansion in history. Capitalism was directed by democracy to give priority to the welfare of ordinary citizens. This was an economic system changed beyond recognition from the capitalism of the Belle Epoch in Vienna, Paris and London. It was far removed from the harsh capitalism that had inspired Marxist and other revolutionary critiques.

The flourishing of democratic capitalism after the second world war was not widely anticipated. Harvard University Professor Edwin Reischauer’s autobiography records his early post-war pessimism about both democracy and economic growth under Japan’s new constitution.

Schumpeter, too, in his book *Capitalism, Socialism and Democracy* anticipated a deeply problematic future for democratic capitalism. The trouble emerged from a contradiction: democracy allowed capital to invest in the shaping of policy to suit its own interests, thus subverting the democratic will; but the correction of the subversion would leave economic performance under capitalism vulnerable to policies preferred by democratic majorities. Schumpeter was right about the change in priorities manifested in the expansion of state intervention in economic activity after the war. He was wrong about its consequences.

The immediate post-war democratic emphasis on expansion of opportunity through education and the social safety net had three effects. It contributed substantial improvements in equity, an acceleration of growth over the “golden age” decades, and greater economic stability arising from Keynesian automatic stabilisers.

These conditions provided a congenial environment for opening markets for goods and services to international exchange. Economic analysis played a larger role in guiding policy decisions on economic stabilisation, on establishing a favourable balance between public and private provision of goods and services, on linking domestic to international markets and on the effects of alternative mechanisms directed at securing greater equity in income distribution. Policy lessons defined by Keynes in the 1930s supported greater economic stability.

GLOBALISATION AND EXTENSION INTO THE DEVELOPING WORLD

The successful democratic capitalist countries in the second half of the twentieth century were shorn of their Empires. The end of Empire allowed the inclusive development that was a precondition for the emergence of modern economic growth in the developing economies of Asia.
There were other preconditions for developing countries participating in modern economic growth. Most importantly, the state needed to be sufficiently effective to provide public goods that are necessary for growth and for equity. The state had to be disciplined and knowledgeable enough to allow extensive exchange through markets that were linked to the international economy, and to secure reasonable macro-economic stability.

Modern economic growth is disruptive. It undermines old belief systems and creates new centres of power. It is resisted by the many interests which are damaged by it. The necessary policies are never sustained for long unless there is wide acceptance within society that the benefits of growth will be equitably shared.

After a lag extending into the 1970s, intellectual and political leaders of more and more developing countries, especially in Asia, absorbed and applied knowledge about the conditions for sustained economic growth. By the fourth quarter of the century, the conditions were being met in most countries of Asia including China (from the end of the 1970s), Indonesia (from the mid-1980s) and India (from the early 1990s). The result in the 1990s (with a dislocation in the Asian Financial Crisis 1997-9) and the early twenty first century was the most broadly based modern economic development in history, as developing economies containing most of the world’s people joined the global economy.

For the developing countries, modern economic growth was a process of catching up with the developed countries. International exchange of ideas and technology was fundamentally important. International trade in goods and services eased resource constraints, brought early gains in incomes and contributed to the transmission of ideas and technology.

Catching up with the developed countries has become easier with improvements in transport and communications technology. It has become more rewarding with the widening of the gap between technology and living standards at the frontiers and in countries which are in the early stages of modern economic growth.

Technological change lowered the cost of moving goods services, ideas, people and capital between countries. Policy reform facilitated links with the international economy. Globalisation gradually turned separate national markets into international markets.

The developing countries in which most people lived—in Northeast, South and parts of Southeast Asia—had high populations and labour forces relative to natural resources and capital from investment. There, expanding trade meant increasing specialisation in exports of goods and services which used labour intensively. For a considerable while, the highly productive export industries could expand in one country by absorbing surplus labour from the countryside at relatively low wages. Eventually, the surplus labour was fully absorbed into the modern economy. From this point, continued economic growth caused wages to rise sharply—typically more rapidly than the value of production, as in China over the past decade. Jamaican British economist Arthur Lewis described this as the turning point in economic development.

