



A Global Forum

Martin Wolf

in conversation with
Ann Bernstein

CDE@25 | Democracy | Markets | Development

A South African resource influencing policy for 25 years

In November 2020, CDE initiated a series of events to celebrate 25 years since its launch in August 1995. The series focuses on global conversations on democracy, business, markets, and development.

Kuben Naidoo, the deputy governor of the South African Reserve Bank, opened the event. "CDE regularly hosts events where South Africans from all walks of life are exposed to new ideas and different ways of achieving common goals. The importance of independent think tanks like the CDE cannot be underestimated in our society and in our policy debates. CDE has made an especially valuable contribution through its ability to tap global experts for the benefit of the country. For many years, CDE has invested in identifying experts from around the world who have knowledge or practical experience that can help us navigate our many challenges.

I found Martin Wolf's 2015 characterisation of South Africa very apt. He described us as 'BelIndia': a wealthy high productivity largely white enclave, inside a poor India. I am looking forward to his insights on how a country like South Africa can feasibly follow a developmental strategy that achieves both open and free markets on the one hand, and democratic social norms on the other".

This is the fourth conversation in the CDE@25 series. Martin Wolf is associate editor and chief economics commentator at the Financial Times, where he has been since 1987. Described as "the world's preeminent financial journalist" and "the premier financial and economics writer in the world", His books include *Why Globalization Works* and *Fixing Global Finance*.

Ann Bernstein: It is my great privilege to welcome Martin Wolf to the CDE platform today. Martin has received many honours in his career. He has been called the Anglosphere's most influential financial journalist. He is an international best-selling author of numerous books, the recipient of six honorary doctorates, and an honorary fellow at two Oxford Colleges and at King's College London. Two years ago, when he received a lifetime achievement award in New York, he said:

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

I am going to start by asking Martin about his forthcoming book on the crisis of democratic capitalism.

Martin Wolf: The book is about the relationship between the two foundational systems of the contemporary world, namely, the liberal democratic political system based on universal suffrage, the rule of law, free political association, the right to protest, and competitive politics – and the competitive market economy, often called capitalism, which is open to the world, and based on open access to markets and a flexible pricing system. The relationship between these two systems – particularly in the developed world – is under enormous stress.

Ann Bernstein: If we look at history for a moment, what is the relationship between democracy and capitalism? Why did the development of market economies generate a rise in democratic rights?

Martin Wolf: I think that is a really deep and important question. If you go back to 1800, there were no democracies. The limited franchise that existed in a few countries were restricted to the wealthy, so they have to be called oligarchies, not democracies. And the great mass of humanity was incredibly poor.

Then, in some parts of the world, the industrial revolution took off and it proved completely transformative economically. It created enormous economic, social, and cultural change. As it advanced and incomes per head started to rise, particularly in the late 19th century, some very profound social changes happened.

We saw urbanisation and the rise of trade unions. We saw an increased demand from the people and their employers for education, so universal education began to be introduced even in some highly authoritarian

countries. There was a rising middle class that demanded a political say. This either led to a brutal reaction or a widening of the franchise. Related to this, there was in the US a war against slavery by those who favoured free labour.

There was a cultural change, an intellectual change, and profound political change, such that by the end of the 19th century in many Western countries you were very close to universal male suffrage and by the 1930s most Western countries had universal suffrage. In a relatively short period of time, the market economic system found itself in a political context of what we now think of as democracy.

Ann Bernstein: How do you see the conflict between capitalism and democracy in the world today?

Martin Wolf: We must remember that there have always been tensions in a successful market economy. There have always been a limited number of winners – the capitalists, owners of vast amounts of capital, who have power and wish to protect their position – and there are of course masses of people who are less well off, who want greater security and who will start electing people who promise to provide this. So, there is tension.

What has to happen for capitalism to work is that there must be a reasonable balance, so that people feel they have opportunities, and their children have opportunities, they have security, a reasonable chance of a good job. If they get that, then they are perfectly prepared to let business prosper and for some people to do enormously well. This balance is constantly fought over and, at least in the developed world in the 1950s and 1960s, it was struck particularly well, although it followed a catastrophic period during the 1930s and the subsequent Second World War. Over the last 40 years, this balance has for various reasons become destabilised in the developed world.

