

Can Democracies Tackle Illiberal and “Inward-Looking” Drives?

Daniel Dăianu¹

Abstract²: *There is evidence of mounting illiberal inclinations in the industrialized world, in democratic societies; an “inward-looking” syndrome (rising nationalism) is also taking place. Are they to be linked with temporary drivers 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, of disruptions and, not least, of failed public policies. The argument that ‘liberal democracy’ is on the wane is misleading 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.*

Keywords: *liberal democracy, illiberalism, “inward-looking syndrome”, nationalism, de-globalisation, multilateralism, protectionism, integration, fragmentation, inclusion, inequality, fairness, Eurozone, risk-sharing*

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

¹ Daniel Dăianu is Member of the Romanian Academy, Professor at the National University of Political Studies and Public Administration (SNSPA) and President of the Institute for the Study of Extreme Events (ISEE), Member of the Board of the National Bank of Romania, former MEP and former Minister of Finance of Romania.
E-mail: daniel.daianu@bnro.ro; ddaianu@hotmail.com.

² This text is a revised and expanded version of the essay that was published (in Romanian) by *Contributors*, 5 May 2018. *Eurozine* published it as “Is Democracy threatened to lose its liberal core?”, August 3rd, 2018; it was also published by *Western Commerce Review* in August 2018.

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. Liberalism in a deep sense is also mindful of the social embeddedness of markets; society is seen not as an agglomeration of individuals who are devoid of joint goals and social purposes.

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; an inward-looking syndrome (rising nationalism) is also taking place. 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, of disruptions and, not least, of failed public policies. The argument that 'liberal democracy' is on the wane is misleading 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.

1. Democracy and economy

Liberalism and democracy have an economic foundation. Freedom cannot exist in the absence of a free economy, without people (as economic actors) having the freedom to make choices about consumption and production, and, ultimately, to make political choices. 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 decent capitalism demands a public sector and policies 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 system.³ National-socialism/fascism demonstrates that private property can underlie a totalitarian regime when property rights do not 'work' for the separation of powers or discourage/prevent an abusive concentration of power, but are instead subservient to abusive and evil power.⁴

Modern capitalism implies cohabitation between public sector and private

³ As can be read in the Communist Manifesto (Karl Marx, Friedrich Engels, 1848), *The State and Revolution* (V. I. Lenin, 1917).

⁴ 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.

sector, ideological/political choices, and management of what economists refer to as ‘externalities’ and market myopia;⁵ 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 be.⁶ 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 ago⁷ and which evolved over centuries towards 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 powers,⁸ 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 be associated with their pre-communist and communist track record in terms of economic development and political regimes. But other causes, which are to be found in western European countries as well, are also at work. For how else one can explain the radicalization of politics in western countries.

2. Markets, liberalism, and democracy – where limits show up

Economic freedom⁹ is the driving force behind entrepreneurship and a vibrant economy. The thinking of Adam Smith, John Stuart Mill and, later, the ‘Austrian School’ is quite relevant in this regard. Development is inextricably linked with markets and entrepreneurship, 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 von Hayek had,

5 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).

6 As libertarians, who oppose any interference with markets, would say. There is in capitalism an almost inherent dynamic of asset concentration, which can negatively affect its homeostasis and, ultimately, the democratic nature of a regime. Middle class erosion is to be viewed in this context. Thomas Piketty’s, Emmanuel Saez’s and Gabriel Zucman’s works are to be interpreted from this perspective.

7 See *Magna Carta Libertatum* (1215), which sought to confine the monarch’s power.

8 Bearing in mind, of course, the absolute power of royal/princely regimes in Europe.

9 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.

among others, anticipated.¹⁰ Over the past few decades, China's economic miracle has been probably 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 advantages (via industrial policies)¹¹. 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' and asymmetries in the functioning of the Single Market.

But markets do not bring optimal 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 (de-globalisation), a spreading propensity to turn inwards and the rise of protectionism¹², are associated with the fallout from a simplistic (neoliberal) vision of globalisation, one which disregards (and underestimates) market failures and 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

10 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 did not witness the decay and collapse of communism.

11 For an illuminating analytical explanation of China's economic rise see Justin Yifu Lin's "The Quest for Prosperity. How Developing Economies Can Take Off", Princeton, Princeton University Press, 2012.