This was the main reason why early modern economic growth in each country typically went through a period of increasing income inequality. In the early stages, when wages grew slowly or not at all, the benefits of expanding the modern economy went disproportionately to the owners of capital. From the turning point, wages grew more rapidly than the value of output and inequality fell. The turning point came in the second half of the nineteenth century in Britain, the 1960s in Japan, the 1970s in Taiwan and Korea, and the first decade of the current century in China.
Until recently, it has been possible to tell the story of changing income distribution in the process of modern economic development country by country. Global development could be seen as the sum of the separate development stories of many countries.

In the twenty first century, we have seen the emergence of a global development story. Modern economic growth is now raising incomes in the new participants—most of the world’s people—most emphatically in China and other countries which have passed the turning point in economic development. At the same time, it is placing downward pressure on living standards of ordinary people in the developed countries.

Largely due to these dynamics, income distribution has become more unequal in the developed countries and more equal in the world as a whole. Much has been made of the capture by the “one percent” of most of the increase in incomes in developed countries so far this century. The top one percent in the world as a whole has also done very well. Ordinary people in the big Asian developing countries have had even bigger percentage increases in incomes (Milanovic 2005).

The globalisation of incomes has begun, but where you live still matters a great deal. Independently of any personal characteristics related to employment, a person’s income is likely to be much higher in a developed than in a developing country, and in a successful than in a poor developing country. These are what Milanovic calls “citizenship rents”, or the unearned benefits resulting from the chance geography of birth. They are still very high in rich countries. The international movement of goods, services, people and capital—global integration—reduces those rents.

Lifting economic integration to the global level brings new governance challenges. Economic regulation is by the nation state. The emergence of a global economy takes many activities beyond the reach of the sovereign nation. Today’s crises in national management of the taxation of capital, movement of people, carbon dioxide emissions, terrorist networks and crime through the internet are just the beginning.

THE TRIUMPH OF DEMOCRATIC CAPITALISM AND NEW REALITIES

After the collapse of the Soviet Union in the early 1990s, Fukuyama (1992) famously declared that history had ended with the triumph of democratic capitalism.

Through the 1990s, economic developments seemed to confirm the triumph. It was hardly noticed that China stepped into determined resistance to “peaceful evolution” to “western” democracy as it deepened its engagement with global markets.

The triumphalism around democratic capitalism in the 1990s deflated through the early years of the twenty first century. and burst in the Great Crash of 2008.

If the third quarter of the twenty first century contained the developed world’s golden age, the last quarter was silver. Silver was not good enough. The setbacks of the 1970s and their aftermath seem modest today, but were a great disappointment. The new problems required measured modification of the post-war policy framework. Instead, they generated proposals for radical change. Business elites and some political leaders took the opportunity to push for a revival of indiscriminate deregulation, shrinkage of state activity, and lower taxation—a return to Hayekian capitalism with a minimal state.

There are lags between changes in the ideas that shape policy, and policy itself. The 1970s reaction against democratic capitalism had its maximum impact at the beginning of the twenty first century.
This meant that extreme financial deregulation and weakening of the fiscal foundations of the state through reductions in taxation were having their maximum impact when changes in economic structure were making them most inappropriate. The Great Crash of 2008 was one consequence. Exacerbation of trends towards greater inequality was another.

Martin Wolfe at the Financial Times has asked why the problems of the 1970s generated fundamental challenge to a brilliantly if imperfectly successful economic model, when the comprehensive failure of the alternative in the early twenty first century has been largely overlooked. He answers that the changes advocated in the 1970s suited the politically influential owners of capital, while economically rational responses to the later problems did not.

Australian policy reform worked on a different timetable and in response to different ideas. Australia moved decisively towards a more open and market-oriented economy after 1983. This had something in common with developments in the United States and United Kingdom at the time. But Australia avoided the extreme financial deregulation of the large North Atlantic economies in the 1980s and 1990s. Australia strengthened rather than weakened policy to secure more equitable distribution, through changes to health, education, taxation and social security. Australia had its strongest economic growth ever relative to other developed countries in the decade after the recession of 1991, while avoiding the tendency in other developed countries to wider disparity in incomes then and into the 2000s.

If the last quarter of the twentieth century was a silver age for the advanced economies, the period since then has not won a place in the final.

