

The Crisis of Democratic Capitalism with Martin Wolf

"We can never assume that our comfortable, safe lives in a democratic capitalist society are going to go on forever if we don't do anything for it. The system is wonderful, but it's also fragile."

Martin Wolf

Chief Economics Commentator, *Financial Times*

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Martin Reeves:

I'm Martin Reeves, chairman of the BCG Henderson Institute. Welcome to the Thinkers and Ideas Podcast, where we discuss important new books and ideas in business. Today, I'm joined by somebody who doesn't need any introduction to anyone in business, I'm sure, Martin Wolf.

Martin is the chief economics commentator of the Financial Times. He writes regularly about all of the issues in economics that underpin business, and [is] author of many books on the topic as well as his frequent articles. And he's just produced a very interesting and important new book, I think. Not an easy read. A huge topic, but the topic is the crisis of democratic capitalism, and he's here today to discuss that. So thank you so much for joining me, Martin, and congratulations on the book.

Martin Wolf:

Thank you very much. Yes, I'm in fear it is a bit of a tough read, but it's a tough subject.

Martin Reeves:

Exactly.

Martin Wolf:

And I'm very pleased to be with you.

Martin Reeves:

Thank you. So it is a meaty topic and book, so let's maybe break down some of the ideas a little bit for our listeners first before we probe them. So perhaps we can start off with a definition, this thing that we all probably understand but could struggle to define: democratic capitalism. What do you mean by that exactly?

Martin Wolf:

The democratic bit is what is sometimes called in the literature liberal democracy, by which is meant a democracy which is not pure majoritarianism, but in which there are individual rights, a protected and secure electoral system, and above all, constraining institutions upon the state and the behavior of the people in the political arena, underpinned by the rule of law. So that's liberal democracy. By capitalism, I simply mean a decentralized market economy with private ownership, but one which is, of course again, underpinned by and constrained by the rule of law and also by regulatory and other institutions of the state. And of course, this capitalism that I've described is protean. It has changed in many different ways over the last 200 years since it really emerged.

Martin Reeves:

Now, you described those two components as a delicate marriage, a delicate balance. Say something about the marriage. How do those two things work together?

Martin Wolf:

Well, I've defined them, I think it's the best phrase I've found, as complementary opposites. They're complementary in the sense that, and here I'm going to talk about theory rather than history, in that they're underpinned by a belief in the value of human agency. The individual, a human, if you like, they are underpinned by what we certainly in England would call a liberal idea, the idea of the value of the individual and the right to make choices for him- or herself in the economy through setting up businesses, deciding where they work, what they want to buy, and so forth. But in politics too, by being actively engaged in politics. We have to have collective decision-making. There's no question about that. And to have politicians and the institutions of the state accountable to them as a collection of individuals. And that is what I think is the complementary elements.

And they compete in the sense that there is tension in two different respects. The underlying idea of the market is, of course, individual and group agency, but there's no commitment to equality of

outcomes in the market, and there's no particular commitment to a particular national community. The market naturally is global. It extends across frontiers. While politics is about collective action, and in principle at least in politics, all voters are equal. They all have equal votes, and it's bound up with a citizenship in a territorial jurisdiction. So they are complementary; I think they need each other. They are also potentially opposed to one another, and I think we're seeing that very clearly at the moment.

Martin Reeves:

Now, the central thesis of your book, which I think is a very important idea, is that that institution is in decline and that that is very regrettable, you imply. I think we have a general sense that these things are under challenge, but what evidence would you point to, to say that we're in some sort of secular decline, some sort of important vector of decline?

Martin Wolf:

Well, I think what we are seeing, and this is perhaps the best symptom of it, in core countries—I'm not going to talk now about what's going on in the rest of the world, except to note that if you look out over the host of large and important countries, it's pretty obvious we are moving toward—or many are moving towards more autocratic systems of government. You could see that in Turkey. You could see it in Mexico at the moment. Some would argue that you're seeing it, at least to some extent, in India. Kind of a host of countries where things look more autocratic, some countries in Central and Eastern Europe; and just look at Putin's Russia. Thirty years ago, we hoped it would become a democracy.