12 Daniel Dăianu, "The New Protectionism", *World Commerce Review*, Spring 2017 (see the Appendix).

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 prevail over costs at the aggregate level, at local/community level costs may be massive and social dislocations hard to bear.¹³ 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, older 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 negative effects of globalization, and to a thinning of the social fabric and social fragmentation that can end in full-blown political disarray; there is even talk of the need to redesign the social contract in view of increasing distributional tensions and a spreading sentiment of unfairness in society¹⁴. 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, of global markets is, therefore, needed; one that takes into account the wide diversity of citizens’ social and economic circumstances. In other words, a narrowly-understood economic liberalism, i.e. market fundamentalism, can pave the way for the erosion of the social foundation of democracy, i.e. the erosion of the middle class. Under such conditions, political extremism and exacerbated populism emerge. Market fundamentalism works against liberalism, against democracy, in its deep meaning.¹⁵

Just as one can talk about ‘illiberal democracy’, one can identify ‘undemocratic liberalism’ (Yascha Mounk).¹⁶ 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 (i.e. government capture by interest groups which are seen as illegitimate). Elites and governments need to overhaul national and international

13 David Autor, “Trade and labour markets: Lessons from China’s rise” (MIT, February 2016). See also his “Work of the past, work of the future”, *VoxEu*, 19 March, 2019

14 Maurizio Bussolo, Maria Davalos, Vito Peregine, and Ramya Sundaram, “Toward A New Social Contract”, Washington DC, The World Bank Group, 2018

15 See also Daniel Dăianu ‘Markets and society: When high finance corrodes economy and undermines democracy’, *Eurozine*, 21 July 2011 (<https://www.eurozine.com/markets-and-society/>); and “Emerging Europe and the Great Recession” (Cambridge Scholars Publishing, 2018).

16 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.

policies so that they be able to “manage capitalism”¹⁷ for the benefit of society at large.

3. More on what fuels illiberal propensities nowadays

Economic insecurity and its ‘illiberal’ fallout can be related to a dramatic shift in the balance of power in the global economy, especially towards 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’.¹⁸ Trade disputes can mushroom in such an environment, not least due to geopolitical and security reasons (just think about the implications of artificial intelligence, or the use of G5 technology).

Social fragmentation and anxiety, which mirror economic insecurity, can be fostered by new technologies (e.g. ‘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 identities. But things can turn highly complex (even ugly) when identity, ethnic, religious aspects fuel illiberal impulses and hate. Here, the democratic process may easily go astray.

Social media can fuel radicalization, anger, hate, intolerance. Radical groups, “supremacists” of all sorts can use new technologies to spread their thinking; this poses a dilemma to public authorities: how to discourage, even prohibit such manifestations while observing the rules of free speech, of democracy. But when radical groups clash with the values that underpin democracy, when their actions do a lot of harm, they need to be forestalled, punished.

An increasingly controversial policy issue is immigration. The fact is that however much one is attentive to humanitarian concerns, massive flows of people can tense social and political relations in local communities, in recipient countries. A free flow of labour internationally is much more complicated and politically sensitive than the flow of capital or of goods. Capital comes in and goes out; people do not operate following the same logic. This is why, properly calibrated immigration policies are needed together with development policies in poor countries, or in countries ravaged by military conflicts.

There is also a disconnection between economic developments and social and political dynamics, which are defined by fury at, and protests against the elites, especially the political establishment.¹⁹ The role of fake news, disputing the ‘truth’ (scientific and of any other sort) need to be mentioned in this context. Likewise, the

¹⁷ Jack Snyder notes that over the past 30 years’ liberalism has become “disembedded”; that “elites in the US and Europe have steadily dismantled political controls that once allowed national governments to manage capitalism. They have constrained democratic politics to fit the logic of international markets and shifted policymaking to unaccountable bureaucracies...” (“The Broken Bargain. How Nationalism Came Back”, *Foreign Affairs*, March-April 2019, p.54)

¹⁸ Robert Kaplan, “*The Return of the Marco Polo World*” (Random House, 2018). See also Kishore Mahbubani, “*Has the West Lost It?*” (Allen Lane, 2018).

¹⁹ Ruchir Sharma, ‘Prosperity is no lock on popularity’, *New York Times*, 27 April 2018.

rejection of ‘experts’, who are blamed for failed public policies (e.g., 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 world political/institutional structures which feature a single ruling party. These are not by definition closed systems. China has opened up its economy for almost four decades by introducing market-based reforms; these reforms have proved remarkably successful in modernising the country, even though the political system has remained that of a single party. Some go so far to argue that there must be something quite singular about the Chinese model – what former Polish finance minister Grzegorz Kolodko calls “Chinism”²⁰. While this seems a pretty odd view, it can be related to what Gideon Rachman describes as a “civilisation state”²¹. There is also a sort of a fascination with the ‘economic model’ of Singapore, although this is a very small (city) state. And hands-on economic policies practised in not a few emerging Asian economies have explanatory power too, for it is hard to refute them analytically in view of their achievements. In addition, in times of economic and security strain, of major disruptions, or when facing major ecological challenges, the appeal of a less deliberative decision-making setups may be quite luring.

