

JAMES GALBRAITH

Development's Discontents

How to explain the link between economics and democracy—and how not to.

ECONOMIC ORIGINS OF DICTATORSHIP AND DEMOCRACY

BY DARON ACEMOGLU AND JAMES A. ROBINSON • CAMBRIDGE UNIVERSITY PRESS • 2006 • 416 PAGES • \$35

A FREE NATION DEEP IN DEBT: THE FINANCIAL ROOTS OF DEMOCRACY

BY JAMES MACDONALD • PRINCETON UNIVERSITY PRESS • 2006
564 PAGES • \$19.95

W

here does democracy come from? Is rule “by the people, for the people” a *telos*—an ethical endpoint—as the great American civic faith would have us believe? Is it the most effective way to solve social problems—as John Dewey and the pragmatists argued? Or is it merely the worst system except for all the others, as Winston Churchill dismissively quipped?

These two important books—*Economic Origins of Dictatorship and Democracy* by Daron Acemoglu and James Robinson and *A Free Nation Deep in Debt* by James MacDonald—take an economic view, well-suited to a material age. They locate the origins of democracy not in ethics or social engineering, but as a side effect of the struggle for goods and services, wealth and market power. And yet, that is their only resemblance. They refer to few of the same facts and none of

JAMES GALBRAITH holds the Lloyd M. Bentsen, Jr. Chair in Government/Business Relations at the Johnson School of Public Affairs at the University of Texas at Austin and is Senior Scholar at the Levy Economics Institute.

the same literature. Their uses of the term “economic” are totally dissimilar, and in that dissimilarity they reveal as much about the great divides within economics as they do about the origins and fate of democracy.

The contrast is, first of all, one of substance. One book associates democracy with the material temptations of populism: Democracy arises because it redistributes income to the masses. The other sees the democratic advantage in evolutionary and comparative perspective: Democracies survive and thrive because they beat out rival systems, most especially on the battlefield, history’s ultimate test of material capacity.

But behind the competing theses lies a deeper conflict of form. One book reflects the dominant spiritual tendencies of political science and neoclassical economics, rooted in methodological individualism and a presumption that institutions efficiently deliver what individuals want. The argument proceeds mathematically, by axiom and proof. Though the reference is broadly to democracy allied with capitalism, there is no discussion of credit, money, banking, financial markets, or other basic capitalist institutions. The approach is timeless and at best decorated here and there by corroborating fact.

The other book is a masterpiece of historical narrative, founded on an immense trove of numerical detail, drawn from the records of public finance and credit markets over millennia. Yet it is not the sort of “measurement without theory” that might be dismissed as redolent of the German Historical School. It is, rather, narrative in service of an idea. The contest between these works is thus as much a contest between the hypothetico-deductive and the evolutionary method, as it is between a “real” and a “monetary” view of economics, and as much between a theory of distribution and a theory focused on efficiency and growth. In short, they offer competing models for economics and political science. And the fact that one exemplifies mainstream practice in our great universities—while the other is product of an unknown outsider—casts a cruel light on the most favored patterns of thought in the contemporary ivory tower. It makes one nostalgic for the days when academic social scientists were interested in society—in its progress and in its prospects.

For Acemoglu and Robinson, an MIT economist and a Harvard political scientist, respectively, the word “economic” signifies the neo-Benthamite doctrine of “rational choice”—a theory of behavior rooted in the “well-defined preferences” of individuals over “outcomes or the consequences of their actions.” To them, democracy is a process, not an end, and the preference for it is utilitarian and not a matter of values. Acemoglu and Robinson ask that we consider “a group of individuals for whom democracy and non-democracy have

the same consequences in all spheres, except that democracy generates more income for them; they naturally prefer more income to less. Therefore, we expect these individuals to prefer democracy to nondemocracy.”

What does this grubby instrumentalism have to do with political systems? Acemoglu and Robinson do not argue that democracies are more efficient, yielding more income for everyone. Their argument is about distribution. But economics argues that distribution is mediated mainly by markets, not by governments. (The phenomenon of “rent-seeking”—mining government for favors—is an exception, but it is not specific to democracy.) So why should any group systematically prefer democracy for economic reasons?

