Capitalism, Socialism and Democracy in the Twenty First Century

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The early twenty-first century has brought tougher times than the developed countries have known since the Second World War. For a while this was disguised by extraordinary increases in expenditure on consumption and housing in the English-speaking countries and Spain—funded by bank borrowing from global wholesale debt markets. It was disguised for longer in Australia by the effects of the China resources boom, which was still lifting resource prices until 2011 and investment until this year.

For ordinary people in the developed countries as a whole, and in Australia since the peak of the resources boom in 2011, the years since the Great Crash of 2008 have seen incomes growth below inflation and employment growth below the increase in adult population. To an extent unknown since the 1930s, the democratic polities have had difficulty defining solutions to emerging problems, or in implementing possible solutions that have been identified.

A month ago, an old American businessman with Australian roots was invited by the Australian Chairman to address the G20 Finance Ministers on what should be done. The businessman correctly defined the stagnation and decline of living standards for ordinary people as a large problem for the United States and the developed world. But he came up with much the same solutions for contemporary economic problems as an American businessman with Australian background brought to the Presidency of the United States in 1929. Australia hosts a meeting of the G20 heads of Government in November 2014 and in preparation has suggested that the way to reduce youth unemployment approaching those of the recession of 1990-91—their highest since the Great Depression of the 1990s—is to restrict income support for the young unemployed.

Sometimes it seems that we are still in 1931.

The 1930s and 1940s were the last decades in which we asked fundamental questions about where our economic and political systems were taking us. The challenges of the contemporary developed world are causing us to ask them again. One contrast with the 1930s is that fewer people now think that solutions can be found for developed country problems independently of the rest of humanity. Accordingly, in this lecture I am explicitly introducing the idea that the end point of successful global development is the enjoyment by most people of the high living standards that are currently enjoyed in the developed countries. I call this the maturation of modern economic growth.

I will illustrate my points this evening with reference to three Western Pacific countries: Australia, Indonesia and China.

Indonesian discussion of politics in the weeks leading up to inauguration last month of President Joko Widodo, Jokowi, was consumed by popular reaction to a decision of the Parliament ending direct elections for local and provincial offices. The Parliament that took the decision was dominated by supporters of the losing candidate in the Presidential election—General Prabowo, who was a coal billionaire from Indonesia’s China resources boom and intimately connected to the old Soeharto military regime. The new law would block the repetition of the success of Jokowi, the charismatic president-elect who had risen from being Mayor of Solo and then Jakarta through his popular appeal over the heads of the large established parties and the business elites which funded them. The cartoon in Kompass captures the mood.
In those same weeks, Chinese in Beijing who talked about politics were absorbed by the arrest for corruption of yet another top business leader. The General Secretary of the Communist Party was striking out to remove the influence of wealthy competitors for influence in Party and Government.

And Australia was absorbed by the consequences of a new balance of power in the Senate. Decisions on the future of carbon pricing, a mining tax and many fiscal measures hung on the votes of a new party that had funded a massive election campaign from wealth created recently by its founder’s participation in Australia’s China resources boom.

All three polities were grappling with the relationship between money and power, within radically different political institutions and cultures.

Australia has long professed government for the people by the people. Government for as well as by the people is currently being tested by the influence of money in politics.

In Indonesia, military government which was reasonably characterised as being for but not by the people had delivered rising living standards and constrained freedoms for most people for over three decades. It collapsed and gave way to government by the people during the Indonesian Great Depression of the late 1990s.

China is governed by a Communist Party committed to government for but determinedly not by the people, inevitably constraining hopes for political change as rapidly rising living standards expand awareness of and unhappiness with limitations on freedoms of various kinds.
All three Western Pacific countries are grappling with the systemic consequences of living within market economies that confer great and for the time being increasing political influence on the beneficiaries of their own or their forebears’ success in the marketplace—people whose continued success in the marketplace is assisted by the influence of their wealth on government decisions.

Each of Australia, Indonesia and China provides interesting perspectives on where the global market economy is taking contemporary political and economic systems.

Distinctive Features of Australian Democracy

Australian with New Zealand economic and political systems have evolved differently from those of the other old, developed democracies. Many of the modern institutions of democracy and economic inclusion emerged first or early in the antipodean offshoots of industrializing Britain (Keane, 2009). Democratic evolution in the colonies that became Australia and New Zealand was less constrained by inherited wealth and privilege than in Europe. In that, it was similar to the United States. It was different from the United States because it was not constrained by the pervasive influence of slavery and its social legacy. Labour was scarce and economically valuable and therefore the democratic polity assertive and self confident earlier than in the North Atlantic.