But the more important point is that in core Western countries, we are seeing the rise of populist politics. And the important thing about populism is not that it's populist, as it were. That's to some extent understandable, by which I mean anti-elite. But the anti-elitism is a reflection of, I think, a profound disillusionment with the people who have been running our societies in the dominant positions, which comes from a sense that they haven't really been looking after the interests of most people very well. And as a result, they're looking around for new leaders with

new stories. And some of those new leaders and new stories look as though they have rather an autocratic view, as well, of how politics should be run: nationalist, somewhat autocratic, really anti-pluralist, and in some respects, anti-democratic. So that we are seeing, and it's pretty obvious who I'm referring to.

Martin Reeves:

Clearly, you see that as being very regrettable. What do we lose if democratic capitalism slips? You sort of seem to imply that it's the best of all possible systems. What is potentially at stake here for business, for society?

Martin Wolf:

Well, I do think that the democratic capitalism we've had in the West—and by in the West, I include, of course, countries like Japan and Korea and Taiwan—has been since the Second World War a dominant part of the world's system, victorious as it were in the Cold War. I think that's pretty obvious. And what it offered and has offered is a combination of material prosperity with individual liberty and collective political rights, which has, on all the evidence, brought about, not perfectly, but the happiest societies full of, on the evidence, the happiest people. The societies that people around the world want to immigrate to, not the other way around. The societies that many people around the world want to emulate. So these are incredibly successful societies.

And the alternatives that are on offer, the sort of autocracies we are seeing emerging in many countries, which I think threatens some of our countries, tend to be more corrupt, crony capitalists. There's no real rule of law, because the will of the autocrat is supreme. The judges are often appointed by the state and the autocrat in charge. Personal loyalty replaces loyalty to the institutions of the state and the people at large. And these states tend to become poorer economically and unpleasant to live in.

And then, of course, the other alternative, I discuss both, is what I call bureaucratic autocratic capitalism, by which I mean, because it's difficult to define what it is, China or perhaps Vietnam. But China's the main case, where the economy has been successful, though it is, I think, losing

the basis of its success now. But where, in all truth, liberty is very limited, the state is arbitrary, and businesses, they're really dependent on the whims of local officials or national officials, which they can't control and influence. And this is completely different from operating within a laws-governed, rule-governed open economy of the Western type. And I think businessmen and - women who have worked in these different countries will recognize that whatever the difficulties there are, and there are many difficulties, of course, with regulation and all the rest of it, it really is more comfortable to operate in an environment where they are protected by legally enforced civil and political rights.

Martin Reeves:

So I take it you believe that we should do something about this, or do you believe that, as with the challenges of the '30s and the '40s to democratic capitalism, that there'll be some sort of automatic adjustment, automatic healing? Does this require proactive efforts, do you think?

Martin Wolf:

Well, obviously, in the case of the '30s and '40s or even in the Cold War, I would say it didn't happen automatically, to put it mildly. The Second World War was nothing automatic. It was a horrendous and horrific conflict in which more than 50 million people died. So the restoration of liberal democracy and democratic capitalism, whatever you want to call it, in Europe took the sacrifices of immense numbers of people. And I certainly don't want to imagine anything like that, particularly in a nuclear age. That just reminds you, and it's part of what my book says, is that the system is fragile. It can collapse, though, of course, Germany in the interwar years was not a consolidated and stable democracy for obvious reasons, given where it came from.

But the lesson one learns from this is that we can never take the stability for granted. But the crucial thing is to stop erosion before it gets anything like that far. And that's why I'm calling the alarm now, not because I'm saying we are back in the '30s. Of course we're not. But because we are seeing signs in important countries of the erosion of the credibility of independent institutions of the law, independent institutions in the bureaucracy, assault on electoral rights, all of which

are disturbing. And if allowed to continue for long enough—even in countries like the US and UK or France or Italy, you can see these things emerging—we might suddenly find ourselves in a rather different territory, which will be very unpleasant for us all. And I think we can and should try to prevent that.

Martin Reeves:

So I'd like to focus mainly on solutions and the role of business, but just briefly, how did we get here? What are the forces or the causes of this decline that you highlight?