For an explanation, Acemoglu and Robinson invoke the familiar mechanics of class conflict. All societies are divided into “elites” and “citizens.” “Typically,” Acemoglu and Robinson write, “there is political conflict between the elites and the citizens.” The original version of the thought—“The history of all hitherto existing societies is the history of class struggles”—is not quoted, but the spirit is definitely kindred. Yet unlike Marx, Acemoglu and Robinson argue that the outcome of struggle is generally not revolution leading to proletarian dictatorship, but democracy. Wanting money, the citizens press for the vote. And, though revolutions obviously occur sometimes, democracy is simply a rational alternative: less costly to the elites, equally beneficial to the masses. In short, democracy arises because elites choose to concede it, rather than face the prospect of being disposed of unpleasantly. A few major social parameters, especially the previously existing degree of inequality, determine these relative benefits and costs. Very roughly, high degrees of inequality deepen class conflict and the resistance of elites to democracy, while very low degrees of inequality reduce the gains citizens expect from democratization. Somewhere in between there is a sweet spot, and there democracies grow.

This theory of causes implies a transition to democracy, which means that we need some way to divide the world between democracies and non-democracies. For Acemoglu and Robinson, this distinction is simply about suffrage. Democracy exists when “the people” vote for their government, in elections that incumbents occasionally lose. At that point, one is led to suppose that class conflict ends and history stops. Of course, this is a simplification. In real life, democracy is not an end-state but an ideal type. There are no countries where “everyone has the vote,” and there is no hard-and-fast boundary between democracy and non-democracy. One group gains the franchise, then another, then another still. Class struggle goes on, and the history of democracy is a struggle toward democracy, a struggled to advance by degrees. Acemoglu and Robinson acknowledge this, but then forget it again: for them a country is a democracy or it is not.

Four cases illustrate their argument: Britain, Argentina, Singapore, and South Africa. In nineteenth-century Britain, Acemoglu and Robinson argue, democracy consolidated because the class differences were relatively small (try telling that to Dickens), and the elites simply decided to accept the citizens' policy preferences. In Argentina, inequality was higher and the costs of repression lower, so that democracy emerged but failed to consolidate: Cycles of democratization and repression result. In Singapore, low inequality and a low cost of repression preclude democracy: Rational citizens perceive that the struggle is not worth the trouble. In South Africa, finally, the authors argue that democratization occurred because the country became *more* egalitarian after the 1970s, lowering the cost to the white elites of conceding the vote to nonwhites.

This model implies and requires certain relationships in the data. British inequality in 1832 or 1928 must have been lower than in 1970s Argentina. Singapore today must be more egalitarian than Britain today. And South African inequality must have declined before 1994. Yet Acemoglu and Robinson cite no sources for these assertions of fact. And it turns out that the World

Can a country—whether the United States or any other—be truly democratic if it is in hock to banks and foreigners?

Bank data set they do cite on other matters gives no support to them. That data set contains no “high quality” points for Argentina at all and none for Britain before 1950. It reports Singaporean inequality today to be substantially higher than British inequality today. South African inequality, among the world's most prevalent, is given only for 1993 and 1994, giving no basis for belief in a decline in the previous 20 years.

Acemoglu and Robinson's theory also runs afoul of many cases they do not discuss. For example, India is a highly unequal yet stable democracy, for which no place exists in their model. Scandinavia, barely mentioned here, is more egalitarian than Britain (or Singapore), yet stably democratic. The collapse of communism in Eastern Europe is another problem, as the low economic inequality of those countries should have repressed the desire for democracy, but obviously it didn't.

Yes, sometimes the initiation of elections can be an elite concession to economic pressure from below. But a general theory of democracy requires more than that: an account capable of explaining the grades and qualities of democracy, its ebb and flow over time, and its sometimes genuine and sometimes superficial nature. This Acemoglu and Robinson do not provide. Although they assemble facts prodigiously, one must unpleasantly conclude that when

it comes to choosing the crucial ones, they have cherry-picked and also sometimes plucked “data” from thin air, in the service of selling an idea that is not so much wrong as it is far too simple.

