

Restoring the firewall between capital and democracy in the capitalist economy

Professor of Political Economy and Development in the Department of International Development Robert Wade shares a comment and elaboration on a new book by Clara Mattei, *The Capital Order: How Economists Invented Austerity and Paved the Way to Fascism*. This was originally delivered by Professor Wade as a presentation at a book launch conference at LSE on 9 November 2022.

Clara Mattei's excellent book ([University of Chicago Press 2022](#)) focuses on the British, Italian and wider European movement – of capitalists, politicians, and especially the “economic technocracy” including academic economists – to restore the pre-World War One capitalist system after the end of the war. That restoration was challenged by workers and intellectuals (including Gramsci) inspired by the new political-economy order in operation during the war, when belligerent governments became actively interventionist in the economy, allocating resources into military and civilian industries and controlling the labour market. There was wide popular support after World War One for continuing with a more active role of government in resource allocation and labour markets, including a welfare state.

This constituted a “structural crisis of capitalism”, in Mattei's term. The economic technocracy in Italy and Britain, and many other countries, urgently focused on how to restore the fully capitalist model, based on private property, market allocation of resources, and the wage relationship whereby most of the population depended on selling their time and attention to a much smaller number of buyers of their labour power, with most of the balance between revenues and wage costs accruing to the owners of capital as profit, and not, for example, as taxes to finance public spending. The capitalist logic to be restored was: no profit, no production, no employment.

The emerging strategy for restoring the “capital order” in the post-war years was the state's “austerity agenda” focused on lowering taxes (especially on the wealthy), cutting government spending on welfare-related activities, tightening monetary conditions, and limiting the workers' rights to unionize and protest. The intended outcome of austerity was wide scope for private enterprise, income highly concentrated in the hands of those who saved and invested rather than those who consumed, and especially,

disempowered workers. This would pave the way to “social harmony” in society, with people in their proper status, and “fair” distribution of prosperity. Also, internationally, the agenda promoted – in some countries more than others – free trade and free capital mobility.

The underpinning idea was a deep distrust of the state and government, and a trust in markets (assuming markets to be competitive rather than monopolistic).

“The capital order” in wider context beyond Britain and Italy after World War One

Mattei’s account of the post-World War One debate between those who championed the austerity agenda and a return to something like the pre-war political economy, and those who wanted to bring forward into the post-war years a more active role of the state in the economy inspired by the dirigiste role of the war-time state, focuses narrowly on Italy and Britain.

We can put it in wider context by starting with Alexander Hamilton’s question. Hamilton began the Federalist Papers, in 1787, by saying that US independence offered an experiment to decide “whether societies of men are really capable or not of establishing **good government** from reflection and choice”. Hamilton said “yes”, and went on to originate the “infant industry argument” for **state-led industrialization** in the US, later adopted by Japan, Germany, Russia, and after World War Two, countries of Northeast Asia.¹

Those who pushed back and said “no” to this positive role of the state came later to be known as “neoliberals” and their approach or mindset, the “neoliberal” paradigm. It championed “austerity” in fiscal, monetary and industrial realms as the way to protect and strengthen the “capital order”.

Unsurprisingly, the “neoliberal” movement opposed the surge in popular and political support for democracy, even before World War One – for the idea that the people, operating through elected political representatives, were the highest authority in each nation state, and entitled to write laws, property rights and contracts in the “public interest”.

The neoliberal movement, with its distrust of the state and trust in the market, resisted

this notion of the good society and the appropriate role of government in a democracy.

Since we are at LSE, let me make the point that LSE in its departments of Economics and of Government has been a leading center of neoliberal philosophy going back to the early decades of the 20th century. Two of LSE's leading economists were exponents of neoliberal philosophy as applied to economics: namely, Lionel Robbins and Friedrich Hayek. Robbins was appointed to the Economics faculty of LSE in 1925 and retired in 1961, 36 years later. He was "*eminence gris*" of all things LSE and built up a group of economists of free-market and anti-Keynesian views. (Robbins remains the only person at LSE commemorated with a bust of his head, made by his son and proudly displayed at the entrance to the LSE library, as though still the presiding angel.) Hayek joined LSE as Professor of Economics and Statistics at LSE in 1931 at Robbins' invitation and stayed till 1950, nineteen years, boosting LSE's reputation as a major center of anti-Keynesian neoliberal philosophy.² Hayek imported his bosom friend Karl Popper after the Second World War to head up LSE Philosophy. They were complemented by Michael Oakshott, a famously conservative political philosopher and "baron" of political science at LSE. Oakshott was appointed to LSE in 1951 and remained till 1980, 29 years. However, LSE also had distinguished professors of very non-neoliberal views, notably William Beveridge and Harold Laski; its faculty was not monolithically neoliberal.

