

“Democracy and Economic Growth”

Remarks prepared for the roundtable “The Enemies from Without”
at the 4th conference of The Center on Capitalism and Society,
November 15, 2007

Jerry Z. Muller; Prof. of History; Catholic University of America

In theory, and sometimes in practice, democracy has a number of advantages when it comes to sustaining capitalist economic growth.

First, a functioning democracy helps to legitimate government actions that are prerequisites of ongoing capitalist growth, including the protection of property rights and the enforcement of contracts.

Second, over time, democracy tends toward the development of policies that blunt the rough edges of capitalism, such as insurance schemes that protect against accidents, illness, and old age, and such policies further add to capitalist legitimacy.

Third, democracy can provide an informational feedback mechanism. That is especially important in dealing with the negative externalities (such as pollution) of enterprises. Indeed, one of the greatest costs of communism was the degradation of the environment that came about precisely because such democratic mechanisms were missing. As a result, at the end of the Soviet era, much of the former Soviet Union resembled one big Love Canal, with terrible consequences for morbidity and mortality, resulting in what a leading student of the subject, Murray Feshbach, has called “Ecocide.” Forcing companies to pay for the pollution they cause may seem like a brake on economic growth, and in the short run, it may be. But since this forces consumers to pay for the real costs of the goods they consume, it leads to a more efficient use of resources, to a healthier populace, and to a more sustainable environment. The Soviet Union provides an example of the negative economic effects of a society with neither democracy nor capitalism. There are signs at least that China may provide an example of the long-term ecological costs of capitalism without democracy.

Democracy and capitalism would be an ideal combination if voters and politicians were knowledgeable about political economy, and focused on the public good. Unfortunately, this is not always the case.

We know that historically a rising standard of living, made possible by economic growth, is conducive to democracy – but democracy is not always conducive to economic growth.

I want to take a few moments to remind you of the ways in which voters and politicians can inhibit economic growth; and then turn for a moment to why the situation in the US might be better than in most other major societies.

First, the political pursuit of economic interests often leads to public policies that diminish market competition and hence economic growth. Lest you imagine that this is a recent development, let me remind you that it is the *Leitmotif* of Adam Smith's *Wealth of Nations*, published in 1776. Most of the first half of that book explains how the capitalist market, under the right institutional conditions, can lead to an ongoing rise in the standard of living for the vast majority of the population. The main condition is that individuals are forced by institutions to pursue their self-interest in the competitive market. But much of the second half of the book examines the forces that stood in the way of the optimal functioning of the market. These were above all various political lobbies that managed to convince politicians to restrict the market in a way that served the narrower interests of the politically organized. In Smith's day, with a highly restricted franchise, it was merchants and manufacturers who were especially well positioned to influence politicians to adopt policies that favored their interests at the expense of the general good. That is why Smith called the system of protective tariffs then in force "the mercantile system" – because it served the interests of merchants, in a way that diminished the beneficial potential of the competitive market. Smith believed but that the public interest would best be served if every man channeled his self-interest through the market. But he realized that from the point of view of the individual producer or group of producers, it was most beneficial to *circumvent* the competitive market. In other

words, the pursuit of self-interest leads to organizing in order to *avoid* market competition.

None of this has changed from Smith's day to ours. What has changed, of course, is that the right to vote has become universal. That means that now *everyone* has a chance to organize in order to try to influence politicians to adopt policies that protect one group or another — farmers, workers, professionals, and merchants and manufacturers — at the expense of the common good. And everyone does.

The situation is made even more dire by the processes examined by public choice theory, or what the Mancur Olson called “the logic of collective action.” The smaller the group of producers of some service or commodity, the greater incentive each has to influence politicians on behalf of the group's particular interest. Each sugar producer, for example, has a far greater incentive to be interested in the government's sugar policy than any given consumer of sugar. Thus, each groups seeks protection from market competition for the good or service it produces. As more groups succeed in pursuing their particular interests, competition diminishes, and with it efficiency and productivity.

If that weren't bad enough, there are a number of other compelling reasons to be concerned with the democratic threat to capitalist economic growth. For not only do voters try to pursue their own interests at the expense of the public interest: often enough, they don't have much rational comprehension of where their interests lie. If there is one thing that it is unfashionable and perhaps hazardous to acknowledge publicly, it is that voters often have very little real knowledge of the economic policies of the candidates they support, and even less understanding of the economic ramifications of the policies they endorse. (See the articles by Jeffrey Friedman, and the recent book by Bryan Caplan on this theme.) In other words, to the pursuit of group self-interest one must add the reality of voter ignorance. And often enough that ignorance of economic processes is shared by the politicians for whom they vote.

Indeed, when they come to engage in political action, voters are often swayed by one or another irrational emotion, such as envy or guilt. As both John Stuart Mill and Friedrich Nietzsche pointed out, the most successful and creative members of society are often the objects of envy and resentment. And that translates into political appeals to soak the rich, even if it means decreasing incentives to entrepreneurial activity. Another irrational emotion that may affect economic growth is guilt. A democratic culture will tend to be suspicious of inequality of achievement. The more successful may feel that at some level their own success is unjustified and unjustifiable. To assuage their guilt they may be led to support government policies that demonstrate good intentions by redistributing income, without looking too closely at whether such policies actually do much good.

When we put all these factors together, it may seem a wonder that we have economic growth at all. But of course we do.

Indeed, in comparative perspective, the United States may be better positioned than most major nations. For while envy and resentment are hazards built into democratic society, they are perhaps less salient in the US than elsewhere. That is partly due to history. Many of the colonies that eventually became the United States began as chartered companies. A capitalist ethos has been evident at most points of American history, even in the slave-holding South, where slave-owners were oriented to production for the internationalist capitalist market. And for hundreds of years, immigrants have been coming to these shores in an effort to better their economic condition. It's important to keep in mind when comparing immigrants to the ethnic group from which they came that those who make the decision to emigrate are different in certain respects from those who stay behind: the immigrants are more venturesome, more open to risk, more eager to get ahead. As a result, Americans probably tend to have less egalitarian expectations than many old-world societies, and they are less prone to envy. Donald Trump is in many respects the embodiment of capitalist competition at its most obnoxious. Any society in which he can become a television star has a high tolerance for inequality of achievement.

Moreover, the US is an ethnically heterogeneous society, or as we like to say “diverse.” That has advantages and disadvantages. We know from comparative research that more homogeneous societies tend to have a greater sense of commonality. Often that is expressed in greater expectations of equality of income, and through a higher level of governmental transfer payments. The very diversity of the US, in other words, may make American democracy less prone to such egalitarian appeals. That has some downsides, to be sure. But it is probably conducive to economic growth.

Then there is the issue of economic ignorance on the part of politicians. No doubt it exists. But it may exist to a lesser extent in the US than in some other western nations. That is because of the way our politicians are recruited. Take Germany, for comparison’s sake. There, most members of the *Bundestag* are professional politicians. They embark on their political career while at university, where they usually study politics or law. They then spend their lives rising through the ranks of the party. By the time they become a member of parliament, they’ve lived their entire adult lives in the political realm, with minimal contact with the realm of the market. As a result, economic modes of thought don’t come naturally to them.

Your typical congressman or senator, by contrast, has usually come to politics from some other profession. Sometimes that is business, though most of the time it is from the law. But American lawyers, like other members of the free professions, have almost inevitably had a good deal of exposure to the market. So their level of economic knowledge and their market orientation is often greater than that of their German counterparts.

And so, despite the inevitable snares that democracy poses to capitalist economic growth, the US may be in a better position to avoid them than many other societies.