Meanwhile, the situation in developing countries is different because they are at a much earlier stage of development. They are going through a wide variety of tensions and compromises. Apart from the Chinese phenomenon, which is in many ways unique, other countries only democratised in the 1980s and 1990s, after they had experienced rapid economic development, whereas India has generally done remarkably well in terms of sustaining democracy, even though it has been the world's largest democracy ever since colonisation ended. The core argument in my book, though, is how the contract of modern citizenship has started to break down in the developed world, and that has led to the 'democratic recession'.

Ann Bernstein: Let me turn to that now – what you call the "unhappy high-income democracies". In your view, what are the realities causing this unhappiness, the inequalities, and the political reaction?

Martin Wolf: For me, the big problem is that the economic processes that drove greater equality in the 20th century, and the political solutions that underpinned the new bargain, have been undermined by a series of very powerful economic changes, which have led to the destruction of the old working class. Many people find themselves trapped with little hope of getting out. And so, we have social fragmentation that has created completely new political structures on the right and left. A simple way of thinking about this is that the income distribution and economies of rich, western countries have become more like those of Latin America, and as a result, the politics in the West looks more like Latin America's. It has increasingly become a competition of the populists of the left and populists of the right.

Yet it is in the centre that compromises are formed that allow a political community to function smoothly, as Aristotle said. When we end up with a polarised political community, liberal democracy does not work, as people are not prepared to lose elections – and if people are not prepared to lose, and regard their opponents as illegitimate, then democracy cannot survive.

Ann Bernstein: You have argued that the globalisation of middle to low-end jobs from rich countries is not that important to the troubles of the West, and that migration is important politically, but not economically. Can you talk about these two issues, as well as technology, which has been a big factor in changing the realities of rich countries?

Martin Wolf: It is important to distinguish the things that cause really significant economic change from the things that cause profound political change. They are not the same.

The evidence is pretty clear that the globalisation of trade and the level of immigration that we have had in the developed world have not had huge destabilising impacts on the old working class. These forms of globalisation have not had nearly the profound economic impact that is sometimes claimed.

It is true that immigrants have become the subject of profound hostility, because when people are unhappy, the most natural thing to happen in politics is to blame outsiders and foreigners. From the Brexit campaign and Trump's rhetoric, we can see the profound political salience of immigration.

Democracy is based on the idea that a political community, attached to a particular area of land ruled by a political constitution, holds government to account, and that the democratic state has a primary responsibility to the people in that community.

The reason immigration, if it is not controlled, shatters this is because people start saying that "There are all these outsiders to whom I feel no obligation, who are just able to walk in and take advantage of the system, potentially take our jobs, use our schools etc., and I don't support this because this state belongs to me and my children."

This is an old story; immigration has always created complications, as it did in America in the 19th century. That is the specific explanation as to why I think immigration is politically salient.

However, the biggest economic reality is the massive deindustrialisation of western economies, and it is absolutely clear that the dominant force behind this deindustrialisation, with all its social and economic consequences, has been technology. Industry is following the track of agriculture in that it is becoming a sector which is so immensely productive that no one needs to work in it anymore. And the result has been a colossal social change.

Ann Bernstein: What needs to be done? You have said: "None of today's dominant systems is working well. Capitalism is innovative but creates huge social, political, and environmental challenges. Liberal democracy is corroded even at its core. But the authoritarian politics that challenge it are vastly worse – unaccountable rule by gangsters or brutal bureaucrats is deeply depressing." What are your recommendations? How do you think we should renew democracy and capitalism?

Martin Wolf: We have the balance wrong. We are going to have to re-emphasise the idea of citizenship, otherwise we are not going to restore health to our democracies. We have to create a situation in which the great majority of people in our democracies feel they have hope for the future, collectively and individually. We have to find a way back to a more balanced system, like the one we had in the 1950s and 1960s. This is going to be extremely difficult because the fundamental underpinnings of economic growth have weakened a great deal. Nevertheless, we have to do the very best we can to promote growth, which means more investment by both public and private sectors. It means putting a lot of resources into supporting innovation, frontier science, and the diffusion of innovation through our economies.