Hayek, Robbins, and others in the neoliberal movement (eg von Mises, Wilhelm Ropke), and their business backers, identified the urgent overarching question as being how to sustain the hierarchy of wealth and power in the face of the spread of, first, organized labour in the West and, second, movements in the global South for decolonization and development. Both trends brought claims by previously excluded people for larger shares of GDP, challenging existing property rights and social hierarchies. Both sets of claims had to be resisted. Robbins disparaged both claims in his sour comment, "'Mines for miners' and 'Papua for Papuans' are analytically similar slogans."

Many neoliberals admired colonial empires and opposed decolonisation. Von Mises especially admired the Belgian Congo, and the Swiss businessman Albert Hunold, who funded neoliberal organizations, declared that the end of white rule in Rhodesia was a disaster comparable to Hitler's rise to power in Germany. Robbins saw decolonization and economic planning at home as reinforcing each other, in the wrong direction.

But Hayek, Robbins and other neoliberals knew they could not oppose democracy

directly, at least not at home. As they opposed the claims of organized workers and the decolonizing countries of the South, they tried to imagine a “capital order” which would *appear* to be a democratic order, with a firewall between the affairs of the democratic order and the affairs of the capital order – so that the masses in each country could not distort the workings of private property and markets.

How was this “capital order” with a firewall between it and democracy to be constructed? They did not set it out like this, but we can infer that they envisaged a three-step mechanism.

- First, states agree to shift some sovereignty upwards to the international realm, where inter-state bodies set rules of property rights, international trade and international investment constraining the actions of national governments (at first to the League of Nations, and after World War Two, the IMF, World Bank, GATT, and some others).
- Second, these international rules promote **property rights across national borders**, such that if one government breaches the property rights of a foreign investor it will invite conflict with that investor’s government. This threat of retaliation is a principle mechanism for enforcing the firewall between the democratic order and the capital order.
- Third, the nation state must be **strong** in the specific task of enforcing property rights, anti-union laws and the like within its territory – but not strong in using a democratic mandate to “interfere” with resource allocation of the private owners of capital, whether domestic or foreign.

So the neoliberals wanted a strong state, not a laissez faire state, but strong only for enforcing their agenda favouring the private property hierarchy and the firewall between the democracy and the capital order.

In short, the main instrument of the neoliberal project – beyond the “austerity project” at home – was and is today international agreements on trade and investment. Why? Because agreements to require free trade and free movement of capital constrain national governments in several ways – by the ever-present threat of “capital flight”, by the threat of retaliation by governments of the foreign firms operating in their territory, and by the need to offer capital-friendly conditions to attract foreign capital.

Today, Investor-State Dispute Settlement (ISDS) clauses written into most so-called free trade agreements illustrate the success of this neoliberal vision in shaping the rules of the international political-economy. ISDS gives a foreign investor in country X the right to bring charges for damages against that government if the government takes actions which limit the company's present or likely future profits – the cigarette company Philip Morris can bring charges against a government that introduces bans on cigarette advertising, for example. The cases are heard by a special ISDS tribunal. The tribunal has awarded damages running into hundreds of millions of dollars. The government of country X cannot bring charges against the company to this tribunal, however. The playing field is stacked against the government in favour of the foreign corporation.

¹Here and later in this section, I draw on J. W. Mason, "The market police", *Boston Review*, June 1, 2018.

²In 1947 Hayek organized a meeting of 39 economists and businesspeople at Mt Pelerin, on Lake Geneva in the Swiss Alps, including Lionel Robbins. This was the start of the Mt Pelerin Society, which became a celebrated global gathering place for intellectuals of neoliberal views. It held its 75th anniversary general meeting in October 2022 in Oslo.

