



Why is illiberalism on the rise?

Daniel Dăianu considers the limits to markets, liberalism and democracy, and finds that the political elites need to change their thinking for liberalism to continue to be a force for good

The distinction made between 'liberal' and 'illiberal' democracy is both conceptually and operationally meaningful, but can still sow seeds of confusion. This is because democracy has liberalism in its genes; liberalism in a deep sense embodies spiritual and civic commitment to a host of *de facto* and *de jure* values.

These values and the related political regime mean, basically, power in the hands of citizens (the people) and decision-making made via institutionalised checks and balances – what John Kenneth Galbraith and others referred to as *countervailing power*, which prevents absolute power from being ceaselessly accumulated.

Democracy implies an effective separation of powers; it also implies respect towards fellow citizens, tolerance, and ethical conduct in social and political life. Within this interpretation of democracy, liberalism is a fundamental, organic foundation of democratic parties' *Weltanschauung*; this foundation is present from the right to the left of the democratic spectrum, in the philosophy and conduct of political parties. In democratic Europe, for instance, Christian democracy and social democracy belong to an enlarged political 'family' that relies on *deep liberalism* at its core.

The extent to which liberalism in Europe overlaps with what one meets in the US, is subject to debate. For there are significant differences in terms of the relationship between the public and the private spheres, the size and content of state intervention in the economy, regulatory systems, etc. Admittedly, conservative political philosophy contains a liberal component when it assimilates the rules of political competition and a democratic political regime.

But there is evidence of mounting illiberal temptations in the industrialized world, in democratic societies. Are these temptations linked with temporary phenomena, in the 'extraordinary times' we are living through, or do they have deeper roots? An answer to this question begs an examination of trends in society and economy, of the emergence of new (unconventional) threats, and, not least, of failed public policies.

The argument that 'liberal democracy' is on the wane is wrong to the extent that policies can be corrected, that citizens and elites alike do not lose trust in democratic values. It may also be true that, although democracy has a 'liberal core', it can also be driven by 'illiberal' components, and that the magnitude of the latter can vary. But for democracy to survive, its liberal core must be preserved.

For world peace it is vital that the democratic order not be dismantled; it is vital to prevent major conflicts, trade wars, and the destruction of the multilateral system that was created in the aftermath of World War II

Democracy and economy

Liberalism and democracy have an economic foundation that inevitably leads to the issue of property rights. Freedom cannot exist without a free economy, without people (economic agents) having the freedom to make choices about consumption and production.

A system of property rights lies behind decisions which mirror individual and organisational preferences (at enterprise level) in the allocation of resources, in production. Clearly defined property rights, transparency and the institutional/legal capacity for enforcing them are called for in free economies. But civilized capitalism demands a public sector as well, for the provision of public goods that enable people to live as dignified citizens.

Totalitarian 'experiences' teach us about the relationship between society and property rights. The command (communist) system excludes economic freedom in resource allocation and production; this system operates according to the logic of a single enterprise, as a fully centralised, command system¹. National-socialism/fascism demonstrates that private property can underlie a totalitarian regime, provided private property rights do not 'work' for the separation of powers or discourage/prevent an abusive concentration of power, but are instead subservient to abusive power².

Modern capitalism implies cohabitation between the public sector and the private sector, ideological/political choices, and management of what economists refer to as 'externalities' and market myopia³; these mould the proportion between the two spheres.

The public sector, via its own policies and productive and financial assets, is asked to provide public goods that are essential for society; and it is asked to implement policies that enhance the very functioning of the private sector, to preserve the 'social cement' in society, and to mitigate economic disparities (inequalities among people).

Income distribution plays a paramount part in the metabolism of capitalism and requires an effective answer as far as public policies are concerned – in the sense that markets should not be left to decide everything, whatever the consequences may be⁴. The impact of new technologies and automation (not least in creating the possibility for massive structural unemployment) should be considered in formulating public policies.

Democracy relies on a 'culture of freedom', which, as history shows, cannot take root within a short time span, nor 'imported', or imitated, as one chooses; roots are important. The United Kingdom is the most relevant example of the limits put on absolute power, a process that started more than eight hundred years ago⁵ and which evolved over centuries toward an advanced democracy.

After gaining independence, the United States set off with a constitution that mirrors the way in which the Founding Fathers understood the importance of the separation of powers⁶, even though equal civil rights for women and African-Americans were only granted much later. These examples are not meant to suggest that people living elsewhere should take a similarly lengthy approach in obtaining democracy.