Martin Wolf:

I think they can be distinguished perhaps into three categories. First, which I don't think is by any means the most important, but they're a reality: over the last half century or so to a different extent in different countries, we've gone through profound cultural and social transformations. Now, we'll leave aside the ones that are linked directly with economics, because they're very important. But obviously, ones that I think have been overwhelmingly beneficial, but if you think about the complete transformation of the social role of women, the much more pervasive acceptance of equality among races and ethnicities within our societies as legitimate and appropriate, the acceptance of individual rights to choose their own lives and the way they pursue their lives, these things are, of course, very upsetting and unsettling for wide parts of our society, particularly the people who are not in those groups, who feel their positions have been made more vulnerable or less valuable as a result. So we are seeing culture wars.

Second and far more important in my view...that's controversial, but it's my view: Natural developments in the economy, ones we could not do anything about, really have changed the position of some very important groups in our society and, above all, undermined their historic positions. And the most important, I would say, are for a shorthand I would call the industrial working classes, the people whose rise transformed our politics in a more democratic and more social democratic direction everywhere. That was the great rise of the industrial working class, the development of urbanization, industrialization, the mass factory working class, who became

prosperous, who had powerful trades unions, and all the rest of it. They have been in steep decline as a share of our population, a share of our economy everywhere. And that's because of transformation of our economies, which I won't go into further.

But the effect of that has been very big. It's left a lot of people without university education demoralized, I think, really demoralized. And of course, lots and lots of factories are closed, and excellent jobs that these people had are gone, and they haven't got equally good jobs afterwards. So those are the automatic forces. I could go through many, many others which have also tended to increase inequality.

And then the third area is areas where we have allowed or encouraged the development of an economy which has not only generated a very steep increase, relative increase, in the incomes and wealth of the people at the very top of society but also a massive explosion of two specific sectors: finance and the tech sectors. And they've been profoundly transformative for our societies. And in particular the former of those, the growth of the financial sector, then led to, badly regulated, this colossal financial crisis, after which growth never really was restored. And that, I think, has been a trigger moment. I discuss why, in leading people to think that not only are these elites—social, economic, intellectual, I can't go into them—dominant in our societies, but they are alien and haven't looked after society. But they've looked after themselves.

And that, I think, led to the shift you can see almost everywhere, particularly in conservative parties, from traditional mainstream business, pro-business conservative parties to a radical right-wing, nationalist, protectionist, and even worse sorts of parties. The move from Mitt Romney as the candidate of the Republicans to Donald Trump, you cannot exaggerate how significant that shift has been, just has been the shift from a John Major to Boris Johnson with his Brexit campaign. So these are the things that, I think, together have led us to where we are.

Martin Reeves:

Yeah. And obviously, you could say much more about that. But let's move on to solutions. You lay out a five-point plan that, to me, sounded a little bit like a variant of the New Deal. But lay out the five points of your agenda for correcting this decline.

Martin Wolf:

Whether I can remember them all perfectly is a very good question. But the general idea I have, because I do also discuss politics, I discuss something about identity, the basis of politics. I argue very strongly that if we are to bring ourselves together, we must try to reduce the identity element in politics on both the left and the right and focus on what we have in common, which is welfare, broadly defined, human welfare. So we have had economies that haven't grown very fast. We need to raise the growth rate. We need to improve equality of opportunity. We need people to believe that they have a really good chance of succeeding, they and their children. And in a faster growing economy, that will mean better lives and the restoration of hope for the future, which I think a lot of people have lost. I think we could do much better—and this varies across countries—in helping people who have been affected by adverse shocks.

So I'm in favor of open trade. But the reality, of course, we've always known there are losers from world trade, and the losers have a vote and quite rightly. And in many countries, certainly, I think, including the US and UK, the people and the regions adversely affected by these global trade shocks, the industrial regions in particular, have been basically left to drown. And the people there resent it. So I think we need to be very aggressive about trying to intervene to help them through a more active jobs creation, more active regional assistance. It will be very, very difficult. But I think we can't just sort of stand aside. And that links with other aspects of sort of supporting the welfare state.

