

Democratic Capitalism

2012 could well turn out to be a testing one for democratic capitalism in the west. While Europe's financial/economic problems have received wide publicity, the rise of ultra right parties in both Europe and the U.S. has not received equal attention; in the U.S., the Tea Party wing of the Republicans, and its representatives in Congress, would like to take the country back to the era of 19th century capitalism where the governments had no social responsibilities – *but there was no adult franchise either* (women and blacks had no votes!). Their solution to the budget deficit is to cut social spending, without increasing taxes. The Democratic President would prefer a combination increasing taxes on the rich even pruning some social spending. Increasingly, the debate would become more partisan as the presidential election campaign heats up. Meantime, we could even see another deadlock on the debt ceiling which only Congress can increase.

The situation in Europe is even worse: as I argued in the last article, the big question is whether democracies can impose an "internal devaluation" through a drop in living standards for several years without creating a major political crisis. Overall, we could see slower growth, if not a recession, in the global economy in the current year even if the Iran situation – and oil price -- does not heat up: and, both Europe and the U.S. face years of slow growth if not stagnancy (as Japan has been experiencing for the past two decades). To be sure, there are some signs of economic recovery in the U.S. in the near term.

One major issue for both Europe and the U.S. is going to be how to get the banking system back to lending money to businesses. Provision of liquidity by the central banks is leading only to investments in risk-free assets. The banks' reluctance to extend commercial loans also stems from capital constraints. It

looks like the impact of monetary liquidity is becoming as ineffective as pushing on a string!

The bigger worry for the global economy is the specter of trade protectionist measures: the U.S. and China continue to spar though the U.S. has once again determined that China is not a currency manipulator; and, its surplus is shrinking. But this apart, China's influence in the global economy is likely to grow fast in the current year. One straw in the wind is that, once the terms of the European Financial Stability Facility (EFSF) were agreed, the first call by President Sarkozy was to his counterpart in China; and Beijing was the first port of call for the head of the EFSF. Not many years back, the calls would have been to Washington. Two other pointers: Japan recently announced that it is buying Chinese government bonds as part of its reserves and the two countries have agreed to promote yen: yuan currency trading; and, IPOs on Chinese exchanges in 2011 were double those on NYSE and NASDAQ combined

Historically speaking, social responsibilities for democratic governments have been a relatively recent dimension of the political economy. While Bismarckian Germany introduced old age pensions in the 19th century, social programs in the west started after the depression of the 1930s and the miseries it inflicted on the poor and the unemployed. While social programs were initiated in the U.S. in the Roosevelt era, in much of Europe and Japan this phenomenon became a part of the accepted governmental responsibilities post Second World War. The big question is whether democratic capitalism would survive in its present form if the U.S. chooses to go back to the 19th century brand of capitalism, and the attempt to impose "internal devaluations" on the troubled countries in the euro zone does not succeed in an era of electoral politics.

Many of today's ills stem from the coming to power of Margaret Thatcher in U.K. and Ronald Reagan in the U.S. The net effect of the policies pursued since then in the Anglo Saxon countries has led to a sharp rise in the share of capital in

GDP, and a corresponding fall in that of wages. The result has been a sharp increase in income inequalities. Protestant ethics justifies such inequalities: it imputes the success of the rich to virtue and hard work and the problems of the poor to their laziness! (I, for one, fail to see much virtue in the obscene earnings of speculators – or of too many chief executives). The Financial Times editorialised on December 28 that “*the achievement of extraordinary wealth may not reflect exceptional merit. In societies that rely on consent, this is politically corrosive*”. The problem of income inequalities is much more virulent in the Anglo-Saxon economies than in countries like Germany, Netherlands Sweden and France. Equality on a per capita basis in voting power, but huge and growing inequality in incomes may not turn out to be a sustainable equation. And this is the problem to which democratic capitalism would need to find a solution.

What about the problems in the world’s largest democracy? I shall revert in the next article.

A.V.Rajwade