Australians used their early democracy to modify the distribution of income that emerged from the untrammelled workings of the market economy. Metin’s description of the social and economic order of Australia and New Zealand as “Le Socialisme Sans Doctrines” (1901) evokes a reality that has helped to shape today’s political culture and institutions. Democracy in Australia and New Zealand has avoided the articulation of policy within an elaborate and consistent set of ideas. Popper’s “Open Society and its Enemies” (1945) with its praise for pragmatic democracy was influenced by his antipodean exile.

Those roots contributed to the distinctive character of market-oriented policy in Australia’s remarkable period of reform from 1983 to the end of last century. Since the deep recession in 1990-91, Australia has enjoyed the longest economic expansion unbroken by recession in its history—or, for that matter, the history of any developed country except by a small margin the Netherlands during the North Sea gas boom. Life has been harder since the China resources boom came off its peak in 2011. It will get harder still over the next few years as Australia grapples with economic challenges within a damaged political culture. That is the story of my recent book, “Dog Days: Australia After the Boom”.

The beginning of Australian reforms coincided with the deregulatory initiatives of Thatcher and Reagan and were often conflated with them. But Australia’s market-oriented reform was fundamentally different, since it was implemented within a social democratic framework.

There was a downside to the absence of doctrine in the late twentieth century reforms. Critics who disliked the larger role for markets were able to set up a caricature of policy as if it had no social democratic content, and to condemn the application to policy-making of economic analysis as “economic rationalism”. Economically rational it was, which made it possible to pursue simultaneously efficient production and efficient distribution of economic value, with the two supporting each other.
The dismissal of “economic rationalism” by many who favoured equity in the distribution of income and services opened the way for people who favoured the market orientation but not the social democracy to claim the success of the reforms over the next quarter century as their own, and to present economically irrational deregulation as a continuation of the policy approach of the reform era. This is a hugely important development in the twenty first century world of uninhibited engagement of business interests in the policy process, as independent application of economic analysis to policy choice is crucial in the defence of the public interest against sectional claims.

National and Global Democracy and Inclusion

Early twentieth century antipodean conceptions of the good life within a young democracy were for a small part and not the whole of humanity.

The exclusion of most of humanity from early concerns for equity was part of a more general exclusion from conceptions of economic development. This is a fundamental flaw in almost everything written about economic growth and the distribution of income until the last half century (with Colin Clark an admirable exception), and in too much of contemporary discussion in the developed countries.

The deepening integration of the large Asian economies into a global economy from late in the twentieth century introduced pressures for widening inequalities in the distribution of wealth within the developed countries, at the same time as it increased average incomes in all countries and reduced gaps between average incomes in the successful developing and the developed countries. There were opportunities for national governments to offset these tendencies with judicious use of progressive taxation and expenditure policies. Some countries, including Australia, made effective use of this potential. Others, including the United States, did not.

Deepening integration increased opportunities for mobile factors of production—capital, and labour with especially valuable skills—to avoid obligations under conventional national systems of taxation and to use those opportunities to apply pressure for shifting the burden of national taxation from themselves to others. Awareness has grown within the developed countries that there are risks of serious corrosion of public revenues in the absence of international cooperation on taxation. This is illustrated in the priority of cooperation on taxation in the G20 heads of government meeting in Brisbane in November 2014.

And the scale of the increase in economic activity with the extension of modern economic growth into the populous countries of Asia, especially China, India and Indonesia, made environmental change and especially climate change induced by human activity a threat to economic and political stability. Effective policy responses required national policy decisions against corporate pressure, within a cooperative international framework.

Prosperity has helped to delay Australians’ curiosity about weaknesses in modern democratic capitalism. However, the Dog Days since the China Resources Boom passed its peak in late 2011 have slowly drifted Australians into the developed world discussion about where our political and economic systems are taking us—questions that were last so prominent in the 1930s and 1940s.
Contemporary Answers to Questions From the Thirties and Forties

Seventy and eighty years ago, big minds in the developed countries were challenged by economic decline and hopelessly high unemployment and the societal tension that accompanied them, and then by the capitulation of continental Europe to Nazism.

While Keynes in the 1930s and Hayek, Schumpeter and Popper in the 1940s were all strongly committed to personal freedom and the advantages of the market economy, they had different hopes and fears about what was possible for the future, and about the greatest dangers to our civilisation.

Keynes’ essay “Economics for Our Grandchildren” as well as the concluding chapter of the General Theory saw the inexorable accumulation of capital and increases in productivity as leading over a hundred years to material abundance. The accumulation of capital would eventually reduce the rate of return on low-risk investment to negligible levels, bringing about “the euthanasia of the rentier”. Some income differentials would remain to provide incentives for innovation and to ensure that the wheels of the economy kept turning, but taxation could safely be more progressive, as the jobs would be done well enough for less. The remaining inequality was unimportant, as everyone with the capacity to enjoy the good life would be living well. Far from leading to the plutocracy anticipated in Piketty’s celebrated recent book, the abundance of capital would make its owners less influential and important, just as abundance would make economists as boring as dentists. War could stop this beneficent process, as could government failure to maintain high employment through policy action when private intentions to save exceeded private intentions to invest. But these disruptions would be consequences of avoidable human errors and not inevitable tendencies in the economic system.