But it is one thing to use authoritarian, less deliberative processes 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, albeit one could argue about its outline and fine print. Even in China, inroads of political pluralism should not be ruled out over the longer run, although authoritarian characteristics will probably remain there for a long time in view of the complexity of its society; pluralism will be more likely once citizens vie and get more voice (to use Alfred Hirschman’s concept²²) in the running of their country.

To be fair with the latter remark, “voice” and legitimacy/accountability are getting at the forefront of public debates in western (advanced) societies as well. Why is it so? For many people feel that they have no longer a say in the running of their societies, or that they have been forgotten, that “elites” do not pay attention to their interests. In this regard, the rejection of mainstream parties can be interpreted through several lenses: the impact of the Great Recession and myopic public policies that have deepened social cleavages; a kind of institutional sclerosis (in the spirit of Douglas North and Mancur Olson Jr.’s writings²³), which can occur in advanced capitalism as well²⁴; a new industrial revolution, aging, and a shift of power toward Asia – all of which seem to confound elites and governments in western societies alike.

20 Grzegorz Kolodko, “Capitalism, Socialism or Chinism?”, *EconoMonitor*, 18 January, 2018

21 Gideon Rachman notes that “A civilization state is a country that claims to represent not just a historic territory or a particular language or ethnic group, but a distinctive civilisation...it is an idea that is gaining ground...The notion of the civilization state has distinctly illiberal implications” (“China, India and the rise of the civilization state”, *Financial Times*, 7 March, 2019)

22 Alfred Hirschman, “Exit, Voice and Loyalty”, Cambridge (Mass), Harvard University Press, 1972

23 Douglas North, “*Structure and Change in Economic History*”, New York, Norton, 1981. Mancur Olson Jr., “*The Rise and Decline of Nations. Economic Growth, Stagflation and Social Rigidities*”, New Haven, Yale University Press, 1982

24 See for instance Steven Levitsky and Daniel Ziblatt, “*How Democracies Die*”, New York, Viking, 2018

4. 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 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, i.e. 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 accountability²⁵ at the national level²⁶; 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.).

²⁵ The status of being accountable to the voters who gave a mandate to top public servants.

²⁶ 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.

Why is the fiscal challenge critical to the Eurozone? Deeper integration (including a sizeable 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 interests²⁷, there are constitutional impediments posed by 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.

Reconsidering the Single Market logic

The Single Market (which sees the EU as a whole) would better rely on a revamped conceptual framework –some of it suggested in the Monti Report of 2010 and, earlier, in the Sapir Report of 2003. However much we praise and value competition as a driver of entrepreneurship and economic dynamism, there are market failures and power asymmetries in the EU which need to be seriously addressed. The financial crisis has indicated the flaws of a paradigm that takes for granted that markets always know better, that systemic risks are non-significant, that “light touch regulation” is fine, that business unethical conduct is quite rare. The Single Market policies should heed the lessons of recent decades, which teach that increasing income inequality, “winners take all” competition, harm economic growth over the longer term.

The reform of finance has to go on and adequate regulation and supervision of financial markets (including shadow banking) should be implemented; this should rely on stronger capital and liquidity requirements, the taming of casino-type activities, and the functioning of a sort of Glass-Steagall legislation –as several reports commissioned by the European Commission have alluded to, although not clearly enough. Arguments that such measures would dent European banks’ ability to compete with American and Asian competitors are questionable.

If we accept, as a working assumption, that deeper integration is the way forward for the EU in order to cope with current and future challenges, a more balanced policy paradigm is badly needed. To the extent member states are asked to relinquish more of their sovereign prerogatives, what would be lacking in the policy mix at the national level has to be replaced by an enlarged and more diversified tool and policy box at the supranational level; in the Eurozone this would take the form, for example, of a “collective unemployment insurance scheme”. This logic could be seen as a “subsidiarity principle in reverse”, and would fit a motion to a more integrated EU. The EU budget reform must not lose sight of the need to reduce economic discrepancies in the Union, the need to foster cohesion.