In Britain, we need to accept the profound change in our economy – we are not going to generate the kinds of jobs in industry we created in the past, but we are going to have to impart some of the security that was associated with the old industrial jobs to the new jobs of the gig economy. And that will mean accepting reasonably high minimum wages, which will require wage subsidies as part of our economic system.

The government will also have to go back towards providing decent housing for people, which is something that it did in the early post-war years and has basically withdrawn from since then.

We need to put immense resources into educating everybody – lots of children are falling behind because their parents don't have good jobs, their families are not stable, and this has to be offset. And we have to provide skills training across the entire population, not just for people who go to university. This is a major source of division in countries like Britain.

To do all this, richer people are going to have to pay more tax. The upper middle class has done spectacularly well, which includes people like me, so I see no issue in why we shouldn't pay more tax – it is the only way we can move back towards the sense of social cohesion that we have lost.

We don't need to move against relatively free world trade in this situation, but we do need to convince our people that we control our borders with respect to immigration.

That gives you a flavour of my proposals. It leaves aside huge global challenges which require global co-operation; the most important are things like the climate and the biosphere. Somehow, we are going to have to go more national and more global at the same time.

Right now, I don't think that any of this is at all likely, but it is clearly what we have to do – and that is why this is a crisis. What we have to do requires us to go in two different directions at the same time. But what I am definitely opposed to is to go completely inward-looking and protectionist – we would end up in the 1930s again, which would be a catastrophe.

Ann Bernstein: A lot of big challenges. Thank you for giving us a flavour of your new book, Martin. As you said, the marriage of liberal democracy with capitalism is going to need a lot of nurturing.

I want to move away from the book now. The obvious question from SA is: what about the developing countries? Far too many analysts and pundits – not you – analyse the developed world and generalise to the developing world, which are in many respects in different situations. Over the past few decades, we have seen a real reduction in global inequality and in many big countries a phenomenal movement out of poverty for hundreds of millions of people. So, what does your analysis mean for these kinds of countries, where the sources of growth and the causes of inequality and poverty are rather different from the rich world?

Martin Wolf: One of the many reasons that I didn't write about developing countries is because my view is that developing countries share a broad problem of being relatively less well-off, but apart from that they are all dramatically different in their economic performance, economic opportunities, political systems, and cultural values. I know enough about them to know that making generalisations about developing countries is perilous. In the last 50 years, some developing countries have been spectacularly successful, and they have transformed the world completely as a result. This is predominantly in East Asia, particularly in the last 30 years with the rise of China. The classic developmental path, which has worked sensationally well, starts with textiles and ends with high-tech.

Other parts of the world aren't catching up at all. Probably the most important example is South America. No South American countries are richer, relative to the advanced countries today, than they were 40 years ago. They are seemingly caught in a middle-income trap. Then there are countries poorer than those in East Asia that have started to grow rapidly, the most important being India. And then in Africa, it is quite diverse. It is very difficult to summarise.

If development is to succeed, experience suggests that you need a high level of social cohesion, a sense of 'being together in this'. You have to have governments that are able to provide essential public goods without too much difficulty, and which are regarded as legitimate. I think this is what East Asia was able to do well. Of course, it helps if there is a great supply and demand for education.

China remains firmly autocratic and is therefore generating what looks like its own model. My own feeling is that it is not a model that anywhere else in the world can adopt, as China is pretty unique, and I don't think it is going to keep working well for China. But one has to recognise that we have a superpower in the world, still relatively poor, but one with immense power – especially in terms of trade – which operates on a completely different basis, politically at least, from the West. So, the world is split in that way.

That is the context for developing countries. How much can they exploit the existing opportunities, which depends on what they can do, how opportunities unfold, and how that relates to the politics they have at home and the new politics emerging globally? These are very big challenges.