Skidelsky and Skidelsky (2012) have recently examined some of Keynes’ prognosis against what is now historical experience. Keynes’ expectation of productivity and incomes growth has been met more or less precisely but there is no sign of satiation of human material wants.

Hayek’s warning against central planning was justified by the subsequent evolution of Soviet central planning and its echo in China from 1949. Both had been confined to the dustbin of history by the early 1990s.

While Hayek’s “Road to Serfdom” became a revered text for those who sought to push back the boundaries of the democratic capitalist state in the late twentieth century, its actual content is helpful today to people seeking to preserve the role of the mixed economy that had been so successful in the postwar decades. Of relevance to contemporary debates, Hayek acknowledges roles for a social security safety net including provision of health care and for systematic intervention to avoid external environmental costs from private economic decisions. As Keynes noted at the time, once the case for intervention has been made in principle, the question is where to draw the line. The answer is not found in doctrine, but in analysis case by case.

Schumpeter in “Capitalism, Socialism and Democracy” was at once convinced of the great merits of traditional, unrestrained capitalism, and doubtful about its survival in a democratic polity.

Schumpeter used Napoleonic examples to show that good non-democratic leadership could produce Government for the people. But in the end, effective leadership for important change
required an appeal to the people that pushed a society towards government acceptable to the people, and by implication in the end by the people.

Of special interest to the twenty first century discussion, Schumpeter thought that the means at the disposal of private interests in a democracy “are often used to thwart the will of the people”, and “to interfere with the working of the mechanisms of competitive leadership”.

Popper was less impressed than Schumpeter both by the pure form of traditional capitalism and by Marxist logic, and more comfortable with the messy reality of democracy and its inevitable tendency towards social democracy. The open society might get many things wrong, but it had a capacity for self-correction and for improvement over time that was more valuable than the occasionally more precise correctness of its enemies.

Popper is interesting also for his identification of Plato as the original source of ideological opposition to the open society. This was ethno-centric in Popper’s time: Confucian political philosophy had said as much about the advantages of leadership by an elite that was aware of its responsibilities to the wider community.

The case for Plato’s general importance in global political thought is stronger now than in the 1940s: the current leaders of the Chinese Communist Party were taught at University and the Party School that their version of socialist thought had beginnings in Plato. General Secretary Xi Jinping’s Herculean (or Sysyphian) efforts to purge corruption from the Chinese Communist Party can be seen as seeking longevity of Party rule through government by Platonic guardians.

The cautionary words from the troubled years assisted the developed world to avoid some traps. This and the favourable experience of incomes growth with equitable distribution through the postwar decades focused the spotlight on more mundane questions about managing the mixed economies that had emerged from Depression and war. Much good work in economics focussed on defining the boundaries between activities that are most usefully undertaken through unrestrained market exchange, those that require regulated markets for good outcomes in the public interest, and those that are best provided directly by the State. These productive strands of postwar economics were influential in the North Atlantic in the golden postwar years and in Australia in the reform period 1983-2000.

The central planning that Hayek thought would be the road to serfdom, that Schumpeter thought might possibly be made to work within a democratic framework and that Keynes never took seriously is dead and gone.

So is the traditional capitalism and associated business-dominated democracy that Schumpeter liked but thought would die. However, grotesque mutations of Schumpeterian ideas on democratic capitalism live on. Their revival in the late twentieth and early twenty first centuries as libertarian ideas for deregulation, especially of finance, and lower taxation, have created large problems for managing modern economic systems. The mutations turn Schumpeter’s support for unbridled competition and creative destruction on its head by preserving and extending monopoly. Schumpeter would see the realisation of his fears about money corrupting democratic policy-making in recent developments.
Keynes and Popper would not be surprised or terribly uncomfortable with the rather messy social democracy which has emerged in all of the open societies. Keynes would be telling us that we were wasting a lot of our state intervention on matters that could be left alone, and neglecting other interventions with the potential to contribute more to the public interest.

Hayek would think that government had strayed too far. But he would have to acknowledge that the path to which the developed countries had strayed was not towards serfdom.

All of the big minds on Capitalism, Socialism and Democracy from the thirties and forties would have been amazed by the successful emergence of China as the largest economy in the world, and of Indonesia as a democracy with a dynamic economy.