Yet, it is a fact that time cannot be compressed at will in terms of institution-building; the 'Arab Spring' is a telling case in this respect. Democracy advanced at different speeds on the old continent, with institutional frailty being visible especially in central and eastern European countries. Illiberal propensities in the countries that shrugged off communism after 1989 can also be associated with their pre-communist and communist track record in terms of economic development and political regimes.

Markets, liberalism, and democracy – where limits show up

Free markets⁷ are the driving force behind entrepreneurship and a vibrant economy. The thinking of Adam Smith, John Stuart Mill and, later, the 'Austrian School' were validated by history in this regard.

Development is inextricably linked with free markets, and the progress of less advanced economies provides many lessons in this respect. The collapse of communism was brought about, primarily, by innate flaws in the command system, as Ludwig von Mises and Friedrich August von Hayek had, among others, had anticipated⁸.

Over the past few decades, China's economic miracle is perhaps the most convincing proof of the extraordinary energy that economic freedom provides in unleashing entrepreneurship, in pushing an economy ahead with the government (state) still the key player in steering the economy and allocating resources, and in building competitive advantage (via industrial policies).

The 'return to Europe' of former communist countries in central and eastern Europe involved radical institutional transformation and entailed economic progress – some less spectacular aspects of the transition notwithstanding. That there is a resurrection of national economic interests in this region of the European Union is an evolution that deserves an analysis on its own; part of it is linked to fear of the 'middle income trap'.

But markets do not bring the best results automatically. Market failures require government intervention. This has brought about, over time, the development of public sectors, the setting up of public and private institutions that insure against risks (pension systems, health-care systems, etc), and mechanisms for the regulation and supervision of financial markets, including antitrust law (against collusion/oligopolistic agreements, rent-seeking). Bismarck's Prussia saw the first ever social insurance arrangement within a capitalist system.

The very functioning of the democratic state has required public policies meant to ensure basic public goods, among which defence and security, education and health (areas that should not be left in the care of the private sector alone), a judicial system based on the rule of law ('no one is above the law'), etc. History shows that where

social cohesion is badly damaged, negative consequences arise and 'social capital' and 'social cement' get diluted, whereby cracks emerge in the democratic process that may give rise to social and political conflict.

Whenever inequality crosses the frontier of what people/citizens perceive as tolerable, when the sense of 'social justice' and fairness is blatantly disregarded, it is democracy that bears the brunt. The remedy can be found in the formulation and implementation of corrective public policies; failing to do so makes matters worse.

Social fragmentation and growing perceptions of individual and collective insecurity can augment political demands for protection via government intervention. The backlash against globalization, a spreading propensity to turn inwards and the rise of protectionism⁹ are associated with the fallout from a simplistic vision of globalisation, one which disregards (and underestimates) the number of losers from global competition.

The higher the number of losers (whose ranks have been growing in advanced economies over the last couple of decades), the more vigorous is the political demand for protection, and the stronger is populism in terms of rhetoric and political action. In other words, globalization, as an embodiment of liberalization/economic openness, unless it is wisely and pragmatically managed, leads to fierce counter-reactions.

It is often said that people do not grasp the benefits of globalization. The problem with this assertion is that while benefits may frequently prevail over costs at the aggregate level, at local/community level costs may be massive, and social dislocations hard to bear¹⁰.

And where communities are rife with losers, their interests can easily be articulated in a quest for protection. Brexit, and the last presidential election in the US (the impact of fake news and media manipulation notwithstanding), epitomize an undeniable reality, one which can be seen in other EU member states as well.

It is no wonder that international institutions, like the World Bank, the International Monetary Fund, the OECD, the EBRD, etc. pay increasing attention to the effects of globalization, and a thinning of the social fabric and social fragmentation that can end in full-blown political disarray. Major central banks (the Federal Reserve, the Bank of England, the ECB, etc.) devote increasing attention to income distribution, a research topic one could hardly have imagined them focusing on not so long ago.

Things get more complicated in countries where political leaders justify public policies that entail high social costs by repeating constantly that 'there is no other way', or 'that this is what international markets demand'. This type of argument is likely, in the end, to damage the institutional and political legitimacy of policymakers; and it can fuel social and economic pressure (on the part of local business groups) in favour of protectionism.