A topic that seems to be underplayed by EU institutions is the massive labour migration from central and eastern European New Member States (NMSs); in some

²⁷ 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.

countries (the Baltic in particular), up to 15%, 20%, even 25% of their active labour force moved westwards in the last couple of decades. One could argue that this is an inevitable outcome of the functioning of the Single Market against the backdrop of large income differentials, that these flows may have peaked in recent years and even reverse movements may take place due to economic catching up. But such a line of reasoning can be seen as self-serving once the overall reality, and not the ideology of the functioning of the Single Market is taken into account²⁸. Remittances to the tune of billions of euros cannot offset a massive depletion of human capital, both volume- and quality wise. Shortage of human capital is increasingly widespread in NMSs, and this shortage would cripple their ability to deal with the middle income trap in the future. There are also major social and political implications of this phenomenon. This is why EU public policies and the EU budget need to consider it attentively.

Unless changes in EU policies are made, fragmentation and “renationalizing” tendencies will continue to gather force, and the Union will be constantly battered by internal shocks and conflicts among member states; muddling through will be the hopeful scenario, and fading away/demise would be the bad outcome.

It is hardly realistic to think that European economies could achieve, on average, the growth rates of previous decades - for the foreseeable future at least. Demographic change, an overwhelming debt overhang (on average, about 250% of GDP, both private and public, in Eurozone), the poor functioning of the Eurozone, and too little investment handicap, inter alia, Europe. However, there are ways to make economies more robust. There is need to invest more, to improve the quality of public goods (education), to pay more attention to R&D and make the Union more attuned to a digital world which is increasingly dominated by the US and China, and to alter the current deflationary bias of the Eurozone by changing its policy matrix.

Business and Ethics

Big Business has to show convincingly its social responsibility mission, if it actually operates. There has been a rising number of scandals in finance, in other industries, which foment hostility toward business companies and their perceived reckless profit-maximization behaviour (short-termism at the expense of society's stakeholders' interests). Christine Lagarde, the IMF chief, pointedly asked the financial industry to “broaden its sense of purpose” because it has strayed from its original purpose; that it has to reshape itself and be aligned with societal values²⁹. She and heads of major central banks, such as Mario Draghi from the ECB and Mike Carney from the Bank of England, have referred to a “culture of finance” that has gone astray.

28 There are pieces of analysis that seem to be out of touch with the reality of the Region. Gaetano Basso, Francesco d'Amuri and Giovanni Peri, notice that “the average elasticity of population size to employment shocks is much lower in the euro area than in the US, with point estimates of 0.2 and 0.8, respectively” (“Labour mobility and adjustment to shocks in the euro area: the role of immigrants”, VoxEu, 13 February, 2019). Factually it can be correct when it comes to most of the euro area. But their analysis is glaringly myopic in view of the enormous outflow of labour from Baltic economies following the Great Recession and austerity policies. In contrast, IMF experts are quite thorough in this regard (Ruben Atayan et al., “Emigration and Its Economic Impact on Eastern Europe”, *Staff Discussion Notes*, Washington DC, July 2016).

29 Christine Lagarde, “The Financial Sector: Redefining a Broader Sense of Purpose”, 32d *World Traders Tacitus Lecture*, London, 28 February, 2019

Tax evasion and tax avoidance have turned into a big policy issue in the EU and blame has to be assigned to the connivance of not a few member states in this regard. Big business has to change its conduct, be more ethical. Unless this happens, even more radical ideas will encroach on peoples’ minds, which may be inimical, in the end, to checks and balances, to democracy. The latter relies on a strong middle class, on an equitable income distribution and on a sense of trust and fairness among social and political actors. When mistrust and animosities abound, the social fabric is torn apart and democratic politics are impaired. More authoritarianism in public and political life would be on the rise. And radical ideas, on the left and the right sides of the political spectrum will continue their rise.

Paul Collier insightfully notes that capitalism needs reinvention via ethical behaviour and more attention to community values³⁰. Raghuram Rajan, a former IMF chief economist and former governor of the Bank of India, also thinks that community should play a larger role in how market-based economic systems do function³¹. Their line of reasoning hooks up with the *Zeitgeist* in the western world after the eruption of the Great Recession (the global financial crisis). They both argue that there is need for pragmatic and enlightened policy-making. The fact that they reject extreme individualism and short-termism, and that they focus on “community”, reminds the Amitai Etzioni’s train of thought, a well-known sociologist.

Liberalism and immigration in Europe

With the benefit of hindsight one can argue that the migrants’ crisis in Europe has been in the pipeline for quite a while. The lack of a common immigration policy, botched interventions abroad that have misfired, the human disaster in Syria, permeable EU frontiers, and the diminishing cohesion and trust among EU members states have all, *inter alia*, brought about this crisis –quite likely, more threatening than the Eurozone crisis.