The Return to Fundamental Questions

The stagnation and in the United States the decline of labour incomes and more generally the large increase in the dispersion of the distribution of incomes and wealth in the late twentieth and early twenty first centuries have renewed discussion of where our political and economic systems are taking us. Mainstream economists in the United States (Stiglitz 2012; Krugman, 2003; Sachs 2011) became critics of the way the democratic system is working and especially of the role of corporate money in the policy-making process.

Piketty’s *Capital in the Twenty First Century* has become the focus of much of the discussion since its appearance in English early this year. Piketty describes a simple economic model within which we can understand part of the change in the distribution of incomes over time—the part that derives from changes in the distribution between labour and capital. He discusses eclectically a range of other influences on the distribution of income and wealth. He applies insights from the model and the eclectic discussion to suggest that in the absence of political upheaval or new policies, inequality is likely to widen to and perhaps beyond levels known in Europe before World War I. He comments that this is likely to be inconsistent with the ethos, good health and perhaps survival of democratic institutions and societies. Finally, he suggests policy reform that could avoid the excesses of growing inequality and preserve democracy—while recognising that wealth will seek to use its influence in the democratic process to block the implementation of reforms to secure a democratic future.

Piketty’s data establish that inequality in the distribution of wealth and income in France, the United Kingdom and the United States tended to increase in the early stages of modern economic growth; shrink decisively from the outbreak of War a century ago until the 1970s; and grow wider again over recent decades. There was once much less inequality in the United States than in Europe, but now much more—as wide in the United States now as in Europe in the Belle Epoch.

The economic model that Piketty uses to explain growing inequality is built on the simple relationship that when the return on capital exceeds the growth rate of the economy, the income from capital tends to increase over time relative to income from labour. He expects the rate of return on capital to remain more or less steady over future time as it has done in the past, and the rate of economic growth to fall over time with the slowing of growth in both population and productivity. It follows that he expects the share of capital in national income to rise over time, probably at a faster rate than in the recent past, leading to vastly increased inequality.
Piketty’s preferred policy response to preserve democracy and a market economy is for all countries to introduce a progressive annual global wealth tax. He acknowledges that for the time being international agreement on introduction of a progressive wealth tax is “utopian”. Pending global agreement, worthwhile results could be achieved for the distribution of income within Europe from two achievable steps: international sharing of information on capital flows and other financial transactions; and the introduction of a progressive European annual wealth tax.

I see merit in the Piketty eclectic discussion of sources of inequality, in his views about the effects of inequality on the health of and prospects for democracy, and in his main suggestion for policy. But there is a big problem in the central analysis of the prospects for inequality.

Is Keynes or Piketty Wrong About the Rate of Return?

Piketty’s strong general conclusions depend on his view that the rate of return on capital will not fall much from past levels, and certainly will not fall below a falling aggregate rate of economic growth. This is entirely a judgement about empirical matters. We can think of conditions under which it would turn out to be correct, and others under which it would turn out to be completely wrong.

Piketty makes a great deal of the historical tendency for the pre-tax rate of return on capital to hold up at 4-5% per annum in real terms. He calculates rates of return in a particular way and concludes that rates of return have remained near these levels in the early twenty first century.

There are empirical and analytical reasons to pause before accepting that Piketty is right and Keynes was wrong.

First, the empirical.

The rate of return on sovereign bonds—the main form of low-risk investment in the nineteenth and twentieth centuries and now—has fallen dramatically in the twenty first century so far and is now close to or below zero after taxation in real terms in developed countries. Nominal bond yields early this week were 2.37% in New York, 2.23% in London, 0.83% in Frankfurt, 0.51% in Tokyo and 3.33% in Melbourne—all at lower levels in real terms than in any earlier year.

So why were Piketty’s numbers on rates of return so high?

Piketty’s calculations on returns to capital in the twentieth century include capital gains, and therefore were lifted by the boost that falling interest rates gave to the value of all assets.

Long term interest rates cannot fall much lower now that they are near zero in nominal terms, and so will soon cease to be a source of rising asset values.

The general presumption is that the low bond yields are a temporary phenomenon associated with the aftermath of the Great Crash of 2008, encouraged by quantitative easing by central banks. If the presumption were correct, we could expect a fall in asset values as abnormal monetary policies are corrected and interest rates rise, and therefore returns on investment fall.

But there is another possibility—that historically low interest rates are the new norm for the twenty first century. Exceptional monetary policies in Europe, Japan and the United States may
have contributed at the margin to low long term interest rates, but have not been the main cause. This is suggested by the persistence of low rates through the (admittedly weak) recovery that is currently proceeding in the United States now followed by the cessation of quantitative easing.

Analytically, the return on low risk long-term investment reflects the balance between savings and investment in global capital markets. In the developed world, ageing, increasing disparity in income distribution and, since the Great Crash of 2008, fiscal adjustments to reduce budget deficits and private desires to reduce debt, have increased savings rates. Lower population growth—in many developed countries, declining population—and an apparently lower trajectory of productivity growth (Gordon 2012) have reduced expectations of returns and therefore investment.