Ann Bernstein: Let me turn to a topic that you and I have talked about in the past, which I think is really important for the world and for South Africa: the role of the corporation in society. You recently participated in an important symposium looking at Milton Friedman's 50 year old New York Times op-ed about business, and you said that you have changed your view. Tell us more about that.

Martin Wolf: Milton Friedman said that the job of companies is to maximise profits – basically, maximising shareholder value – provided they play by the rules of the game, as decided by democratic legislatures. But he didn't discuss how the rules of the game work and how they are formed.

The problem today, and this probably wasn't a big issue at the time that Milton Friedman was writing, is that there are some very important aspects of the market economy that don't work as well as they used to. A lot of the new players have vast market power – and that market power needs to be brought under control. The same is true of the financial sector.

The challenge governments face is that the companies they wish to regulate dominate political access because of their huge resources. And so, people are asking: who forms the rules of the game? If the people who should be operating within the rules of the game make the rules of the game, you don't have a democratic system and you don't have competitive capitalism – you are moving into a rentier system. What is a rentier system? It is the oldest system in the world, one in which politics and wealth are controlled by the same people, who then use politics to support their wealth and use their wealth to control politics. That describes most political systems in history.

One of the main arguments in my book is that the capitalists have to be pushed back out of politics. Milton Friedman didn't see this as a relevant danger 50 years ago, but it is very clearly a relevant danger now. Just look at the overwhelming domination in the US of donations from the immensely wealthy. I don't believe that is democracy.

The focal issue is that politics has to be free to set a framework within which market actors operate, otherwise the system collapses.

Ann Bernstein: Let me push back on this issue. One hears that Amazon or Facebook don't pay any tax, and if this is true it would be surprising and outrageous. But many people blame the companies for that, and you are saying it is because they have effectively bought the legislature. But I am not sure that it is as simple as that. I agree with those people (Micklethwait and Wooldridge for example) who are saying that the West has allowed their states to become weaker and that has been a consequence of the Reagan-Thatcher revolution. The state should be more effective, and it has been difficult for states to know how to tax companies, which the OECD is looking into now. But I also think if it were that simple, then maybe Michael Bloomberg would have been a stronger political candidate. In addition, you have other interests with enormous power – think of the teachers' unions in the US. It seems to me that the state is often at fault and could be doing more, but surely you have to prove law by law and country by country how companies have bought the state.

Martin Wolf: I am certainly not arguing that corporations are the only powerful interest, though in many western countries there are basically only public sector unions left and there are corporates who have immense power on labour laws and many other things.

I think that different countries have different opportunities and different politics. We need to separate the US from the rest. The US is so large that it has very substantial degrees of freedom in setting the rules and regulations governing its corporate sector, because they don't have anywhere else to go. Most of the dominant companies globally are American, which of course is a sign of their health economically, as well as the challenges it creates. It allows the US to impose a tax system which reduces the many loopholes that there are.

At the same time, if you look at, for example, the Trump tax cuts, it is very clearly a response to the fundamental role of the donor class, which is a very small group influencing the Republicans' platform. And there are other examples, such as the elimination of inheritance taxes, which is a consequence of plutocratic political lobbying. So, the evidence on this is clear in the US: I cite one paper which shows that if you look at the laws that are passed by both parties, they reflect far better the views and aspirations of the top 1% than the median voter.

This has effects globally. There is no other country that can make these decisions without paying very serious attention to the possibility that as a result of making these decisions, companies will simply leave their country. The EU could co-ordinate on tax, but they find it very difficult to do so and they struggle to co-ordinate even on competition policies.

Martin Wolf in conversation with Ann Bernstein

As I said, I think part of the resolution here is to reduce the role of companies in politics. I don't expect that to ever happen, by the way – and that is why I think we won't see these problems being resolved and why we are more likely to see populist politics.

Ann Bernstein: Unfortunately, we have come to the end of our time together. I would love to continue this conversation about business, democracy, and liberal values. We really appreciate that you have given us this time. I think I speak for many when I say we are looking forward to your new book and hopefully further debate on it once we have read it and can engage with you on the basis of that.

Martin Wolf: It was a great pleasure, as always.

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