It is true that aging in Europe is a formidable challenge and that immigration can help improve demographic trends at home over the longer run. There are also humanitarian concerns and the very values of democratic Europe which commend certain actions and support a vision. But to hail a massive flow of migrants/refugees as the solution to demographic strain at home, in Europe in general, is to underestimate the policy conundrum many governments are facing, which is, not least, related to security and social stability concerns. One should not mix up a possible opportunity over the longer term with existing policy trade-offs and enormous security concerns.

Europe cannot harbour whoever flees areas of much distress around the world. A wise balance has to be found in this respect between solidarity, humanitarian concerns, and pragmatism, common sense in public/economic policies. Otherwise we will see failing EU policies repeatedly. Having said, one has to be resolute in combating racism, xenophobia, and hate overall and in identity politics in particular.

The EU needs to have a more clairvoyant international aid and development

30 Paul Collier, “*The Future of Capitalism. Facing the New Anxieties*”, Allen Lane, 2018. In a sharp critique of “neo-liberalism” Paul Mason talks about a post-capitalist future (“*Post-Capitalism. A Guide to Our Future*”, London, Penguin Books, 2015).

31 Raghuram Rajan, “*The Third Pillar: How Markets and the State Leave Community Behind*”, London, Penguin Press, 2019

policy. The EU needs to cooperate more closely with neighbouring countries, to help countries where refugees are hosted.

Concluding remarks

Liberalism at its core identifies itself with democracy, the rule of law, fairness, and respect for fundamental human rights. Yet, when globalism, as a vision, leads to unrestrained liberalization by disregarding market failures and losing sight of those who lose in economic competition, and when the disruptive impact of new technologies is underestimated, democracy is jeopardised and “radicalism”³² of all sorts gains ground. 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 up³³. Markets have to be judged, therefore, in their social and cultural context, while society is to be understood as more than a competition among individuals and company level profit-maximizers. Highlighting the social responsibility that many companies talk about is not sufficient in this regard. Rediscovering Karl Polanyi’s mistrust of the “markets know best paradigm”³⁴ and Max Weber’s emphasis on ethical conduct (which can be linked with Adam Smith’s *Theory of Moral Sentiments*) makes sense in trying to figure out a way out of a seemingly historical conundrum.

Neither do markets care about ecological threats. Nicholas Stern, years ago and, at the time, being the chief economist of the World Bank, pointed out that the inability of our models and policies to pay due regard to climate change and ecological menaces is, quite likely, the greatest market failure in human history³⁵; this, simply put, is a strong criticism of practiced public policies and of underlying cognitive approaches. Green finance and sustainable finance are concepts of recent years; they indicate that climate change and its impact on economy and, ultimately, on society are increasingly acknowledged by the corporate world, financiers included.

In the European Union (and the Eurozone) reforms are needed to increase the legitimacy of – i.e. the democratic nature of – its institutions; markets need to be viewed in their social embeddedness. 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.

Working on a “new social contract” is a must for making our societies more inclusive, for averting their further radicalization. A new social contract would have to redefine the boundaries of the welfare state, restore the principle of “equal opportunities” at the centre of social policies, find ways to foster social inclusion (minimum wage is an idea to be considered), adapt education to what new technologies entail with their cultural and social impact, combat economic (power) concentration that is inimical

32 Wolfgang Munchau, too, roots the rise of radical ideas in the failure of neo-liberalism, of unmanaged globalization (“The Future belongs to the left, not the right”, *Financial Times*, 25 February, 2019)

33 See also ‘The End of the Democratic Century’ by Ascham Monk and Roberto Stefan Foe, *Foreign Affairs*, May-June 2018. This issue contains a set of texts listed under the generics ‘Is Democracy Dying?’

34 In his “The Great Transformation” (New York, Farrar and Reinhart, 1944...) Karl Polanyi highlights the need for society to protect itself against unrestrained markets.

35 Nicholas Stern quoted by *The Guardian*, 29 November, 2007

to sound competition and that leads to market abuse, reduce (if not eliminate) the range of “winners take all” competition, rein in finance, combat tax evasion and tax avoidance resolutely, make the corporate world behave more responsibly socially, etc.

It may also be that we are going through the downward phase of a very long-term economic cycle (Kondratiev, Schumpeter³⁶). Such a phase can explain the ‘inward looking syndrome’ (a resurrected nationalism) one sees in industrialized societies; the Great Recession (the global financial crisis) belongs, admittedly, 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 such dynamics, which are increasingly non-linear and disruptive. The rise of “the civilisation state” compounds the geopolitical and a related political and economic regime completion/confrontation.