A reinterpretation of globalisation is, therefore, needed; one that takes into account the relationship between the wide diversity of citizens' social and economic circumstances. In other words, a narrowly-understood economic liberalism, ie. market fundamentalism, can pave the way for the erosion of the social foundation of democracy, ie. the erosion of the middle class. Under such conditions, political extremism and exacerbated populism emerge. Market fundamentalism works against liberalism, against democracy, in its deepest meaning¹¹.

Just as one can talk about 'illiberal democracy', one can identify 'undemocratic liberalism'(Yascha Mounk)¹². This happens when people feel that they no longer have a grip on their lives, when they lose trust in their leaders, and when they ascribe decisions to the power of money (ie. government capture by interest groups which are seen as illegitimate).

More on what fuels illiberal propensities nowadays

Economic insecurity and its 'illiberal' fallouts can be related to a dramatic change in the balance of power in the

global economy, especially towards the new economic powerhouses (China in particular, but also India, etc). Robert Kaplan alludes to this with a metaphor: 'The Return of the Marco Polo World'¹³.

Trade disputes can mushroom in such an environment. Social fragmentation and anxiety, which mirror economic insecurity, can be fostered by new technologies (eg. 'big data', the power of some companies – the Facebook scandal is a harbinger in this regard) and strengthen the case for government intervention, not only via regulatory steps.

New technologies can even enhance the resort to illiberal methods in societal management. Fear of the unknown (of all sorts), of insecurity in general, has to be factored in. People need to feel comfortable in a habitat where they have lived for a long time, and this sentiment cannot be divorced from habits and customs, from a sense of belonging to communities that share identities¹⁴. But things can turn highly complex (even ugly) when authoritarianism is associated with identity, ethnic, religious aspects. Here, the democratic process may easily go astray.

There is also a disconnect between economic developments and social and political dynamics, which are defined by fury at, and protests against, the elites, especially the political establishment¹⁵. The role of fake news, disputing the 'truth' (scientific and of any other sort) need to be mentioned in this context. Likewise, the rejection of 'experts', who are blamed for failed public policies (eg, the light-touch regulation paradigm when it comes to financial markets) should not be overlooked.

When people are looking for responses to overall insecurity, a sort of demonstration effect in both economic and politic regimes can be at work. There are still world political/institutional structures which feature a single ruling party.

These are not necessarily closed systems. China has opened up its economy for almost four decades by introducing market-based reforms; the latter have proved remarkably successful in modernising the country, even though the political system has remained that of a single party. There is also a sort of a fascination with the 'economic model' of Singapore, although it is a very small (city) state. And hands-on economic policies practised in emerging Asian countries have explanatory power as well.

In addition, in times of economic and security strain, or when facing major ecological challenges, the appeal of an authoritarian setup may tempt some people. But it is one thing to use authoritarian means within a democratic (liberal) framework, and another to alter the democratic nature of a system (society), to give up its liberal core; there is a red line which should not be crossed.

Even in China, political pluralism should not be ruled out completely, although authoritarian traces will probably remain for a long time; such evolution will become more likely once citizens vie for more voice (to use Alfred Hirschman's concept) in the running of their country.

The European Union and the question of legitimacy and democratic accountability

The European project aimed to reconstruct economies after World War II and put aside the great rivalries between European powers – principally Germany, on the one hand, and France and the UK, on the other.

It was a success story, despite the bumpy road towards building a new Europe – from six founding states in 1957 to 28 member states by 2013 (but before Brexit).

But the EU is a vast, very intricate institutional construction. The union's economic gains hid for quite a while the incompleteness of its design (to take just one example, the lack of a significant budget, as stipulated by the 1977

MacDougall Report, of 2-2.5 percent of GDP at the beginning and 5-7 percent of GDP upon the establishment of monetary union).

The financial crisis that broke out in 2008 underscored the shortcomings of its decision-making procedures and a stark fact: European institutions suffer from a 'democratic deficit', as many pundits and officials have put it. Financial assistance programmes for beleaguered eurozone countries (grappling with liquidity and solvency crises) have been implemented via *sui generis* methods and mechanisms.

The latter, albeit largely understandable due to the enormous pressure of events and the need to manage acute crises, have fuelled popular discontent and increased the amount of distrust in the functioning of national and European institutions.