Acemoglu and Robinson’s single-minded dedication to their idea is manifest in the last two-thirds of this book, which are given over to game-theoretic models, presented in mathematical form. The models are of rational social choice—the decision, by “elites” and “citizens,” between dictatorship” and “democracy.” They are statements of pure theory; there is no further effort at evaluation, let alone critique. A typical example occurs on page 232:

The state is either (D, ϕ^H) , (D, ϕ^L) , (N, μ^L) , or (N, μ^H) , where N denotes elites in power (i.e., nondemocratic regime) and D denotes democracy. Let $\sigma^e = \{\omega(\cdot), \phi(\cdot), \tau^N(\cdot), \zeta(\cdot), \tau^N\}$ be the notation for the actions taken by the elites, and $\sigma^p = \{\rho(\cdot), \tau^D(\cdot), \tau^D\}$ are the actions of the citizens. The notation σ^e consists of a decision to repress $\omega: \{\mu^L, \mu^H\} \rightarrow \{0,1\}$ or to create democracy $\phi: \{\mu^L, \mu^H\} \rightarrow \{0,1\}$ when $P=N$, and a tax rate $\tau^N: \{\mu^L, \mu^H\} \rightarrow \{0,1\}$ when $\phi = 0$ (i.e., when democracy is not created). Clearly, if $\phi = 0$, P remains at N , and if $\phi = 1$, P switches to D .

Work of this kind raises grave questions. It is not so much incomprehensible as pointless. It actually isn’t incomprehensible, if you work hard enough, but the symbols are empty, and the description is not of a real society, but of an institutional vacuum, uninhabited by actual human beings, untracked by actual data. No measurement will ever test the theory. Words with real meaning, like “to repress,” are conscripted as names for variables. The adjoining algebra serves heavily to intimidate and does very little to persuade. The presentation descends to parodies of jargon, enlivened by the absurd interjection of words like “clearly.”

As an empirical study, this book illustrates perfectly the decline of discourse brought on by the fetishism of formulae and the neglect of rigor where it matters, in the pursuit of evidence to support, refute, or refine what is otherwise little more than a conjecture. In the end, it isn’t about democracy. It’s about a cardboard caricature, the existence or absence of certain rituals, which by no means assure that the citizens rule the state. In sketching their caricature, Acemoglu and Robinson strip the democratic ideal of substantial and also of ethical content. By treating the democratic impulse as an exercise in money-grubbing, they feed the contempt for democracy already characteristic of elite circles—the rational member of Acemoglu and Robinson’s “elite” is, in other words, a fascist. Indeed, if Acemoglu and Robinson’s democracy is the only type on offer, there is little reason to support it—unless one belongs to a transfer-receiving group.

Is there an alternative? If so, what would it look like? It would feature quantitative precision, married to knowledge of history, command of evidence, narrative skill, and to a fresh and important idea. Beyond this, it would give new insight into the success of democratic systems and also into the reasons they sometimes decay. As a bonus, it might help those of us predisposed to favor democracy on ethical grounds to understand that our sentiments might have a material foundation, and therefore the reasons for the loyalty we instinctively feel. It would, in other words, have many of the properties found in James MacDonald's *A Free Nation Deep in Debt*.

This book begins with Moses, ends with World War II, and covers just about every important development in public finance in between. Yet, for all his range, MacDonald offers a simple, stunning thesis: Democracy arises from public debt.

For MacDonald, a British former investment banker, there is no distinction between “citizens” and “elites.” The citizens are the elite. To be a citizen in society is to be a free member of it; those who are not citizens are slaves or little better than slaves. Moreover, the progress of democracy is the expansion of the franchise, a word with two meanings: its present one of the right to vote and an ancient one meaning freedom from direct taxation. In turn, public debt is the hammer that knocks down the walls restricting citizenship, expanding democracy by degrees. Thus the institutions of finance, missing from Acemoglu and Robinson's economics, suddenly take on the pivotal role. As MacDonald puts it:

Democracy (even in its most partial and imperfect form) is a system in which the citizens control the state. As long as democratic states borrow from their own citizens, their good credit is simply a reflection of the virtual identity of borrower and lender.

It's a simple but compelling argument. States exist to make war; those who win survive. Public credit is a powerful weapon; states that can borrow win wars. And so even narrow democracies, rooted in parliaments going back to the Middle Ages, have an evolutionary advantage over absolute monarchies, for the king's credit is always poor.