These tendencies in developed countries have changed the balance between savings and investment in ways that reduce long term interest rates.

The cost of capital and therefore the rates of return that can reasonably be expected have fallen decisively in the developed countries. Many businesses continue to expect to be able to obtain the higher rates of return on investment that were once available to them, and decline to invest unless these expectations are expected to be met. Unprecedented numbers of listed companies in many developed countries have been buying back their own shares ahead of investment in business expansion. Unrealistic expectations of returns have contributed to weak business investment and to even higher excess of planned savings over planned investment.

Are these causes of low real interest rates in the developed countries so far this century likely to persist?

If low rates of return on investment continue, presumably the unrealistically high expectations of returns on investment will turn out to be a temporary phenomenon. Business leaders will adjust their expectations to new realities or the firms that they lead will become smaller and less influential. The effects of ageing on saving can be expected to persist for a considerable period, although the tendency to higher savings may eventually be reversed when an old population begins to draw more heavily on savings.

Other causes of excesses of savings over investment may persist and even intensify.

We also see pressures for lower interest rates when we lift our eyes to the contemporary developing world. There is a tendency for savings rates in the rapidly growing developing countries to be high by world standards, with China the dominant influence. This becomes a more important source of pressure for increases in the share of the successful developing countries in the world economy. These pressures are now being reinforced by the historic economic transition in China away from investment led growth, which is likely for a while to see investment fall more rapidly than savings from 2014 levels.

This, of course, conflicts with an expectation from first principles that successful developing countries will invest more than they save and draw capital from developed countries. There are ample opportunities for profitable investment in the successful developing countries’ “catching up” with the developed world. And age structures in developing countries are generally more favourable to lower savings. One would expect that successful global development would put upward pressure on interest rates as well as raise the rate of global economic growth—make it
more likely that Piketty’s rate of growth would exceed Piketty’s rate of return on capital. A shift to capital flows from developed to developing countries would be helpful to development in both sets of countries.

Global Development and Inequality

Hayek at the London School of Economics once remarked that Keynes lacked curiosity about anything that had not been written in English. The most important gap in Keynes curiosity, however, was the consequences of extending modern economic development to the whole of humanity.

If the Keynesian euthanasia of the rentier is with us already in the early twenty first century, it has arrived surprisingly early given the globalization of economic activities.

Large-scale sustained capital outflow into income-earning investment in the developing countries could ease the twenty first century problems of the developed countries. A substantial part of the increase would need to take the form of public investment—the private sector can be expected already to be investing abroad most of what seems to be justified by its perception of commercial opportunity. But we could expect some increase in private investment as well, encouraged by higher rates of economic growth, improved infrastructure and confidence in stability of commercial arrangements. The capital outflow would be associated with lower real exchange rates, larger net exports, and higher production of tradeable goods and services. The income-earning investments abroad would help to reconcile high savings in anticipation of retirement requirements of an ageing population with high employment in the developed countries. Income from or sale of the assets abroad would provide resources when required to support expenditure in an old population.

These considerations support high levels of contemporary investment abroad by Chinese official agencies and the recent Chinese efforts to lead the building of a “BRICs Bank” and an Asian Infrastructure Investment Bank.

Many developing countries, including India and Indonesia, are in a good position to absorb higher levels of investment from abroad, especially if it is long term investment in infrastructure and other assets contributing to rising living standards.

China is moving so swiftly through the middle income range of development that only a political cataclysm would block its attainment of developed status within a decade or so. It is better considered as a developed country for these purposes.

Let us look at how global income distribution has changed in recent years, and then at how it might be affected as the world moves towards the maturation of modern economic development.

All measures of inequality show increased dispersion of incomes in the major developed countries in the early twenty first century. Australia until recently was a partial exception to the general tendency, once taxation, transfer payments and public services are taken into account. The pressures for growing inequality in the market place have increased since the peak of Australia’s China resources boom in 2011 and some of the policies which secured more equitable outcomes are in the process of being modified.
Let us define the contribution of the pure Piketty framework to rising inequality as the tendency for the rate of economic growth to fall while the rate of return on investment stays high. Two influences from outside that pure framework on the distribution of income in the developed countries have already been mentioned: the globalization of the market for goods and services; and the lowering of taxes on capital and higher incomes in the developed countries.

In the big developed countries, the changes in the tax regimes emerged from the interaction of more effective pressure by business interests on the political process with deregulatory ideology. In the smaller countries, one motive for the reduction of taxation on capital income was an attempt to increase capital inflow and so to raise domestic incomes at the expense of other countries. The actual effect of reductions in taxation on capital incomes in the smaller countries was not always in the direction of raising incomes of residents of the host country.