The strain in society which is caused by economic conditions can be compounded by inter-ethnic and religious conflicts. “The clash of civilizations” that Samuel Huntington forebode a couple of decades ago seems to find additional concrete forms in various parts of the world. Wars and geopolitical tensions do exacerbate “civilizational” misunderstandings.

For world peace 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 a global order cannot proceed to reform the multilateral order and inter-country relationships. One can imagine the emergence of a several block based international economic system, which should prevent the complete dismantling of an orderly, rules-based global system.

The liberal order of the world, as established after the victory over Nazi Germany and its allies, is being severely tested³⁷. But the liberal idea still has much support in the industrialized world. However, if its power to shape people’s minds and conduct is to continue, an enlightened version of liberalism (“embedded liberalism”³⁸) needs to operate and political elites need to show more respect for their fellow citizens. “Winners take all games” and extreme income inequality have to be fought against if democracy is to survive. *Elyseum*, the movie with Matt Damon as its main character and which portrays a dystopian world in which a superrich minority lives on a giant spaceship while the rest of people lives on a decrepit earth, is a very powerful metaphor about what can go terribly wrong in the decades to come.

The *resilience* of nation states needs to be considered in regional and international arrangements. This must be taken as a key datum in dealing with the

36 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 foundation.

37 See also Richard Haass, ‘Liberal World Order, R.I.P.’, *Project Syndicate*, 21 March 2018. Haass examines the Trump administration’s attitude towards the order established after World War II, and its global impact.

38 As put by John Ruggie, who is quoted by Jack Snyder (*Op.cit*, p.54)

tense relationship between nation states and global markets³⁹. The demise of nation states, as it was postulated by some pundits a couple of decades ago⁴⁰, has proved to be a false dawn⁴¹. This reality poses major challenges in the European Union, for avoiding its further fragmentation against the backdrop of a seriously strained transatlantic relationship, trade conflicts, and a shifting balance of economic power toward Asia. *Nota bene*: the latest report of the authoritative EEAG group on the European economy talks about “A Fragmenting Europe in A Changing World”⁴². By the way, those who advocate a “European sovereignty” in order to deal with future challenges imply, one way or another, a form of European nationalism⁴³. However, the latter rests on reconciling national with EU level interests.

In order to resuscitate the European Project a new overall policy stance, together with new policy instruments, are needed. A properly functioning monetary union implies both risk-sharing (that should rely on both private and public sector vehicles) and risk-reduction instruments. Likewise, reforming the fiscal discipline rules in the EU is also needed in order to deal with asymmetric shocks.

To the dismay of many, a fragility of democracy (i.e. 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, at least in the West. Remembering Winston Churchill’s words is as timely as ever.

Appendix: The “inward looking syndrome” -- simple analytics of a trade-off

Dilemmas an open society has when facing threats and trade-offs may be captured by economic analysis. More specifically, one can relate protection/security to openness (economic freedom) as public goods. This may be illustrated as a social utility function which includes protection/security (S) and economic freedom (O) as an expression of economic openness, as public goods. A function $F = F(S, O)$ would indicate levels of citizens’ comfort in terms of these public goods; it could look like $F = ((1 - a) xS + a xO)$, where (a) would be a variable in consonance with people’s attitude toward the two public goods; this variable could not be higher than 1 and not lower than 0. The substitution between protection/security measures and economic openness (economic freedom) has limits because these two public goods (as a state of the social and economic system) are not completely independent of each other; from a certain

39 For Yael Tamir, the problems are rooted in the growing clash between nationalism and neoliberal globalism (“Building a Better Nationalism”, *Foreign Affairs*, March-April 2019, pp.48-53). It is telling that this issue of *Foreign Affairs* has on its front cover and as its leading topic “The New Nationalism”.

40 Kenichi Ohmae, “*The End of the Nation State, The Rise of Regional Economies*”, New York, Free Press, 1995

41 William Pfaff seems to have had a much more acute sense of history in this respect (in his “The Wrath of Nations”, New York, Simon & Schuster, 1993). See also my “*Economic Vitality and Viability. A Dual Challenge for European Security*”, Frankfurt am Main, Peter Lang, 1995 (chapter 3 in particular)

42 EEAG (European Economic Advisory Group), “*A Fragmenting Europe in A Changing World*”, CESIFO, Munchen, 2019. Quite tellingly, the last chapter is called “Looking outward: Western disarray, China rising”.