The inequality in income distribution has increased so much that it has been associated with falls in living standards of the general run of people in the United States and some other countries. If inequality in the US were maintained at its 1980 level, the top 1% would have US$1 trillion less in annual income today, and the bottom 80% would have US$1 trillion more. As the International Monetary Fund and the Bank of England have noted, this materially reduces demand for goods and services.

There are several other important headwinds to economic growth in the rich countries in the present era.

One is ageing. Low fertility will ensure that this remains with us for the foreseeable future. Ageing contributes to loss of business dynamism, lower investment and higher savings. It also lowers incomes per person by reducing the proportion of people in the labour force.

A second is a marked decline in productivity growth, to the lowest levels over a comparably long period since the early days of modern economic development. There are doubts about whether standard measures properly value services from some of the new technologies. However, the standard measures pick up impacts on government budgets and employment. There is no reason to expect an early return to the high rates of productivity growth that were once considered normal.

A third is the capital-saving nature of technological change in the twenty-first century, driven especially by the falling cost of computation. Less investment is required for any growth in economic activity.

Increased inequality, ageing and the increasing weight in the global economy of China have increased global savings. Low productivity growth, ageing and the capital saving bias have reduced business investment. Savings have tended to exceed investment, especially after the Great Crash. Demand in
the developed countries has fallen below levels necessary to support optimal economic growth and employment.

The early months of the Great Crash threatened a decline in output and incomes redolent of the 1930s. The worst outcomes were averted by early fiscal and monetary expansion in many countries.

The headwinds have remained. In response, central banks have sought to revive demand with the lowest ever short term interest rates. Unconventional monetary expansion has added additional stimulus. The response has been weak, with growth in activity and employment lower since the Great Crash than in any comparably long period since the second world war. The tendency for global savings to exceed investment has generated the lowest market interest rates in history. Rates for 10 year borrowing by governments are now below zero in a majority of developed countries. Real rates are near or below zero in all developed countries.

Low long term interest rates set in the market are the result of deep changes that are here to stay. In themselves they are favourable for equitable distribution. They eventually reduce the incomes of wealthy people. Over time, they favour investment in public infrastructure that is important for equity, and in the renewable energy that is centrally important for climate change mitigation. But their immediate effect is to increase the value of all existing wealth—land and housing, shares and government bonds. The capital gains from falling interest rates are responsible for much of the increase in income inequality observed this century. The low interest rates have increased inequality in wealth distribution—between, for example, housing haves and housing have nots. Negative distributional effects from this source are large but as they are driven by falling interest rates will not continue once rates stabilise at low levels. Low yields on all assets are a continuing challenge for the retirement incomes of people who have not been beneficiaries of the increase in value of past accumulations of wealth.

Real incomes of the majority of people have ceased to grow in the developed countries since the Great Crash of 2008. The real incomes of most people in the US and some other developed countries are below those a generation ago. Australian real income per person held up better until the China resources boom began its retreat late in 2011, but has been stagnant or falling in each of the 17 quarters since then.

Grumpy electorates have withdrawn unconditional support for globalisation. The conditions are likely to include pushing less forcefully to expand less valuable dimensions of international exchange, and restoring policies that do more for equity in domestic distribution.

Trade protectionism has increased—look at steel in Europe, the United States and Australia.

International trade has stopped growing. This is rare outside recessions in the developed world.

There have been large electoral reactions against immigration into the United States, Britain, continental Europe and Australia.

Australia and the United Kingdom have blocked large-scale direct investment from China of kinds which had been explicitly welcomed not long before.

Institutionalised cross-border integration has ground to a halt. The Doha Round initiated in 2001 is the first multilateral trade negotiation to fail. The wounding of the Trans Pacific Partnership by Donald Trump has drawn applause. The English have voted to withdraw from European Union; and
Brexit has stalled negotiations on a European-United States trade agreement. Anti-EU feeling is strong across many members of the bloc.

The democratic response to popular grievance interacts with vested interests’ increased hold over the democratic political process in the developed countries. Private interests have become more skilled in making and getting private value from investment in the political process. These developments are especially acute in Australia and the United States, where corporate donations are hardly constrained at all by laws and regulations on campaign finance—not even donations by foreign entities—and in Australia is reinforced by the influence of a single dominant media group.

