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## ECONOMIC NEWS UPDATE

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### **Democracy And Capitalism Under Threat**

Two very important changes have occurred in America, and indeed in other Western economies. My guess is that they will prove to be permanent phenomena, just as permanent as the changes introduced by Franklin Roosevelt's New Deal.

The first is the decline of faith in democratic institutions as managers of the economy. In Greece, economist Lucas Papademos (Ph.D., Massachusetts Institute of Technology) was selected to manage the economy despite not holding any elected office, while in Italy Mario Monti (graduate study in economics at Yale University), also without facing the voters, was chosen to reform the economy and bring its debt burden into line

with its ability to repay. In neither country could the elected politicians agree on and institute the reforms necessary to reduce borrowing, prompting the powers-that-be in the European Union -- German chancellor Angela Merkel and French president Nicolas Sarkozy -- to refuse to make bailout funds available unless those countries' democratically elected governments gave way to technocrats. This eurocratic impatience with the democratic process had previously been confined to devising ways to avoid putting changes in the EU treaty to a vote, and above all to avoiding any referenda on treaty changes, lest the voters use that opportunity to override the decisions taken by the elites.

Here in America, the stalemate produced by congressional Republicans' unwillingness to raise taxes, congressional Democrats' unwillingness to cut entitlement spending, and President Barack Obama's unwillingness to govern lest he lose time from campaigning for re-election, forced the unelected Federal Reserve Board, which Ron Paul wants to eliminate, led by Ben Bernanke, whom Newt Gingrich wants to fire, to battle alone to prevent a double-dip recession. With fiscal policy more or less off the table until after the November 2012 elections, and perhaps even thereafter, the Fed printed money, kept interest rates down, shored up the mortgage market, tried to coordinate its efforts with other (unelected) central bankers in order to avoid contagion from eurozone problems, and pleaded with politicians to act. No luck, no democratically determined economic policy. As a result, the Fed has become the target for the slings and arrows usually directed at elected officials. Not doing enough, cry economists on the Left who favor QE III, IV ad infinitum; printing too much money and risking inflation, counter those on the Right.

The second profound change that marked the year now coming to an end was a collapse of support for capitalism and free markets, as those have functioned in 2011. For one thing, the centrally managed economy of China seemed to do better than the market economies of the West. I say "seemed" because the data issued by the Chinese regime often leave much to be desired -- we don't know the true extent of un- and under-employment, its real estate bubble, the living conditions of rural Chinese, the condition of the nation's banks, or the extent to which China's success is a result of systematic theft of Western intellectual property. No matter: China is doing better than the U.S., growing at around 7% in a slow period, and somehow managing to keep its banking system from collapsing. The regime can take some satisfaction from hearing the rattling of the eurozone's begging bowl, and the groans coming from America as its IOUs held in Chinese vaults mount. Just as the revival of Italy's economy by Fascist Mussolini, Germany's by Nazi Hitler, and the Soviet Union's by Comrade Stalin were once taken to be the future that

worked, as compared to depressed America which didn't, so Communist China is being trumpeted as the successor to America as the world's future economic superpower.

This retreat from markets is not confined to those who would sacrifice freedom for economic growth. Newt Gingrich, now leading in the race for the Republican nomination to oppose Barack Obama, thought it good conservative politics to attack Mitt Romney for restructuring companies while running Bain Capital, because among the successes (Staples with 1,521 stores in the US, providing more than 70,000 jobs) there were some failures. Not for him economist Allan Meltzer's view, "Capitalism without failure is like religion without sin. It doesn't work."

In both Europe and America there is a strong belief by politicians that regulation and taxation are needed to return power from the market to the political class. Mrs. Merkel has declared, "We must re-establish the primacy of politics over the market", a position that has widespread support in her country and, of course, in France, where free markets and the Anglo-Saxon law of the

jungle are taken as synonyms. And president Obama has staked his future on creating a social democratic state along European lines, with serious constraints on businesses, and taxes on the "millionaires and billionaires" until now treated with respect bordering on reverence by Americans who believed that their turn at riches would soon come.

Three things in addition to infatuation with the success of the Chinese regime explain the flagging support for market capitalism. The first is the cupidity of bankers, bailed out by the tax payers, aware that rising income inequality and falling social mobility are creating a groundswell of objections to market capitalism, but still relatively unrestrained in their bonus claims. The second is the falling or stagnant incomes of the middle class, causing them to question whether the capitalist system that has historically created more wealth for more people still works for them, and will work for their children.

Third is the failure to correct the newly apparent flaws in the capitalist system. Laws designed to reform corporate governance are attacked as failures by the Right, which calls for their

repeal, and as failures by the Left, which calls for their toughening. Tax policies that bestow breaks on various industries are attacked by the Left as favoring the rich, and benefit programmes that provide a modicum of help to the unemployed are attacked by the Right for reducing work incentives. The voices of the few extolling the virtues of market capitalism are lost in the din of complaints and criticism by both Left and Right.

Everyone expects the decline of democratic control and of faith in market capitalism to disappear after the November US elections, or at least with the return of prosperity. That's what some thought would happen to Franklin Roosevelt's New Deal reforms of capitalism when peace and prosperity returned. They were wrong.