Within each of the developing countries, including all of Northeast and South and much of Southeast Asia, an initial abundance of labour has caused the dispersion of income distribution to expand in the early stages of economic growth, until labour becomes scarce and wages start to increase as or more rapidly than output. The possibilities are wider in resource rich countries: some countries have been successful in supporting widely based development with the capture of resource rents for public purposes (for example, Botswana). However, the political economy of resource development has more often generated a “resource curse”.

China has seen different tendencies in income distribution over time. The first steps in market-oriented reform were concentrated in rural areas, and early success led to falling inequality from 1978 to 1984. A long period of investment-led growth followed, leading to massive increases in inequality well into the twenty first century. Labour began to be scarce and real wages to rise rapidly from about 2005, and since the shift to the new model of economic growth in 2011 the standard private as well as official measures have revealed reductions in inequality.

The Indonesian story has also varied over time. Through the 1990s until the collapse in the Asian financial crisis in 1997-8 wages rose consistently and inequality declined moderately. Slower growth since the Asian financial crisis has seen a return to widening inequality, although the democratic governments, like their authoritarian predecessor before the financial crash of 1998, have had some success in reducing poverty through fiscal measures. Interestingly, the largesse of election campaigns has been directed overwhelmingly towards the poor and Resoduschomo and Yusuf (2009) have noted a decline in inequality in election years.

Whatever is happening to income distribution within individual countries, a global measure of inequality would show declining inequality through the early years of the twenty first century and especially after wages started to rise strongly in China in about 2005. The incomes of ordinary people in the big Asian developing countries accounting for about half of the world’s people have been growing substantially more rapidly than the incomes of all but the elites of the developed countries.

How might this change over time? The favourable developments in global income distribution in the twenty first century so far are likely to continue for as long as the developing world continues to “catch up” with the developed in average incomes and productivity. Rapid economic growth in the world as a whole, associated with an increasing global capital stock and sooner rather than
later a falling global labour force, would see wage rates rising relative to returns to capital. This would accelerate sharply with a global “turning point in economic development”, when stocks of surplus labour in developing (by then encompassing underdeveloped) countries were exhausted. The turning point in the global labour market would accelerate the euthanasia of the rentier in the global economy.

The turning point in the global labour market, with labour becoming scarce everywhere, is the one certain means of generating sustainable upward pressure on employment and wages in developed countries. If associated with a sustained reduction in rates of return on capital, the maturation of global development would see a sharp lift in the relative position of low-income people all over the world.

International movement of capital from developed to developing countries, supporting the developing countries’ “catching up”, would hasten the onset of the turning point in the global labour market.

The turning point would also be brought forward by the tendency for successful development to reduce fertility and eventually growth in the labour force in developing and underdeveloped countries. Everywhere, higher incomes and the education and greater security of women that accompany it have been associated with falls in fertility, usually eventually to below replacement levels. This is the source of the ageing of the developed populations.

Here one threat to favourable long-term outcomes is the growing relative demographic weight of the underdeveloped countries—Paul Collier’s Bottom Billion (Collier, 2007) which in the recent past has come to include Papua New Guinea and all of the small island states of Australia’s immediate neighbourhood. The persistence of low incomes and high fertility in the “Bottom Billion” if they failed to join modern economic development would make these countries an ever-increasing proportion of humanity. Humanity could become mired in a Malthusian bog. Persistence of underdevelopment may cause the absolute number of people and perhaps the proportion of humanity living in poverty to rise even as many countries make the transition from developing to developed countries.

Bringing the Bottom Billion into modern economic development turns out to be crucial not only to income distribution within the poorest countries and between them and the rest of the world, but in the developed world as well.

Could a world after the maturation of global development—the lifting of all countries to high living standards—have Piketty-like tendencies for the capital share of income to rise? To be sure, it would not be open to the world as a whole to resolve a tendency for savings to exceed investment through long term capital outflows and high net exports.

But with the maturation of global development, the challenges would be those of Keynesian abundance. The emergence of abundance and increased equity in income distribution is now no less certain and no more distant for the world as a whole than it was in the 1930s for the developed countries alone.
Political Blocks to the Maturation of Global Development and to Equity in Income Distribution

Of course, anything that blocks the maturation of modern economic development also blocks the decline in returns to capital and increase in returns to labour. There are many candidates. Here I focus on problems relating to the political systems’ capacities to take and to implement decisions in the public interest. Several of these relate to national decisions to support international cooperation. Some relate to more purely domestic policy decisions.

With global capital markets, the contemporary corrosion of corporate tax revenues from the shifting of income into low tax jurisdictions and the associated reduction of tax rates to avoid the shifting has become a serious drag on national revenues. This, in turn, has complicated the task of maintaining stable public finances with equity in domestic distribution.