MacDonald pursues this story from Athens, where citizens would sacrifice their fortunes to the armies and navies when required, through the republics of Venice, Florence, and Genoa, whose citizen-creditors developed the first full-fledged public financial systems, and onward to England, France, and Spain in the age of conquest. He contrasts the strength of Anglo-Dutch finance with the repeated bankruptcies of Habsburgs and Bourbons—state finance by calculated

confiscation, compounded with a privatized revenue system that deprived the crown of revenue while creating a hated class of tax farmers. It is no coincidence that Britain slowly became democratic, while revolution followed the French default of 1788.

Across the Atlantic, MacDonald traces the maturation of American public credit in the Revolutionary and Civil wars, as well as the struggles between soft and hard money in the years following. A resolute member of the banker class, he argues powerfully in favor of Ulysses S. Grant's financial policy, for federal interest costs fell in 1869, when the United States promised to redeem its debts in coin, and again with the Resumption Act of 1875.

Democratic finance differs from totalitarian not because it is easy, but because it is open. Holding the liabilities of the state directly, citizen-creditors understand that they form an essential part of private financial wealth. They take a direct interest in their government and its financial affairs (even though, as MacDonald shrewdly notes, the exact extent of public debt may be concealed from outside eyes). In totalitarian systems, banks and other buffer institutions handle state finance—or foreigners do. Accordingly, democratic systems understand the value of maintaining their credit; despotisms do not.

Mass democracy emerged following World War I precisely because this was the first war to be financed almost fully by the direct sale of government bonds to the public. All the Great War combatants sold bonds with zeal, and at war's end all (except bankrupt and revolutionary Russia) found themselves in debt to nearly every household in their lands. Universal suffrage had to follow; you cannot ignore your bankers, even when there are millions of them. World War II repeated and deepened the experience, and in the aftermath popular democracy reached its zenith throughout the West.

A beauty of MacDonald's idea is that it can be tested against situations he doesn't discuss. Thus the democratic decolonization of India fits: It occurred after India had become a large war-time creditor of Britain. And the struggle for democracy in Latin America is complicated by foreign debt, easily analyzed as an external electorate of enormous power—one in obvious economic conflict with the voters who, at best, only hold the internal debt. The communists of China and Cuba maintain their insular systems because they are financially autarkic. Meanwhile, in democratic Venezuela, the rise and survival of Hugo Chávez owes everything to the singular financial autonomy conveyed by oil.

Finally, MacDonald's financial perspective helps explain the relationship between democracy and economic development. The most democratic states are not only powerful; they are rich. They are richer than the monarchies they succeeded and also than the communist states with whom for much of the

twentieth century they competed. Why? Surely the simplest answer lies in their ability and willingness to mobilize public debt for development as well as for war. Democracies yield higher incomes not because of vulgar redistribution, which cannot distinguish them from communism, but because they alone can master the great Keynesian financial tools required for the achievement of full employment and national construction on the grand scale.

Given the simplicity and power of this argument, one reads the epilogue of this great book with surprise and sorrow. In MacDonald's view, it's all over. In the nuclear age, deficits and bond drives on the world-war scale are history, and the American citizenry has lost its pride of place as creditor of the American state. Today, financial intermediaries hold about 37 percent of U.S. public debt; Japan and China, along with other countries, now hold about 30 percent. The proportion of U.S. debt owned directly by Americans has fallen to below 10 percent; in 1945 (when the debt was more than twice as large in relation to GDP as now) citizen-creditors just about held it all. He concludes that the link is broken and "for all practical purposes, the venerable marriage between public credit and democratic government, so vital a factor in the history of the world, has been dissolved."

But there is another possible way to interpret this fact. If MacDonald's thesis is right, the disappearance of the citizen-creditor forces a question. Can democracy survive when its financial roots have been cut? The scale of public debt is not the issue, but its ownership is. Can a country—whether the United States or any other—be truly democratic if it is in hock to banks and foreigners? And this is only the obverse of questions raised by our pathetic voter turnout, by the vote suppression that regularly poisons our elections, by the judicial *coup d'état* of December 2000, and by our regression toward a tax system from which the state's main creditors are exempt, leaving the burden to fall heavily on all who do not or cannot vote—exactly those who comprise our passive and disregarded lower classes.

To put it bluntly, are we still a democracy? And, if not, what would it take to bring democracy back? ■