

# CRISIS OF DEMOCRATIC CAPITALISM

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*“In 2016, I declared, ‘I am your voice. Today, I add: I am your warrior. I am your justice. And for those who have been wronged and betrayed, I am your retribution.’” Donald Trump, 4<sup>th</sup> March 2023.*

*“It is clear then that the best partnership in a state is the one which operates through the middle people, and also that those states in which the middle element is large, and stronger if possible than the other two together, or at any rate stronger than either of them alone, have every chance of having a well-run [democratic] constitution.” Aristotle, Politics.*

*“μηδὲν ἄγαν” (Nothing in excess.)*

*From the Temple of Apollo at Delphi*

In 1937 my father left Vienna for England, on his own. His immediate family managed, by a miracle, to escape to Palestine in 1939. Their wider family was stuck in Poland

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<sup>1</sup> Chief Economics Commentator, *Financial Times*, London.

<sup>2</sup> This is the text of the first G. Mavros Lecture of the National Bank Cultural Foundation, which was delivered in Athens on the 12<sup>th</sup> November 2024. The lecture is based on Martin Wolf, *The Crisis of Democratic Capitalism* (London and New York: Allen Lane, 2023).

and, apart from one young woman, perished in the Holocaust. In May 1940, my mother's father, a self-made Jewish fish merchant, hijacked a trawler, to take his family to England, as the German armies poured across the Dutch frontier. He was one of nine. He asked all his brothers and sisters to join him, with their families. None did. Their families also perished in the Holocaust. I am not certain of these numbers. But about 40-50 of my parents' aunts, uncles and cousins were slaughtered.

This was of course the result of the collapse of civilisation in Europe. There were many reasons for this collapse. But important among them was economic failure, particularly the Great Depression. If people cannot gain a decent standard of living, a peaceful and stable democratic order becomes hard to sustain.

This is why the theme of this book, which I began as Donald Trump became president of the US and the lies of the Brexit campaign seized this country, also seized me. I am *not* saying that what happened then will happen again. I am saying that one must never assume the stability of a civilised democracy.

## 1. THE DEMOCRATIC RECESSION

Remember this: in a liberal democracy — a democracy characterised by individual civil rights, the rule of law and respect for both the rights of the losers and the legitimacy of the winners — fair elections determine who holds power.

Attempts by a head of government and state to subvert the election or overturn the vote are treason. Yet that is what Donald Trump attempted to do both before and after the last presidential elections.

He failed. Decent and brave people ensured that. Yet now he is back, unrepentant and unpunished, seething with a desire for revenge.

Meanwhile, conservative stalwarts, such as Liz Cheney, were defenestrated. Her crime? Stating that Trump's Big Lie that the outcome of the election was a Big Lie is itself a big lie.

Yet how can a democracy survive if people take *their perception of reality itself* from their leader? This is what the Nazis called *Fuehrerprinzip*.

Democracy is founded on moral values: we are all citizens; we argue honestly; we agree that all citizens have

equal civil and political rights; and we accept the result of fair elections.

The US is, alas, far from alone. *Freedom in the World 2024*, from the independent US watchdog, Freedom House, published in February, stated that:

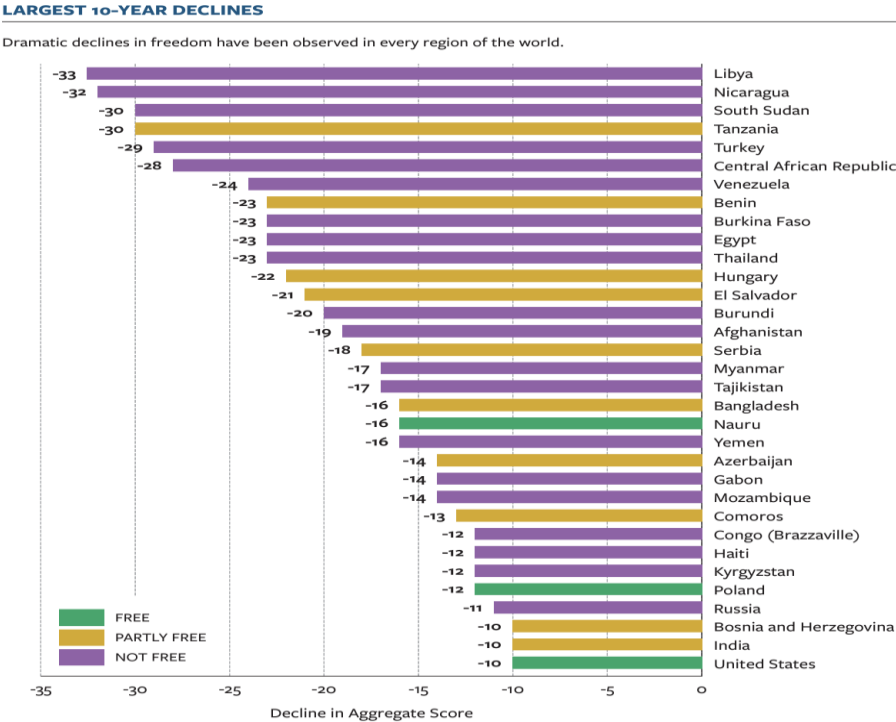
“Global freedom declined for the 18th consecutive year in 2023. The breadth and depth of the deterioration were extensive. Political rights and civil liberties were diminished in 52 countries, while only 21 countries made improvements. Flawed elections and armed conflict contributed to the decline, endangering freedom and causing severe human suffering.”

The “democratic recession” noted by Larry Diamond of Stanford University and the Hoover Institution almost two decades ago is now close to a “democratic depression”.

This decline occurred in all regions of the world, notably in the fragile democracies that emerged after the cold war. But, most significantly, it is observable in core western democracies, above all, the US, far and away the most important of all democracies, indeed the country that saved democracy in the 20<sup>th</sup> century.

Today, however, we have to say, that the congressional, judicial and democratic guardrails of US democracy have failed. Trump will return victorious over all his foes.