The current EU commissioner for economic affairs, Pierre Moscovici, and other high-ranking European officials (including Germany's former finance minister Wolfgang Schäuble) were quite candid in noting that the decision-making framework in the euro area needs to be reformed as part of the push to streamline public institutions and policies, in order to give them more legitimacy.

In light of the need to reform eurozone institutions and policies a key question arises: can financial integration overcome economic fragmentation without fiscal arrangements, ie. risk-sharing schemes? Fiscal integration implies more than institutional cooperation; it requires institutional integration and a eurozone budget, which leads implacably to the fundamental political question of the eurozone – integration.

But political integration in the euro area is a fantasy under the present circumstances. Besides, there is a fundamental contradiction in European integration, which is epitomized by Dani Rodrik's trilemma: integration

(globalisation via the 'single market') can hardly cohabit with autonomous economic policy and with democratic accountability¹⁶ at the national level¹⁷; something must give in in this triumvirate.

This trilemma may simplify reality, and trade-offs and compromises may be worked out. However, it poses a formidable challenge to the eurozone unless integration is backed by policies and mechanisms that can iron out excessive heterogeneity and competitiveness gaps between member states – policies and tools which would prevent growing tensions that erode the social fabric and give rise to extremist reactions, populism, euroscepticism, etc.

Again, the incompleteness of the eurozone is to be singled out, for this is not a genuine monetary union, as it lacks proper fiscal arrangements (as one finds in the US, in Germany as a federal state, etc).

Why is the fiscal challenge critical to the eurozone? Deeper integration (a single budget, among others) would bring, as mentioned above, the political issue to the fore. Wealthier/creditor countries fear a 'transfer union' (fiscal transfers), however much sense the latter makes in a monetary union that would not be merely a single currency area. Yet, beyond narrowly-defined economic interests¹⁸, there are constitutional impediments posed by fiscal arrangements that involve fiscal transfers.

Here lies the greatest difficulty in reforming the eurozone. To believe that the Banking Union (when it is completed with the setting up of a single deposit insurance scheme and a more solid common resolution fund) can make up for fiscal arrangements is, arguably, an unrealistic approach. For the eurozone to be viable, both public and private risk-sharing schemes are needed.

Disquieting prospects

Liberalism at its most fundamental identifies itself with democracy. Yet, when globalism, as a vision, leads to unrestrained liberalization by disregarding market failures and losing sight of those who lose in economic competition, democracy is jeopardised. This happens because the social fabric is worn thin, the middle class (its social basis) withers, confidence in the ruling elites fades away, and, ultimately, a crisis of democratic governance is brought about. Simultaneously, authoritarian propensities and endeavours crop up¹⁹.

It may also be the case that we are going through the downward phase of a long-term economic cycle (Kondratiev, Schumpeter²⁰); this phase can explain the 'inward looking syndrome' one sees in several industrialized societies, and the Great Recession (the global financial crisis) admittedly belongs to the downward phase of a secular cycle. The new industrial (technological) revolution and the emergence of new global economic powerhouses play an important part in these dynamics.

For world peace it is vital that the democratic order not be dismantled; it is vital to prevent major conflicts, trade wars, and the destruction of the multilateral system that was created in the aftermath of World War II (starting with the Bretton Woods system). This does not mean that major stakeholders in the global order cannot proceed to reform the multilateral order and inter-country relationships.

In the European Union (and the eurozone) reforms are needed to increase the legitimacy of – ie. the democratic nature of – its institutions. In order to avoid worst-case scenarios, pragmatic public policies need to reconcile the requirements of a free economy with what political and social inclusion mean in a democracy. The liberal order of the world, as established after the victory over Nazi Germany and its allies, is being severely tested and its current prospects are worrisome²¹.

But the liberal idea still has the upper hand in the industrialized world and many people stand behind it. However, if its power to shape people's minds and conduct is to continue, an enlightened version of liberalism needs to be practised and political elites need to show more respect for their fellow citizens.

To the dismay of many, this fragility of democracy (ie. of liberal values) is now all too apparent. This is all the more reason to learn the lessons of ancient and recent history, to be candid and honest about mistaken policies, and to be bold in trying to amend them. Democracy, with its liberal genes, is the best political regime mankind has come up with.