And finally, I think there are aspects of fundamental fairness that people have to perceive. The truth is there is a staggering amount of tax avoidance going on. It's perfectly legitimate. It's built in the tax codes, but these tax codes didn't get there by accident. I mean, it's just ridiculous, for example, how large a proportion of profits are parked in tax havens. Everybody knows that the intellectual property on which major companies base their profits isn't located in the Bahamas or the Cayman Islands, and it's ridiculous that they're allowed to put them there. There are huge loopholes in the tax system, which, as Warren Buffett himself famously said, means I pay a lower

tax rate than my secretary. People know this, and they feel very angry about it. It's part of the disillusionment that's going on.

And the other area which is also important is a sense that in certain important areas, we're not getting the competition we want. We're seeing a sort of degree of monopolization. There's lots of evidence of that. It's controversial. And I am very much in sympathy with the current American administration on the idea that we need to restore an active competition policy. We shouldn't allow companies to buy up their competitors freely. We want to go back to a properly competitive market economy. So those are the range of things in economics that I've considered. Just to come back to the equality of opportunity, the effort to ensure that every child in our society has the hope of a really first-rate education, which is not where we are now, is, I think, a crucial element of this.

Martin Reeves:

Well, that was a good summary of the recommendations. Unfortunately, we don't have time to go into the tactics. You do in your book deal with how to get these things done and the specific policies and so on. But I wanted to ask you about the bootstrapping problem here. So let's suppose that these are precisely the right recommendations. Almost by definition, by necessity, they are political propositions. There will be opposition to many of these propositions. So how do you go from divided politics, divided society, to enough cohesiveness to be able to implement and bootstrap some of your recommendations? How do we get from A to B?

Martin Wolf:

Well, that's obviously the best question of all. If I could answer a question like this sensibly, I would be a politician, and I'm not. And I'm embarrassed about it. I'm genuinely embarrassed about it. So the intelligent people who've read my book, including people on the left, have said, "Well, this is basically a lecture by Martin Wolf to people who tend to read Martin Wolf, who are the top 1%." I said, "Well, not quite, but something like that."

So one way of thinking about what I'm trying to do, which may be ridiculous and laughable—I understand that, but then I thought, "I'm old enough to accept that." I'm writing for the sorts of people who might listen to this podcast, which is to say, Okay, you've been doing generally very, very well in our societies. You are the elite, and many of you deserve this by your abilities and work. If the system of democratic capitalism, as I've defined it, collapses, and instead we get xenophobic populist parties or, even worse, autocrats, you, the elites, will be among the losers. You won't like the way regimes like that deal with your businesses and deal with you. It's not much fun being a rich person in Erdogan's Turkey. He can turn on you at any moment. And it's even less fun being, not that I'm comparing it with this, being a rich person in China, as we can see. The great thing about our societies is everybody is protected, including very definitely you. And you're protected because of the general system, not just because of your own powers.

Now, of course, maybe you all think you can go to New Zealand, as it were, but really do you want to sit in New Zealand in a world that looks like that? So you are the elites of our societies. You are the privileged people of our societies. You have more power actually because of your resources in different ways, personal and institutional, than anybody else. You have an enormous role to play in the sort of society you live in. And preserving as best we can the consensus around liberal democracy, the consensus around the rule of law, the consensus around a fair political battle with acceptance of the electoral outcomes properly, that's in your interest. It's a better world to live in. So you should fight for it. And you should say that certain things like Trump's attempt to overturn the last election are absolutely unacceptable, because they threaten not just ordinary people, not just Democrats, as it were, but you, you too. You're part of this, and you need to act. Ultimately, the fate of democracy is in the hands of all the people, and it definitely includes the sort of people who might listen to this podcast.

Martin Reeves:

That's a very good answer. So you're saying, basically, it's an intellectual and a rational and a human appeal to the elites that may have more than average power to implement some of these ideas?

Martin Wolf:

Just doing your best for yourself is not necessarily good enough. You too are citizens. And I end my book with an appeal to the idea, which I think is a fantastically powerful idea which goes all the way back to ancient Athens, of citizenship.

Martin Reeves:

Yes, indeed. In the remaining minutes, let's bring this down to our audience. I know you're primarily in your book addressing issues of macro-economy and politics, but corporations. How are corporations part of the problem and potentially part of the solution?