Meanwhile independent citizens and institutions have less influence in policy-making. Independent contributors to the analysis and public discussion of policy choice were critically important to the success of democratic capitalism in the post-war period, and to the reform era in Australia. They are now diluted by the cacophony of comment from economists paid by various private interests to influence the policy debate on their behalf. The clash between vested and popular pressures uninformed by independent analysis leads to arbitrary and inconsistent decisions, and over time to lower productivity growth.

Globalisation compounds the problem of corporate investment in the political process. Global capital has no home. It owes a duty to shareholders (over which executives; duties to themselves sometimes prevail) and not to any of the countries in which it operates. Corporate involvement in the political process sets up tension not only between capital and citizens, but between foreign and domestic interests. This important issue has risen to prominence in Australia around Chinese political donations. While there are additional layers of problems with some Chinese donations, there are very real problems with all foreign donations—indeed, with business donations.

In Australia, which has become by far the largest recipient of Chinese direct investment relative to size of economy, popular distrust of foreign investment interacts with genuine security reasons for restricting Chinese investment.

Globalisation gives capital more opportunities to avoid and to evade national taxation. Some countries lower taxation rates to attract investment. This erodes the tax base of others. International tax evasion favours large international over small business in each country.

Lower tax revenues undermine the capacity of the nation state to fund the programmes that were important to the success of democratic capitalism. Less corporate tax revenue means higher tax on households, at a time when real disposable income per person is falling.

ALLOWING DEMOCRATIC CAPITALISM TO WORK AGAIN

Democratic capitalism’s return to success depends on reconciling concerns for ordinary citizens’ standards of living with the demands of globalisation.

A global economy would work better with global governance. However, there is little tolerance for international governance in contemporary democratic polities. There are some real advantages in governance at smaller scales where it is appropriate. Efforts towards global economic governance should therefore concentrate on issues where it has the greatest value.

I focus here on trade and development, where we can build on the role of the World Trade Organisation.
The first guiding principle should be subsidiarity—a principle of European Union governance the dishonouring of which contributed to the British vote to leave. Under subsidiarity, decisions should be left to national and sub-national governments unless there are large advantages in international agreement. Where international cooperation has high value, more ambitious outcomes are possible if commitments are voluntary and enforced by the domestic political process and international peer pressure. Concerted Unilateral Trade Liberalisation under Asia Pacific Economic Cooperation from its formation in 1989 until the Asian Financial crisis 1997-9 and Concerted Unilateral Mitigation shaping the Paris agreement on climate change are successful examples of this approach.

Getting global governance right for trade is critical, given that free movement of goods and services across international borders is now much the most important vehicle for promoting global development. Movements of labour and capital can help, but are less powerful. Domestic political reactions in the developed countries are less neuralgic on trade than on immigration and capital flows. Maintaining open borders for goods and services should have priority.

The recent proliferation of preferential trade agreements and the TPP focussed strongly on the negotiation of behind-the-border regulation. Coordination and reform of regulatory arrangements behind the border in each country can generate large benefits, but is much more likely to be fruitful if it involves voluntary decisions following open discussion among representatives of states and within each domestic community. The negotiation of arrangements on immigration, intellectual property and new rights of business to take extra-territorial legal action against governments was of doubtful potential value and a bridge too far.

A focus on open trade at the border within a framework of concerted action towards an agreed goal of multilateral free trade is more likely to be productive. This recognises the sovereign state as the locus of decisions, with the domestic electorate the main constraint on policy choice. Domestic public education on the effects of trade liberalisation in the context of wider policies supporting equitable distribution can expand what is feasible.

On investment, Australia is entangled in a web of security reasons and populist pressures for excluding some Chinese investment. We need to uphold security interests. We also need to establish transparent process, and remove officials’ discretion case by case to transfer billions of dollars of public revenue to private entities. Clear process will help to avoid costly stirring of xenophobic sentiment and anxiety in Australia’s most important economic relationship. The wise course is for the Government on official advice to define and to make public the list of business assets that have such high security value that they cannot be allowed to be sold to foreigners at all—or in the most sensitive areas, not sold into private ownership at all.

On dealing with international tax evasion, the exchange of taxation information among national tax authorities helps and has been the subject of agreements in the G20 and other global fora. Information on tax evasion has been expanded in recent years by whistle blowing and investigative journalism. Coordination of tax policies could stop a race to the bottom but must overcome corporate pressure on each state to withhold cooperation. It may be feasible amongst a subset of major countries. Larger states can apply pressure to opportunistic smaller states.