Remembering Winston Churchill's words is as timely as ever. ■

Daniel Dăianu is Professor of Economics at the National School of Political and Administrative Studies, Bucharest, a Member of the Board of the National Bank of Romania, a former Finance Minister of Romania, former MEP and a CASE fellow

Endnotes

- 1. As can be read in the Communist Manifesto (Karl Marx, Friedrich Engels, 1848), The State and Revolution (VI Lenin, 1917).*
- 2. Hitler's seizure of power was backed by business circles eyeing expansion at home and abroad. Those business circles presumably feared the growing power of the socialist movement in Germany, not least because of the Great Depression.*
- 3. For instance, internalising the effects of climate change, it manages the relationship between the present and the future generations (which is a weakness of the general equilibrium models).*

4. *As libertarians would say. There is an almost inherent dynamic of asset concentration, which can negatively affect the system's homeostasis and, ultimately, the democratic nature of a regime. Middle class erosion is to be viewed in this context. Thomas Piketty's and Emmanuel Saez's works are to be interpreted from this perspective.*
5. *See Magna Carta Libertatum (1215), which sought to confine the monarch's power.*
6. *Bearing in mind, of course, the absolute power of royal/princely regimes in Europe.*
7. *Markets exist even in command (communist) systems, yet they operate underground in the main. Ironically, they help the system work by 'greasing the wheels' of the machinery.*
8. *Their dispute with Enrico Barone, Oskar Lange, Abba Lerner, Fred. M Taylor and others on The Economic Calculation is famous. It is noteworthy that Joseph Schumpeter proved ambivalent in judging the systems' dynamics (see his 'Capitalism, Socialism and Democracy', New York, Harper and Brothers, 1942). This work introduces the term 'creative destruction'. But Schumpeter's death in 1950 prevented him from getting more knowledge on the Stalinist command systems at work, and he meant he did not witness the decay and collapse of communism.*
9. *See Daniel Dăianu "[The New Protectionism](#)", World Commerce Review, Spring, 2017.*
10. *See also David Autor, Trade and labor markets: Lessons from China's rise (MIT, February 2016).*
11. *See also Daniel Dăianu '[Markets and society: When high finance corrodes economy and undermines democracy](#)', Eurozine, 21 July 2011; and Emerging Europe and the Great Recession (Cambridge Scholars Publishing, 2018).*
12. *Yascha Mounk, The People vs. Democracy (Harvard University Press, 2018). See also Dani Rodrik, 'The Double Threat to Liberal Democracy', Project Syndicate, 13 February 2018.*
13. *Robert Kaplan, The Return of the Marco Polo World (Random House, 2018). See also Kishore Mahbubani, Has the West Lost It? (Allen Lane, 2018).*
14. *See Jochen Bittner's recent text in Die Zeit, which addresses how the need for Heimat, leading to the notion of 'patriotism' Heimat as a concept, can stir controversy because of its Nazi-era echoes.*
15. *Ruchir Sharma, 'Prosperity is no lock on popularity', New York Times, 27 April 2018.*
16. *The status of being accountable to the voters who gave a mandate to top public servants.*

17. Dani Rodrik, 'The Inescapable trilemma of the global economy', 27 June 2007 (personal blog). See also his essay 'The Double Threat to Liberal Democracy', Project Syndicate, 18 February 2018.

18. The euro functioned as an undervalued Deutschmark and guilder, fuelling exports; the euro operated also as an overvalued lira, escudo and peseta. This fostered the emergence of large imbalances between north and south in the eurozone.

19. See also 'The End of the Democratic Century' by Yascha Mounk and Roberto Stefan Foa, Foreign Affairs, May-June 2018. This issue contains a set of texts listed under the generics 'Is Democracy Dying?'

20. Nikolai Kondratiev, a renowned Russian statistician who passed away in a Soviet gulag. He identified successive secular (very long-term) cycles (40-60 years) driven primarily by technological developments; these cycles would mirror social tensions and culminate in major conflicts. Joseph Schumpeter also thought in terms of long-term cycles in his 'Theory of Economic Development' (1911), where he emphasises 'revolutionary' technology clusters that change society's technological basis.

21. See also Richard Haass, 'Liberal World Order, R.I.P.', Project Syndicate, 21 March 2018. Haass blames the attitude of the Trump administration towards the order established after World War II, and its global impact.

This text was published by Eurozine as "Is democracy doomed to lose its liberal core?" on August 3rd. A version of this text was published in Romanian in Hotnews.ro and Contributors.ro on 14 May 2018. The author bears sole responsibility for the views expressed in this article.