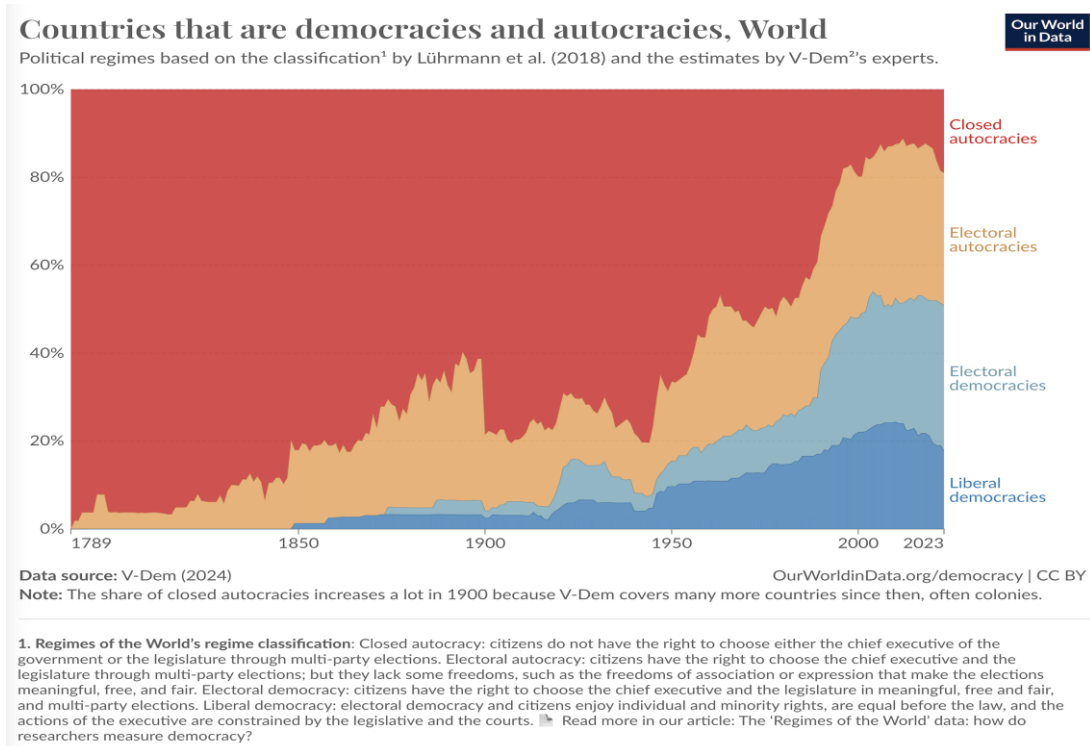
**FIGURE 1: THE DEMOCRATIC RECESSION**



**2. HOW DEMOCRATIC CAPITALISM WAS BORN**

*There were no democracies two centuries ago. Even where republican institutions did exist, the franchise was highly restricted, on the grounds of sex, race, and wealth.*

**FIGURE 2: THE RISE OF DEMOCRACY**



Then in the 19<sup>th</sup> century franchises were widened and universal suffrage democracy emerged and spread in fits and starts to cover half of the world's countries after 1990, before declining once again. This did not happen everywhere. But it happened in enough important countries to change the world.

Why did this happen? It is, after all, rather extraordinary that democratic principles were accepted by so many countries. The normal way to structure the economies and politics of complex societies has been for power to accrue to wealth and wealth to accrue to power.

*The most powerful people in society were the richest and vice versa. Absolute monarchs were thought to own everything.*

Why then did the revolutionary change towards democracy occur? The answer lies with the emergence of a marriage between a liberal economy and a democratic polity. Market capitalism and democracy are “*complementary opposites*”.

A market economy and a universal suffrage democracy both reject ascribed hereditary status. They both embrace the idea that people are entitled to decide important things for themselves.

Market capitalism rests on ideals of free labour, individual effort, reward for merit and the rule of law. Democracy rests on ideals of free discussion and debate among citizens when making those laws.

Historically, the market economy also brought urbanisation, a need for a more educated workforce, the newly organised working class as a political force and, with rising prosperity, opportunity for a “positive sum” form of politics.

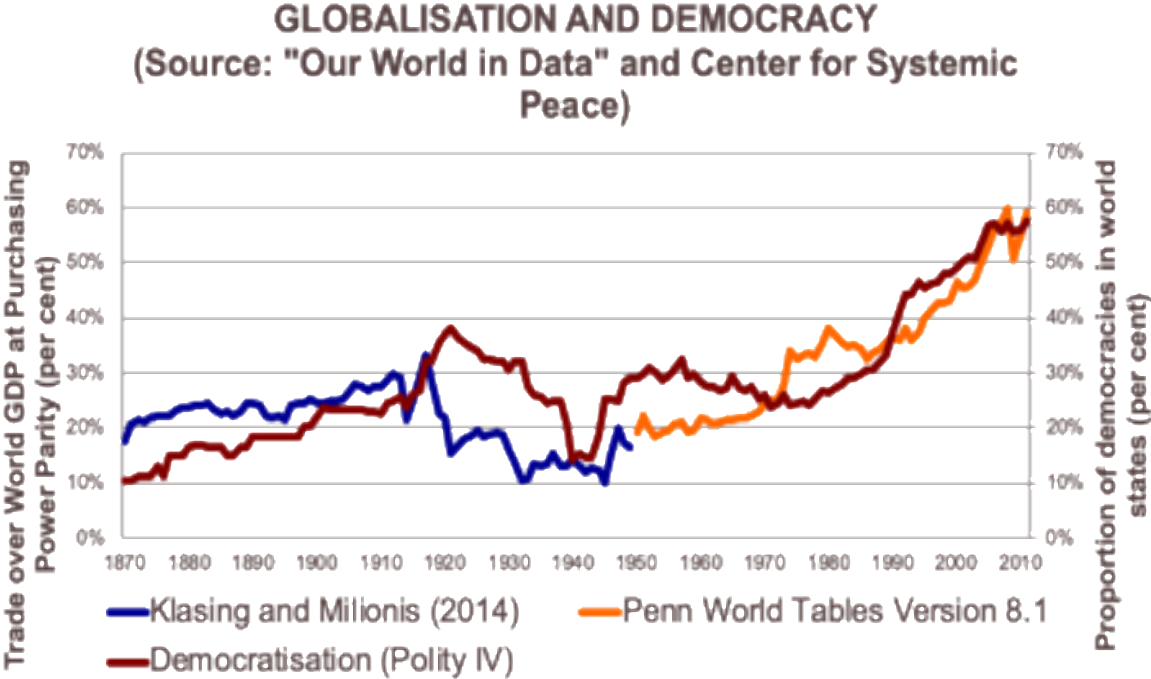
Democracies also rest on the existence of an economically independent citizenry. That was Aristotle’s point. A fully socialist society bound to be a dictatorship, since the ownership of productive assets is vested in the state. In the absence of co-ordination through competitive markets,