New forms of business taxation can greatly reduce opportunities for shifting profits into tax havens or low tax regimes. Large business generally opposes measures to strengthen the corporate tax base. The reactions to the Australian Resource Super Profits Tax (in which the hand of opponents was strengthened by large errors in taxation design) and the European penalties against Apple, are early battles in a war for the future of democratic capitalism.
Australia in the Dog Days after the end of the resources boom faces severe adjustment challenges arising from its special circumstances as well as from the international situation. The structural budget deficit has to be reduced, and the real exchange rate depreciated further. Making the necessary adjustment while minimising the damage to living standards for ordinary citizens must be a touchstone of policy reform.

The necessary increases in taxation and reductions in expenditure will only be achieved by a Government satisfying a major part of the electorate and the Senate that the proposals allocate the burden equitably across the community. It must do this in an electorate sensitised by recent experience to the influence of corporate interests on the composition of the budget.

How to curb the excessive influence of corporate donations on policy? The question has been placed on the Australian public policy agenda by the recent work of ICAC in New South Wales and by publicity for Chinese donations to Australian political parties and leaders. Campaign funding reform has been the subject of recent discussions sponsored by the John Cain Foundation. There are problems in any approach short of bans on all campaign-related donations by companies, trade unions, other organisations involved in campaigns that have direct and large impacts on the partisan political contest and foreign citizens. Political campaigns would then be funded from public sources, and from donations up to a moderate limit from individual citizens on the Australian electoral roll. Such reforms have been introduced in Scandinavia and Canada, and have been advocated by leading figures on both sides of Australian politics.

DEMOCRACY AND THE MATURATION OF GLOBAL DEVELOPMENT

The massive, disruptive, beneficent and surprising river of modern economic development that had its source on the island of Britain a quarter of a millennium ago has overflown its banks and changed course on several changes in its journey. It has changed course again in the early twenty first century. That change has thrown up large problems.

The challenges are large, but the benefits of overcoming them larger still. At stake is the whole of humanity enjoying the fruits of modern economic growth while some of our grandchildren are alive. The abundance of capital and scarcity of labour that would accompany the extension of high material living standards to all of humanity would make for more equitable distribution within each country and in the world as a whole.

Getting things right requires conservative reform, to restore the integrity of democratic political systems that have been weakened by the growing influence of vested interests. It requires innovation in policy to deal with new issues arising out of the globalisation of economic life.

If we get it right, the maturation of global government can be led by confident democratic capitalist societies freed from the subterranean pull of pre-democratic ideology.

Yet we would be naïve to think that democratic capitalism will be alone in the long flow to the maturation of global development.

China is struggling now with adjustment of its economic system for transition to a high-income country. The Chinese Communist party’s struggle against corruption may turn out to be a cover for the settling of factional scores. The recent step back into authoritarian control may go further and block the free and confident exchange that underpins a modern economy. But there is a chance that movement along today’s rocky road will lead eventually to an authoritarian capitalist economy with
Chinese socialist characteristics that restores and retains legitimacy by delivering equitably distributed prosperity.

This contest of political systems will occur within a more complex global political environment. There will be other powerful states, with different variations on the themes of democratic capitalism and authoritarian capitalism. Continued economic success in the great Asian democracies, India and Indonesia, may turn out to be transformational. The recent strengthening of authoritarian government in such major countries as China, Egypt, Russia, Turkey, Thailand and the Philippines adds complexity.

International pluralism in political systems is going to be the reality, and peace and the maturation of global development depend on us making that work.

Australia is just about the world’s oldest democracy, and a pioneer of such central democratic institutions as manhood suffrage, the secret ballot and votes for women. All of these developments were noticed and helped to change the world. Ours was the most successful of the democratic capitalist societies for several decades until a few years ago.

We have recently walked into harder times. We need to correct the weaknesses for our own sakes. Correcting the weaknesses will encourage the rest of humanity to see democratic capitalism as a worthwhile vessel for the last stages of humanity’s journey to the maturation of global development. Making the most of that possibly is worth some effort.
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