43 Bruno Le Maire, the French finance minister, talks suggestively about “A New Empire” in Europe, which should be able to fend off the US and Chinese pressures; he has in mind the EU and a reformed euro zone (*Le Nouvel Empire*, Gallimard, 2019)

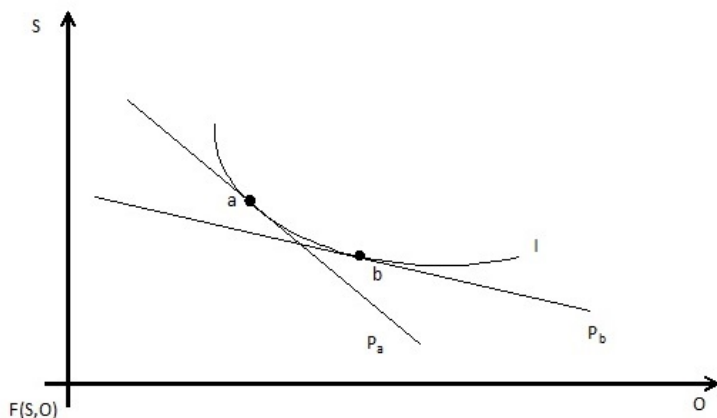
level, protection measures, or restrictions may distort open society (democracy) exceedingly. Likewise, a total openness of the economy/society, with no rules and protection measures, may cause enormous costs, social anomia.

The graph below illustrates citizens’ growing need for protection in times of hardships, when threats abound. Various combinations of (S) and (O) may be imagined so as to ensure a degree of citizens’ acceptance that would minimize discontent/discomfort in given conditions. An optimal combination is where the price line (S, O) is tangent to the preference (social choice) curve (I). The (a) point refers to an initial level of economic freedom –as flows of capital, workforce, investment, and the range and scope of regulations. At point (a) things are relatively good, calm, and this is revealed by the price line between (S) and (O); a steeper slope, P_a , shows that (S) is regarded as being sufficient (people feel safe) and economic openness as a public good is in high demand.

When times worsen a more inward looking society emerges; such a turnaround is revealed by the change in preferences in favour of (S). When the need for protection measures grows, the change is reflected by a less steep slope of the relative price, (P_b), between (S) and economic openness (O); this may involve protectionism and other restrictive measures and their combination is indicated by point (b) on the indifference (utility) curve.

The graph below simplifies reality not least because it refers to people in general, but, nonetheless, is not irrelevant. Who decides and how decisions are made regarding the two public goods brings politics into the limelight, as citizens may have different options, may share different political views or values; a community may be made up of different ethnic groups and religions, a large part of the population could be made up of immigrants, etc. In a democracy, one is tempted to say that the social collective option (social) is given by the majority vote. But things are much more complicated if society is profoundly divided and various values are guiding people’ choices (The Nobel Prize winner John Kenneth Arrow explained the difficulties of building social utility functions in his “Social Choice and Individual Values”, Wiley, 1951). Moreover, economic interdependencies between states may be very strong.

Graph: The relation between protection (S) and economic openness (O)



It is also a fact that the way people value protection vs. openness may vary over time. What is abnormal, unpalatable today, may be termed differently at another moment in time; it may be that people adjust to different circumstances, their habit change.

Protection measures can trigger similar responses from partners - and trade wars will likely lead to damages for all parties involved. Therefore, any measures at a national level should be pondered given potential answers from partners. Widespread protectionism comes along with significant dangers; beggar your neighbour policies can easily backfire. It is worth recalling that the globalism of the XIX century Victorian Era was followed by commercial and “hot” conflicts.

The analysis should be adapted for the case of economic and military Alliances. For example, within the EU there is a pressing need for common efforts in the area of intelligence, border protection, and military defence --as all these are European public goods. The context outlined above might explain why some developed states seem to be seeking to regain a former power status via a journey back in time.

There are additional aspects that can help to see through future trends:

- The global economy gets multipolar;
- The EU is fragmented by centrifugal forces and weakened by Brexit;
- The post WWII institutional economic arrangements (“Bretton Woods’s arrangements”) are under siege due to alternative accords and institutions promoted mainly by China;
- Unrestrained globalization has brought benefits, but it has also damaged social cohesion by neglecting distributional effects;
- “Realpolitik”, as a way to articulate foreign policies, goes up at the expense of placing moral values and the interests of what is called the international community at centre stage;
- Can an open international system, which is based on multilateral accords, be saved under such circumstances? Such a question begs others:
 - Are there international arrangements that can address and redress flaws of unrestrained globalization?
 - Is it possible to reinvent the EU, to make it fit the new conditions in the global economy?
 - Can the Eurozone be turned into a genuine monetary union, with proper fiscal arrangements? For this to happen the German-France nexus is vital.
 - Can the EU get safer security arrangements? This involves its relations with the US and NATO, with Russia, the US-Russia relations.
 - How should military conflicts, in different areas of the globe, be tackled?
 - How would the new big rivals in the world (the US and China) cooperate on issues of interest for the whole world, in a systematic way?