that state must be responsible for the allocation of those valuable resources. *This creates both a huge concentration of power and an overwhelming incentive not to lose it.*

Thus, markets protect democratic politics from an excessive concentration of power, while democratic politics also protects markets from an excessive concentration of wealth.

This then is how the market economy and liberal democracy are complementary.

**FIGURE 3: GLOBALISATION AND DEMOCRACY**



Yet democracy and capitalism are also opposites: capitalism is inherently cosmopolitan; the democratic state is territorial. The market is the domain of “exit”; democracy is



the domain of “voice”. The market economy is inequalitarian (one dollar, one vote); democracy is egalitarian (one person, one vote).

If the economy fails to serve the interests of the majority, the sense of shared citizenship will fray and populist demagogues are likely to emerge. Those are the people Plato called “protectors”. Trump is just such a “protector”.

Populism is not necessarily lethal for democracy, so long as it takes the form of a justified (even fruitful) hostility to elites. But too often it takes the form of hostility to pluralism itself, which is a fundamental element in any democracy – pluralism not just of culture, but more profoundly of values.

Democracy is then transformed into a “plebiscitary dictatorship” and ultimately a dictatorship, *tout court*, in which the dictator claims that “*le peuple, c’est moi*”.

Alternatively, the concentration of wealth will lead to plutocracy as wealth is once again transmuted into power.

Indeed, a predatory autocracy *and* corrupt plutocracy can live in uneasy tension. That was the governing system of the Roman Empire

### **3. UNHAPPY HIGH-INCOME DEMOCRACIES**

Large rises in inequality, the deteriorating prospects of the old “respectable” working and middle classes in core democracies have been weakening the foundations of democracy.

Fear of downward mobility has created “status anxiety” and cynicism. These have then been diverted by right-wing propagandists into cultural and racial resentments, especially in ethnically diverse societies. Mass immigration is a potent weapon in such politics

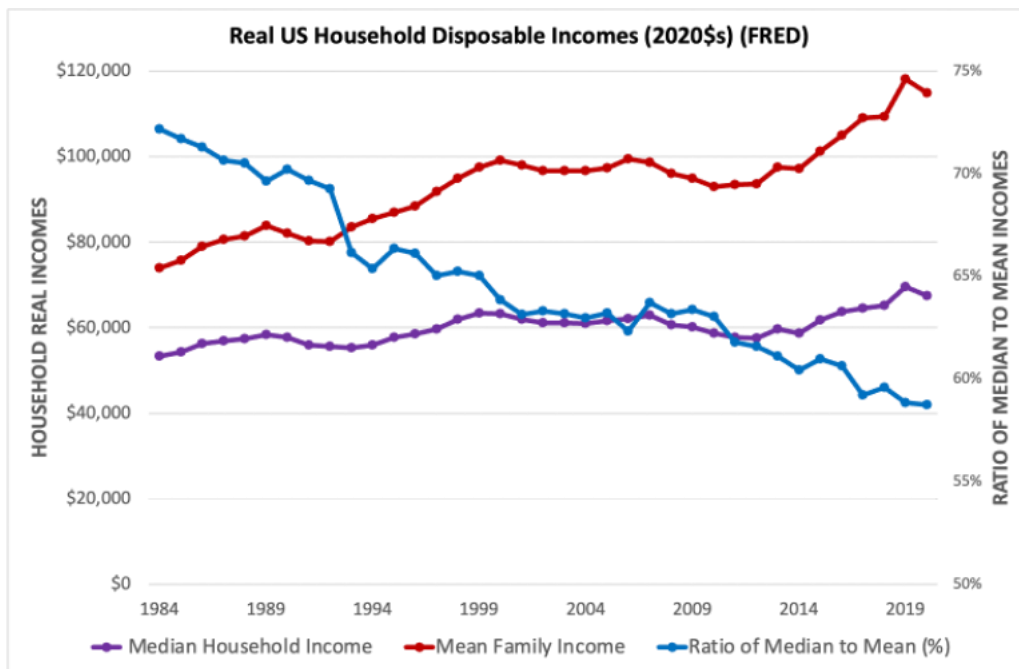
Those resentments have been greatly aggravated by the emergence of a large and discontented class of university-educated “clerics” dedicated to a “progressive” cultural and racial politics. This identity army of the left clashes with the majoritarian (“silent majority”) identity army of the right.