Today's legacy of the post-World War One capital order

As is clear from the above, the post World War One vision of the desirable capital order continues to be influential in government circles today, even to the point of being the standard from which other policies can be judged as deviations. For example:

- Wolfgang Schauble, German finance minister, "Austerity is the only cure for the eurozone", *Financial Times*, 5 September 2011.
- New York Times journalist Louis Uchitelle summarized the consensus at the World Economic Forum meeting in Davos, 2002: "A nation that opens its economy and keeps government's role to a minimum invariably experiences more rapid economic growth and rising incomes."
- Charles Koch, the American billionaire businessman: "Our movement *must* destroy the prevalent statist paradigm" (1978).

- “Charles Koch believes that an unregulated free market is the only sustainable structure for human society” (C. Leonard, “A Koch brother’s big bet on Judge Barrett”, New York Times (International), October 14 2020).

But in post-Second World War democracies, the project to advance the capital order has to be disguised, advanced through organized hypocrisy. Here are two examples:

- Alan Budd, a top UK Treasury civil servant during the Thatcher years: “The Thatcher government never believed for a moment that [monetarism] was the correct way to bring down inflation [though this is what it claimed]. They did however see that this would be a very good way to raise unemployment. And raising unemployment was an extremely desirable way of reducing the strength of the working classes....[This] has allowed the capitalists to make high profits ever since” (in Cohen 2003).
- “Reagan’s head of the Office of Management and Budget, David Stockman, publicly divulged the ideological strategy to camouflage tax cuts that redistribute income to the elite. In an unguarded moment, he characterized the supply- side theory behind the tax cuts of 1981 as a ‘Trojan horse’ to re- craft fiscal policymaking to benefit the wealthy: ‘It’s kind of hard to sell “trickle down”, so the supply- side formula was the only way to get a tax policy that was really “trickle down.” Supply- side is “trickle- down” theory” (Greider 1981, 46).

Budd and Stockman could scarcely be clearer in explaining the code used to hide the reality of the austerity agenda from the public.

But today, especially since the smart phone in 2010 and then algorithmic social media, politicians have learnt to combine (a) attracting support and donations from the wealthy by advocating low taxes on the wealthy, cuts in public welfare spending, rises in police and military spending, with (b) attracting voting support from non-wealthy sections of the population by stoking moral outrage and promoting anti-liberal “identity” values – including anti-abortion rights, anti-feminism, anti-gay marriage, anti-LGBTQ rights, anti-people-of-colour, anti-immigrants, anti-non-Christians, anti-elites, anti-globalization, anti-European Union. Trump is just one case of many who have used this playbook, which we could call the “pluto-populist” playbook.

The populist side of the pluto-populist playbook builds the politics of resentment into a promise to older voters to restore the society to the “way things were in the good old days”, to “Make America, or Britain, or Brazil, or Hungary, or India, or Turkey, or Israel, many others, Great Again”, with emphasis on the last word. In effect, a promise to cure the widespread sense of “disorientation” and “loss of “status” experienced by many in the older generations, especially white men without college education.

I am not clear to what extent the global phenomenon of the rise of the far right in the past decade is tied to the “austerity” strategy. For example, to what extent do: Italy’s new government under President Georgia Meloni, France’s Marine Le Pen (who won 40% of the vote in the final round of the presidential elections), Sweden’s hard-right party which won the second highest number of seats in Parliament in elections earlier this year, Bolsonaro’s government in Brazil, Modi’s government in India – to what extent do they adopt a “pluto-populist” playbook which combines austerity, income concentration at the top, and identity politics based on anti-liberal values? To what extent do they mobilize mass electoral support by softening the austerity agenda with forms of targeted economic protection – which then join the standard **populist** components of “tough on crime”, cultural reaction in the form of identity politics, topped off with electoral chicanery like gerrymandering?

How do the strategies of populist authoritarians like Putin, Lukashenko and Xi compare with the strategies of these more democratic leaders? Putin and Xi have both moved in the past several years to exercise broader and deeper state control of the economy, expanding state firms and further constraining non-state firms. (Neither Russia nor China has “private” firms in the sense understood in the West, because ostensibly private firms have much less legal protection from state intrusions than they do in the West.) President Xi used the important Communist Party congress in October 2022 to establish almost-one-man-rule and make it clear that national security trumps the economy as the top priority. He mentioned “security” 52 times, “Marxism” 15 times and “markets” three times.³

³Li Yuan, “China’s business leaders see country slipping away”, *NYT (I)* 10 November 2022.

The views expressed in this post are those of the author and in no way reflect

those of the LSE International Development blog or the London School of Economics and Political Science.

Main image via [FT.com](#).