References:

- Atoyan, Ruben *et al.* (2016) “*Emigration and Its Economic Impact on Eastern Europe*”, Staff Discussion Notes, Washington DC
- Autor, David (2019) “Work of the past, work of the future”, *VoxEu*
- Autor, David (2016) “*Trade and labour markets: Lessons from China’s rise*” (MIT)
- Bussolo, M., Davalos, M., Peregrine, V. and Sundaram, R. (2018) “*Toward A New Social Contract*”, Washington DC, The World Bank Group
- Collier, Paul (2018) “*The Future of Capitalism. Facing the New Anxieties*”, Allen Lane
- Dăianu, Daniel (2018) “*Emerging Europe and the Great Recession*” (Cambridge Scholars Publishing)
- Dăianu, Daniel (2017) ‘The New Protectionism’, *World Commerce Review*
- Dăianu, Daniel (2011) ‘Markets and society: When high finance corrodes economy and undermines democracy’, *Eurozine*, (<https://www.eurozine.com/markets-and-society/>)
- Dăianu, Daniel (1995), “*Economic Vitality and Viability. A Dual Challenge for European Security*”, Frankfurt am Main, Peter Lang
- EEAG (European Economic Advisory Group), (2019) “A Fragmenting Europe in A Changing World”, CESIFO, Munchen, 2019. “Looking outward: Western disarray, China rising”
- Haass, Richard (2018) ‘Liberal World Order, R.I.P.’, *Project Syndicate*
- Hirschman, Alfred (1972) “*Exit, Voice and Loyalty*”, Cambridge (Mass), Harvard University Press
- Kaplan, Robert (2018) *The Return of the Marco Polo World*, Random House
- Kolodko, Grzegorz (2018) “Capitalism, Socialism or Chinism?”, *EconoMonitor*
- Lagarde, Christine (2019) “*The Financial Sector: Redefining a Broader Sense of Purpose*”, 32d World Traders Tacitus Lecture, London
- Lenin, V.I., “*The State and Revolution*”, 1917
- Levitsky, Steven and Ziblatt, Daniel (2018) “*How Democracies Die*”, New York, Viking
- Maire, Le, Bruno, “*Le Nouvel Empire*”, Gallimard, 2019
- Marx, Karl and Engels, Friedrich, “*Communist Manifesto*”, 1848
- Mason, Paul (2015) “*Post-Capitalism. A Guide to Our Future*”, London, Penguin Books
- Mounk, Yascha (2018) “*The People vs. Democracy*”, Harvard University Press
- Munchau, Wolfgang (2019), “The Future belongs to the left, not the right”, *Financial Times*
- North, Douglas (1981) “*Structure and Change in Economic History*”, New York, Norton
- Ohmae, Kenichi (1995) “*The End of the Nation State, The Rise of Regional*

- Economies*”, New York, Free Press
- Olson, Mancur Jr. (1982) “*The Rise and Decline of Nations. Economic Growth, Stagflation and Social Rigidities*”, New Haven, Yale University Press
 - Pfaff, William (1993) “*The Wrath of Nations*”, New York, Simon & Schuster
 - Polanyi, Karl (1944) “*The Great Transformation*”, New York, Farrar and Reinhart
 - Rachman, Gideon (2019) “China, India and the rise of the “civilization state””, *Financial Times*
 - Rajan, Raghuram (2019) “*The Third Pillar: How Markets and the State Leave Community Behind*”, London, Penguin Press
 - Rodrik, Dani (2018) ‘The Double Threat to Liberal Democracy’, *Project Syndicate*, 18 February
 - Rodrik, Dani (2007) ‘The Inescapable trilemma of the global economy’, personal blog, 27 June
 - Schumpeter, Joseph (1911), ‘*Theory of Economic Development*’, Harvard University Press
 - Schumpeter, Joseph (1942), ‘*Capitalism, Socialism and Democracy*’, New York, Harper and Brothers
 - Sharma, Ruchir (2018) ‘Prosperity is no lock on popularity’, *New York Times*
 - Snyder, Jack (2019) “The Broken Bargain. How Nationalism Came Back”, *Foreign Affairs*, March-April 2019, p. 54
 - Tamir, Yael (2019) “Building a Better Nationalism”, *Foreign Affairs*, pp.48-53
 - Yifu Lin, Justin “*The Quest for Prosperity. How Developing Economies Can Take Off*”, Princeton, Princeton University Press, 2012