The emergence of the “new media” has facilitated these trends. But they have not created them. After all, old media created right-wing populism, including fascism. The big difference is that there is no longer the same need for powerful parties.

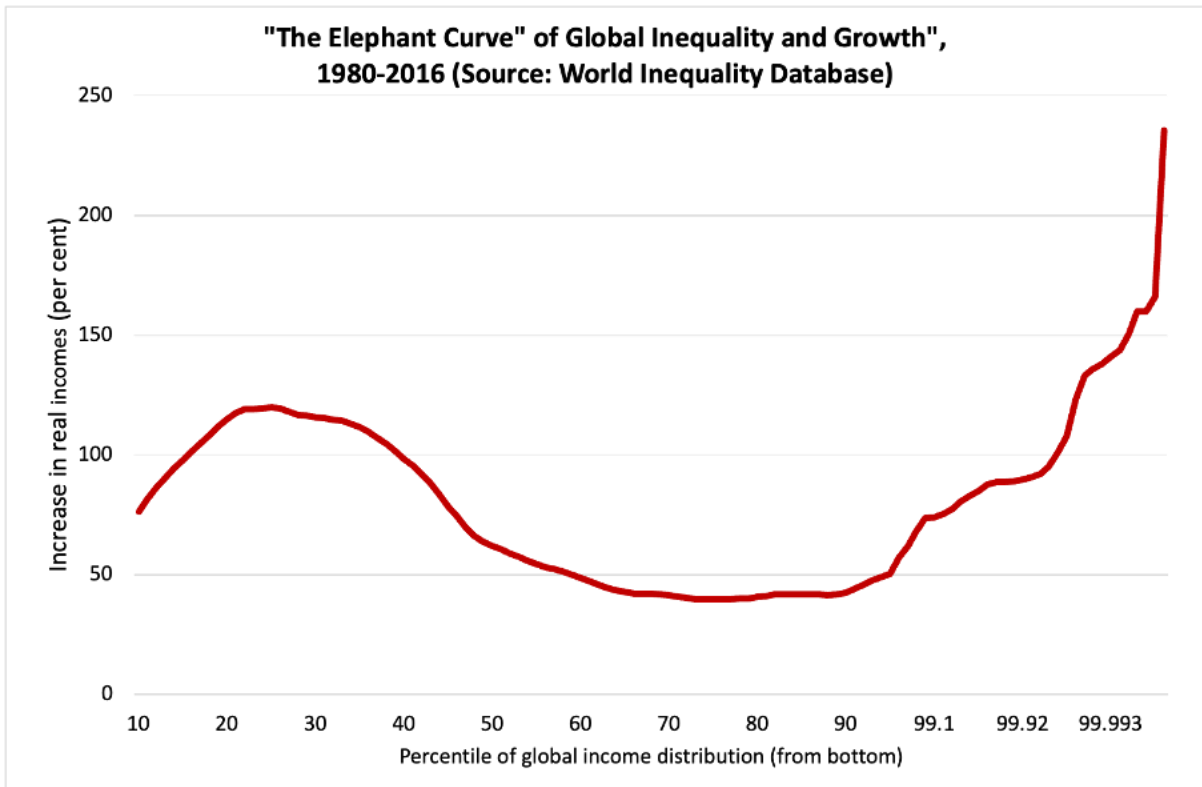
A big question is what has happened to create this “status anxiety”, especially in people who did not go to college.