International cooperation on the integrity of national taxation systems—first of all through the sharing of tax information and desirably through cooperative setting of tax rates and structures—is necessary if this large contemporary problem is to be resolved. The main barrier to effective action to protect the historical national tax base is the influence of corporations on policy-making by national governments. While companies take different views on the shifting of income amongst jurisdictions, they are united in favouring reduction of tax rates to achieve harmonisation with lower taxation.

The democratic political systems are having greater difficulty than China in asserting a national position on the taxation of capital. China is especially important, since it is likely soon to account for more savings and investment than all of the developed countries together. China has been a strong supporter of cooperative action within the G20, which increases the chances of effective international action. Xi Jinping’s success in cleaning the Augean stables would strengthen the likelihood of China maintaining current positions consistently into the future.

The large countries working together against avoidance of taxation on internationally mobile capital could fundamentally change the outlook for inequality in the developed countries. Working together would involve use of political and economic weight against free-riding smaller countries—Luxembourg, Ireland, Switzerland and Singapore all come to mind. The biggest barrier to success will be the influence on domestic policy-making processes of business interests everywhere that stand to lose from effective action.

Would more effective global taxation of capital and high incomes slow global economic growth and delay the maturation of global development? That depends on whether stronger national fiscal positions were used in ways to promote development. It is unlikely to be a significant influence on global consumption and savings rates. It may reduce global savings to some extent, and probably global investment as well, simply because capital income accrues mainly to high-income people who consume a lower proportion of their incomes. This in itself would be a blessing and not a problem for as long as current tendencies persist for savings to exceed investment.

Higher taxation from capital and high incomes would provide greater capacity to invest in productive infrastructure and education and so facilitate stronger growth. A cessation of the recent tendency for incomes of ordinary people to fall in the developed democracies would support the implementation of policies that improve economic performance. It would reduce contemporary
pressures to resist deeper integration into the global economy, which itself would be a considerable benefit to global economic growth.

Effective cooperation in avoiding dangerous climate change is a necessary condition for the maturation of economic development.

We have learned a great deal about international cooperation on the mitigation of climate change since the disappointment at Copenhagen five years ago. Assessments of the costs of reducing emissions are now much lower than they were at the times of the Stern Review in 2007 and the Garnaut Climate Change Review in 2008, principally as a result of large-scale Chinese manufacturing of capital goods for all of the low-emissions technologies. More sophisticated understanding of the relationship between economic growth and emissions is recognizing more completely the costs of fossil energy systems for health. These developments are shifting the balance towards stronger action to reduce greenhouse gas emissions to avoid dangerous climate change.

The world’s two largest emitters of greenhouse gases are taking strong action after sitting on the sidelines until 2009. China is now leading the world in deployment of low-emissions energy technologies and seeking to do as much with transport. The United States is making headway towards meeting ambitious emissions reduction targets for 2020. Europe has been the global leader in climate change mitigation, and has indicated an intention to move forward strongly with its recent articulation of post-2020 goals for emissions reduction.

As with action against corrosion of revenue from capital taxation, the main barrier to effective policy action is the influence of vested interests in the policy-making process. In most countries, the corporate community is more divided on the climate change issue than it is on capital taxation, although the concentration of interests opposing climate change action makes them more influential than they otherwise would be. Observation of the Australian political process would encourage pessimism about climate change mitigation and therefore the prospects for the maturation of global development. Fortunately, Australia is not representative of the democratic polities—although the effect of one laggard’s actions on the political difficulties of action in other countries can be large.

The evidence favours Keynes’ over Piketty’s views on the long term consequences of successful capitalist development. But for ordinary people in developed countries, the prospect of waiting several generations for the reversal of recent declines in income shares and in some cases real living standards is an unattractive prospect.

The failure to introduce policies to sustain living standards pending the maturation of modern economic growth is likely to undermine the political basis for effective policy in the developed countries. It is likely also to undermine the legitimacy of the political systems within which the failures occur. The Chinese government’s recognition of this reality is a powerful motive for the current efforts to transform the economic model that delivered rapid economic growth but growing inequality through the first eleven years of this century. There is a larger issue for those who, like me, value the special benefits of government by the people and the open society more highly than any benefits that might come from a successful authoritarian Platonic state: the prospects of democracy everywhere will be damaged if it is discredited in its early homes.
Making the most of the substantial opportunities allowed by the modern global economy to raise living standards of ordinary citizens in developed countries without damaging global development itself will be important for the maturation of modern economic development. Success in the open societies requires the application of sound economic analysis—economic rationalism—to policy choice. It requires the shifting back of the balance of influence in policy-making to a strong centre of the polity, independent of vested interests and partisan politics. The closed societies seeking to implement policies for the people have other options.