Martin Wolf:

I think corporations are in a very difficult situation in a world of this kind because, for example, it's perfectly proper and appropriate and even a good thing for a corporation to decide that the best opportunities we have now is to move our production from our factory somewhere in the United Kingdom to somewhere in Vietnam, say. We will employ more people. We'll make people more prosperous there. And this is in line, in a sense, with comparative advantage, just what we should do. And I don't object to that. I don't object to that.

But the things I think they should be thinking about very, very carefully is their role in politics. Like it or not, corporations and very wealthy people, but corporations are hugely powerful political actors. They contribute massively to political campaigns. That's particularly true in the US. They shape legislation. They shape tax legislation, competition legislation, a whole range of things which affect the working of the system. And I think they should be asking themselves, "Is what we are doing in the public sphere legitimate?"

So let me get to the point that the core point is. Well, remember, Milton Friedman famously said that the job of business is to maximize profits, but he said it within the rules of the game. Well, the question is, who sets the rules of the game? My view is the rules of the game must be set by society as a whole. The problem is that in many of our societies, business itself is an enormously powerful setter of the rules of the game for business. Now, that's really problematic. So I think

business should be asking, “So what is our legitimate political role? Should we be pushing for this tax favor or that regulatory favor? Is that actually in the national interest? Because ultimately, the national interest, as I’ve tried to explain, is also our interest, because we’re not floating in free space. We’re part of countries, and countries matter to us because countries are what give us the rule of law and the stability on which ultimately we depend.” So that’s what I would like them to ask themselves, and I think it follows naturally from Milton Friedman’s own principles.

Martin Reeves:

So, just wrapping up with a couple of personal questions, if I may, Martin. Your background, in a sense, reflects some of the things that we’re talking about today. You’re the son of two Jewish immigrants who escaped from Nazi Europe in the run-up to the Second World War. Has your family history informed your worldview on these matters at all, do you think?

Martin Wolf:

Yes, it has in multiple ways. First of all, it has shaped my view on the importance of running economies so that they are stable and provide a decent life to the majority of the population. And the failure to do so in the interwar years was, in my view, what brought about the catastrophe more than anything else, and I discuss that in the book. So that’s why I reacted so vigorously in response to the financial crisis and the importance of not letting it become another Great Depression, and I think it was very important and successful that we didn’t. But more broadly, what this brings out, and it’s rooted in my interest in economics throughout my life, is that giving people a good life, hope for the future, is a core function of economic policy. And that underpins not only economic life. It underpins social stability. It underpins political stability.

That was the great understanding, and we can’t go back to the ’50s and ’60s. That economy is gone. But the great understanding of the politicians who came out of the war and the prewar years was we had to run our economies and societies in a way that gave the great majority of people, practically everybody, hope for the future and security and reasonable prosperity. And that is what I learned from the great failures of the ’20s and ’30s and the great successes in the postwar period.

We haven't been doing so well recently. That's obvious. Just look at the statistics I have. So we've got to try and restore that. And if we don't, we can't be surprised if people come along and vote for charlatans, and that's the truth, who put forward completely ridiculous ideas about how we're going to get better off, like Brexit. That's my view. Controversial, but never mind. And again, as I said, that affects us all. So that's the background, which makes me feel this is really important, and we can never assume that our comfortable, safe lives in a democratic capitalist society are going to go on forever if we don't do anything about it. The system is wonderful, but it's also fragile.

Martin Reeves:

Well, thanks so much for spending time with me today, Martin, and congratulations on this very important book. Not a quick read, but a very rewarding and important read, I think.

Martin Wolf:

Thank you very, very much.

Martin Reeves:

I've been discussing the crisis of democratic capitalism with Martin Wolf, the author of the new book with that title, which came out February 2023 from Penguin Press. A very comprehensive read that requires some concentration, but I find it very rewarding. A topic I was superficially familiar with, I think I now understand a lot more deeply. And I think I'd strongly recommend it to any thinking person in business that wants to understand the broader social, political, historical, and economic context upon which the well-being of their business stands. And I personally enjoyed it very much. If you like this conversation, make sure you subscribe on your favorite podcasting platform. And as always, we welcome your feedback.

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