In the long run, the most important phenomena, I believe, have been economic. Namely, rising inequality, deindustrialisation, and falling growth.

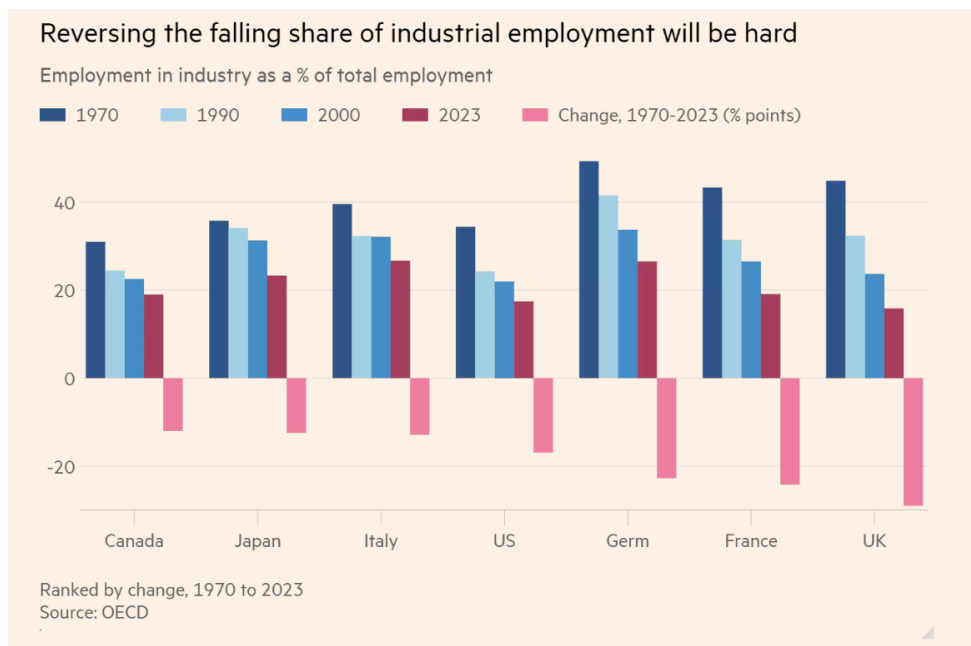
**FIGURE 4: US HOUSEHOLD DISPOSABLE INCOMES**



**FIGURE 5: THE GLOBAL “ELEPHANT CURVE”**



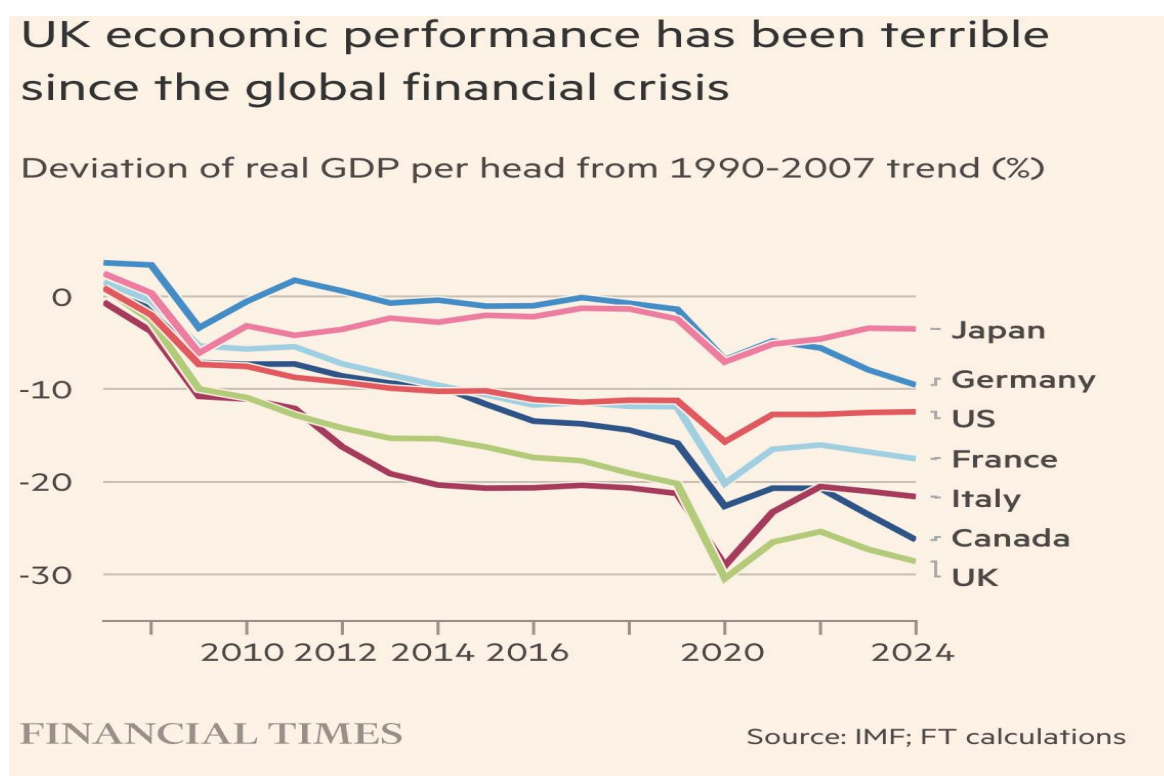
**FIGURE 6: DEINDUSTRIALISATION**



Raghuram has Rajan argued that easy credit papered over these trends. But this blew up in the financial crisis. The scale and visibility of the crisis and subsequent rescue of the banks and bankers convinced many that elites were both corrupt and incompetent.

## FIGURE 7

### AFTERMATH OF FINANCIAL CRISIS



That is why the Republican establishment became ripe for a populist take-over. But in truth what happened discredited the establishment in both parties, as it did in the

UK over Brexit. The same thing happened in the EU, especially after the eurozone crisis.

The shift towards skill-intensive sectors and technologies, de-industrialisation of the labour force, globalisation and the rise of China were the product of powerful economic forces.

Yet there is also substantial evidence of the emergence of forms of “rentier” capitalism, with declining competition, rising monopoly, and unbridled self-seeking by corporate executives.

Furthermore, the role of money in politics, especially in the US, has eroded the tax base and the effectiveness of regulation.

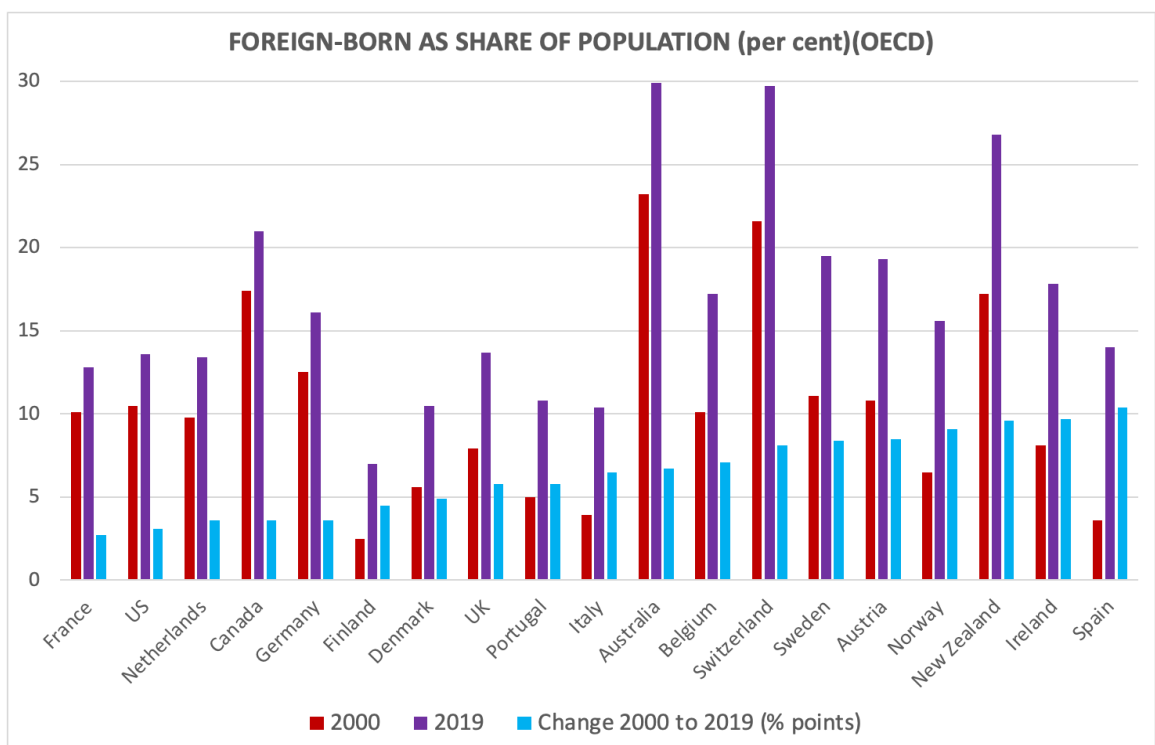
Some argue that this is mostly cultural. I would argue that culture primes people for right-wing populism. But there needs to be a trigger for it to become actual.

This is what happened in Germany in the 1930s: the Great Depression and the policies adopted in its aftermath led to the enormous rise in support for the Nazis in the early 1930s. The financial crisis and subsequent failures (e.g. recent

inflation) are such triggers. They are the answers the “why now? question.

But there is one cultural issue that does matter: immigration. It is not simple to explain the link. But immigration has certainly been important.

**FIGURE 9: IMMIGRATION**



#### **4. DEMOCRATIC CAPITALISM IN THE WORLD**

Branko Milanovic has argued that capitalism is “alone”: it has won.

Yet what sort of capitalism has won? Is it what Milanovic call “liberal capitalism” and I would call

“democratic capitalism” or is it to what he calls “political capitalism” and I would call “authoritarian capitalism”?

There are two forms of authoritarian capitalism.

The most common derives from a hostile takeover of democracies. The would-be autocrat eats out democracy from within. Usually, he starts as a populist demagogue. This is the path of Erdogan, Orban, Modi and Trump.

Features of such regimes include: a narrow circle of trusted servants, promotion of members of the family and “power ministries” who are personally loyal to the leader. Plutocrats may find it necessary to support the gangster in charge. Ultimately, however, they survive only as his cronies.

The other challenger is the Chinese system, which I call “bureaucratic authoritarian capitalism”.

In this, a communist bureaucracy operates a form of capitalist economy. This has proved self-disciplined, long-sighted, technocratic and rational.

Even so, bureaucratic capitalism also suffers from the vices of authoritarianism, especially the tendency



towards corruption, and crony capitalism. These failings damage both the economy and political legitimacy.

Bureaucratic authoritarian capitalism is indeed a significant challenger to western democratic capitalism. Yet, we must not despair.

Autocracies do not have a structure of accountability; they do not have open debate; they cannot ensure the peaceful transfer of power; and they tend towards unbridled cronyism and corruption. Indeed, corruption too often *becomes* the system.

Moreover, liberal democracy has come through many challenges over the past century.

More fundamentally, I believe it remains the right system. It rests on the magnificent belief in the right of people to make up their own minds and lead lives they choose within societies whose joint decisions are taken with the active consent of the governed.

## **5. IS IT TOO LATE TO SAVE DEMOCRATIC CAPITALISM?**

The renewal of democracy and capitalism must in my view be animated by a simple, but powerful, idea: that of shared citizenship.

If democracy is to work, we cannot think only as consumers, workers, business owners, savers, or investors.

We must think as citizens.

Today, a sense of citizenship must have three aspects: loyalty to democratic political and legal institutions and the values of open debate and mutual tolerance that underpin them; concern for the ability of fellow citizens to live a fulfilled life; and the desire to create an economy that allows citizens to flourish.

## **6. CONCLUSION**

We are social animals. We must act collectively as well as individually. Acting together, within a democracy, means acting and thinking as citizens. If we do not do so, democracy will fail, and autocracy will return.

It is, I hope, not too late to save this precious inheritance. But it is very late, all the same.