Application of rational economic analysis to policy choice will be contested by established business interests. The rentier will not quietly accept modifications to currently highly favourable arrangements. Indeed, she and he will be exerting all of their considerable influence against policy reform.

The larger owners of capital will seek to change policies to hold up the return on capital after tax in the face of powerful tendencies for it to fall. This is where Piketty's story of money distorting democratic processes in the late twentieth and early twenty first centuries assumes great practical relevance. Falling returns to capital encourage pressures for lower tax rates on capital and high incomes; for privatization of community and public assets whether or not there is economic justification in particular cases; for resisting regulation of business in the public interest; for turning competitive markets into monopolies; and for extension of changes in law and culture that have led to the explosion of executive remuneration in the early twenty century.

The spreading of the benefits of modern economic development across the whole of humanity, continued increases in material conditions for ordinary people in the developed countries and the future prospects of democratic political systems all depend on effective resistance to these pressures.

Concluding Remarks From the Western Pacific

Where does China's Platonic or oligarchic market economy go next? If Ji Xinping succeeds in cleaning the Augean stables, a barrier will have been removed from the emergence of China as a developed economy. That must be the more likely if not certain outcome. If he fails, we can expect disorder that is deeply disruptive outside as well as inside China.

There is a widespread view in the West that the emergence of a developed market economy in China and other countries will be accompanied by movement towards open, democratic political arrangements. A successful China will be home to continuing change in political structure that brings wider personal freedoms that are valued by many people. But will it be change in the political superstructure that people in the West would call “democratic”? Success in raising material standards of living, continuing the reversal of the early twenty first century increase in inequality, allowing people to travel across and between the great cities rapidly and in comfort, cleaning the air and leading the world’s mitigation of climate change will all give the Guardians more time and options.

But the experience of authoritarian systems seeking to rule for the people is one of eventual instability. The pressures for change come from many sources. The large numbers of young people on the Hong Kong streets last month tell us that material living standards are not the only things
that count. The slogans of young people in Hong Kong were directed against a power elite that encompassed the Communist Party leadership in Beijing and the business leaders of Hong Kong. Their elders urged caution. The young people who have been on the streets will still be here tomorrow but their elders will not.

Events will force responses to pressures for political change from time to time and the ideas of the Guardians at those times will be one of the influences on events.

Continued success in China as a Platonic market economy would be influential in the developing countries in which political structures remain open to debate and transformation. So will success in the democratic capitalist countries in cleaning out their own Augean stables and restoring the inclusive growth that won the Cold War in the second half of the twentieth century.

Large numbers of Indonesians are deeply committed to their democracy and excited by their choice of a new President from outside the old elites. But they fear that money and the forces of the closed society will find common cause and take it away: that an exciting young democratic market economy will mutate into an oligarchic market economy. Current discussion of limits on campaign funding and introduction of public funding of election campaigns are on the front line of the defence of the open society in Indonesia.

Australia is also at an historic point on the future of capitalist democracy.

Corporate money has played a direct role in Australian policy-making and electoral competition over the past half dozen years in a way and on a scale that has no precedent. Climate change mitigation and taxation are simply the most important of the issues on which this has had important effects.

In the 2013 election, the Palmer United Party took the new political culture to new depths. Of deepest concern, the general polity accepted with little demur the party’s deciding votes in the Senate on carbon pricing, with little regard for the most naked of conflicts of interest.

There is one source of hope. The hope comes from the work of the Independent Commission Against Corruption in New South Wales, and the new Premier’s response to it.

The good news for Australian democracy is that what had become common practice amongst major parts of the political and business elites of Sydney was rejected powerfully by the community as soon as it was brought into the public view. Premier Baird, himself clear of any allegations of foul practice, has announced his intention to legislate tight restrictions on corporate and trade union and to limit personal donations to political parties and to fill part of the void by increasing public funding of parties.

Effective campaign funding reform in New South Wales would be an important step towards reviving a democratic political culture in Australia after a difficult period. It will be resisted strongly by the established power elites which have done well out of the deteriorating status quo.

So in Australia as well as Indonesia and China, the influence of vested interests in the policy-making process has emerged as the most important battleground over which the future of Capitalism, Socialism and Democracy will be fought.
This seems less grand than the clash of ideas involving Keynes, Hayek, Schumpeter and Popper, or before that of Reeves and Shaw and the Webbs, or earlier still of Lincoln at Gettysburg.

Maybe it is less grand. But it will be no easier to win than old battles for democracy. And what is at stake is as grand as anything ever was. Such simple things will determine whether Government by as well as of and for the people will be the main vehicle on which we travel to the maturation of modern economic development, or perishes from this earth.
References:


