

# 6. Politics beyond neoliberalism

## History does not end

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Economic policies do not exist in a vacuum. Political processes shape which policies get enacted and how they are implemented, as well as who pays for and who benefits from them. And economic policies and outcomes, in turn, shape politics and political outcomes. The two cannot be easily separated.

Yet neoliberal economic policy advisors often downplayed or ignored politics. Beyond vague appeals for “good governance,” neoliberalism’s focus on “best practices” that could apply uniformly to all countries dismissed how political contexts shape and constrain economic policymaking. Today, however, there is an increasing awareness that economic policy is inherently political, and that development interventions need to take politics and political processes seriously.<sup>1</sup>

This brief chapter assesses some of the broader political questions that will shape the future of emerging markets. It begins by placing the rise of neoliberalism in historical political context, then discusses the complex and contested relationship between neoliberalism and democracy, and identifies some of the key issues that will drive politics after neoliberalism. It closes by considering whether either of two potential alternatives to liberal democracy—authoritarian capitalism and neo-nationalism—will be lasting rival political models.

### New political fault lines

In 1989, just before the fall of the Berlin Wall, Francis Fukuyama published his famous essay, and subsequent book, on “The End of History”. Fukuyama’s argument was that liberalism had triumphed and that the long historical struggle between Marxist inspired centralist socialism and market based democratic liberalism had ended with the victory of the latter.

Democratic liberalism in the sense of Fukuyama is a broad mantle. It includes social democracy reformed by the historic Bad Godesberg Congress in Germany (1959) as well as its other European variants. European Socialist and Social Democrat Parties embraced market based liberal economies and political systems. In this definition, the rights of individuals are paramount. So liberalism was not by any means confined to the political right. But of course it included conservative and centrist parties in Europe and the United States that had already adopted market based economic philosophies and that all put individual human rights “at the core of their political communities.”<sup>2</sup>

Of course, Fukuyama did not project the end of politics. Arguments about fiscal and monetary policies, taxes and transfers, regulation, retirement, and other social policies continued. But the systemic and ideological clash between liberal capitalism and centralist socialism was over. It may be worth noting that this systemic clash was strongly felt all over the world for

decades, except in domestic politics in the United States, where socialism had always been very weak.

By the early 1990s it seemed that Fukuyama's thesis was being borne out by the facts. Liberalism as broadly defined had triumphed over Soviet style socialism.

The disintegration of the Soviet Union and the disappearance of its socio-economic model also had a tremendous impact in developing countries. Many adopted some form of democracy during the 1990s. Soviet centralism was abandoned as an economic model, although autocratic regimes persisted mainly in Africa. This profound change in the world order was a victory for democratic liberalism at a time when neoliberalism had largely won the battle for pre-eminence within the panoply of liberal ideology.

What developed more widely in the 1990s was a less Keynesian liberalism, with a more limited role for pro-active monetary and fiscal policy, a great deal of financial sector deregulation and a great deal of privatization. This laissez faire liberalism, referred to as neoliberalism, was not a pure application of the Chicago school ideology and it varied a great deal: the United States and the United Kingdom were much more neoliberal than France or Japan, for example.

The neoliberal period was also one during which international cooperation flourished. The International Monetary Fund expanded its mandate and started dealing with microeconomic issues. The World Bank was active with policy loans, in which a mostly neoliberal set of policies were conditions for lending. The World Trade Organization increased its membership and assumed its arbitration role. A new regional bank, the European Bank for Reconstruction and Development, was created for the post-communist countries.

It is in this context that one has to understand the Washington Consensus, a term coined by John Williamson that refers to the advice given to developing countries by the IMF, the World Bank, or bilateral donors. This advice and the aid programs accompanying led to a wave of neoliberal advice being extended to the governments Latin America, Asia, and Africa. In the post-Soviet republics, particularly in Russia, such advice led to disaster, as the minimal institutions to make markets function did not yet exist. In 1997-98, a certain version of neoliberalism was also at least partly responsible for the great Asian financial crisis.

The performance of the advanced economies during the 1989-2007 period was mixed. There was no significant crisis or economic downturn; this time was referred to as the great moderation. Global growth averaged 3.7 percent and 3.0 percent in the United States. But income distribution became more unequal. A crucial feature of the neoliberal period was the decoupling of productivity growth from wages in many countries but particularly in the U.S. Income inequality increased with strong concentration at the top. The phenomenon was not as strong in developing countries, except China.

Looking at the period from 1989 to 2008 (Lehmann Brothers bankruptcy), one cannot therefore say that it was entirely smooth economic sailing. Inequality increased within countries and the Asian crisis caused substantial output losses. The neoliberal model had a quasi-monopoly on economic policy, or at least economic policy advice. The Keynesian brand of liberalism was weak and did not have much influence. When looking at the guidance developing countries received—privatize-liberalize prices, lower trade barriers, adopt flexible labor markets—it was essentially the same everywhere. One could almost interchange the country advice and get virtually the same set of recommendations. There certainly was no longer an altogether different socio-economic model as during the Cold War years. Moreover, the other strands of liberalism had lost intellectual influence, although policy practice still contained Keynesian traces and social democrat aspects in Europe.

However, *the political part* of the neoliberal model was not equally successful. While the number of democracies has increased, many countries remained dictatorships. This led to markets functioning under political control, which in turn facilitated corruption and nepotism. Nonetheless, the economies of these countries basically followed the neoliberal model and while some might not have engaged much in international cooperation, they did not disrupt widespread participation in multilateralism.

It is this neoliberal world that suffered the devastating 2008 financial crisis, threatening the world with a great depression on a scale not seen since the 1930s. At the height of the crisis, most observers thought that the spectacular failure of market capitalism would lead to a movement to the political left and the abandonment of large parts of neoliberalism. The question was asked: What comes after neoliberalism? Analysts in the U.S. predicted the return to more regulation and to Keynesian liberalism. In Europe, many went further and predicted a move towards new forms of socialism. In the developing world, neoliberalism lost its shine and observers eagerly followed the post-2008 events in the advanced countries. The Chinese model of strong state intervention gained sympathy, but it was not adopted by other countries. On the whole, it is fair to characterize the state of economic policy making in developing countries as a mixture of Keynesianism, neoliberalism, and socialism, with no clear direction for the future.

## Capitalism and democracy: Modernization theory revisited

There is a long-standing debate in the social sciences on the relationship between capitalism, economic development, and democracy. Early proponents of this ‘modernization’ theory argued that economic development was an important catalyst of democratization.<sup>3</sup> The development of market-based economic institutions and democracy-based political institutions are assumed to go hand-in-hand. There is, after all, a certain harmony between the logic of economic neoliberalism and one-person-one-vote democracy, which both privilege individual liberty and share an assumption that individuals operating in their own self-interest will lead to efficient and stable society-wide outcomes.

Yet in reality, the relationship between democratic politics and neoliberal economics is much more complicated and contested. Many economic neoliberals embraced political structures that could shield markets from populist pressures that might gain power through democratic means, and attempted to “encase” markets from democracy, particularly in post-colonial settings.<sup>4</sup> Indeed, democratic demands for redistribution and the (possible) suspension of property rights suggest an inherent tension between democracy and lightly-regulated capitalism. At the same time, hopes among some political liberals that growing economic development and liberalization in authoritarian countries, particularly China, would necessarily unleash democratic pressures appear to have been misplaced.

Similarly, among the current crop of leaders who have adopted illiberal political policies, we do not necessarily see a concomitant shift away from neoliberal economic policies. While it is too early to draw any conclusions, leaders such as Brazil’s Jair Bolsonaro appear to be quite happy with a broadly neoliberal economic outlook. Still other illiberal leaders, such as Hungary’s Victor Orbán, have adopted a complex mix of both neoliberal and more interventionist economic policies.<sup>5</sup> While contemporary populists have often embraced strident rhetoric against multilateralism and the global economy—and in particular against migration—they are not necessarily rejecting global capitalism.

Ultimately, we observe substantial variation among both democracies and authoritarian countries in their choices of economic models. The linkages between economic development and democratization are not firm as was once believed,<sup>6</sup> as the economic policies adopted by

democracies do not strictly conform to neoliberal economic principles, and illiberal leaders do not eschew capitalist policies. While economic policies and analyses can inform political debate, it cannot settle it.<sup>7</sup>

## What comes after neoliberalism?

What is likely to emerge from the 2010s, which proved to be a period of political and economic crisis? For decades, be it in various forms, the center-right and center-left competed for power. Is a new politics likely to take form? The 2008 global crisis centered in the U.S. and the 2010 Euro-crisis is now behind us. What actually happened after 2008 crisis subsided has been very different from what was expected. Overall, there was a political shift to the right, epitomized in the victories of Brexit and Donald Trump. The increasingly inflammatory rhetoric and actions from autocratic-leaning populist leaders such as Viktor Orbán and Rodrigo Duterte of the Philippines demonstrate an unsettling trend. Although the specific drivers of these political changes vary, these movements all seek to undermine democratic institutions due to their perceived, and real, failures.

After a period of uncertainty, during which the direction the world would take was unclear, 2016 brought a wave of populism and nationalism. However, these movements were not born overnight. They were brewing over time, gathering strength during the early 2000s recession and gaining significant steam in the aftermath of the global financial crisis. It is unsurprising that one of the main economic weakness of the 1990-2010 era was worsening of income distributions.

While the recent rise, and spread, of populist and neo-nationalist movements have been linked to rising frustrations with economic inequality, globalization, and rising identity issues, one must also keep an eye to history. Cycles of populism and authoritarianism are often followed by waves of democratization, and vice-versa. This is often amplified by global political and economic crises, as evidence by the experiences of the 1930s. In this context, to what extent did neoliberal policy prescriptions lead to this rise in populism, and, is it possible to roll back the tide?

In assessing how emerging markets' political models may evolve after the neoliberal era, three key themes are paramount:

### **State capture, corruption, and the turn toward populism**

In many countries, incomplete political transitions have allowed a small group of individuals to wield disproportionate political power. The concept of “state capture,” where powerful firms and individuals are able to shape and distort lawmaking and regulatory processes to their own advantage, was first developed in the context of the former Soviet Union’s liberalization process.<sup>8</sup> Here ambitious oligarchs were able to seize control during hastily organized privatization programs.

More recently, South Africa has been grappling with charges of state capture, following revelation of the extent to which the Gupta business empire influenced policymaking. Meanwhile, in Brazil, the complex web of corruption that links the construction conglomerate Odebrecht, the state-owned oil company Petrobras, and the Brazilian state has also come unraveled through the Operation Car Wash investigation. The challenge of state capture raises the question: which is the bigger obstacle to the future of political liberalism in developing countries—state-owned enterprises or enterprise-owned states?<sup>9</sup>

To the extent that state capture and corruption undermine the notion of equal representation in a liberal democracy, they contribute to weakening liberalism as a political model. They may also challenge the liberal model if citizens’ respond to state capture by rejecting existing

models and demanding new populist responses. As an empirical question, however, it is not clear if there is a generalizable relationship between corruption and demands for radical political change. Indeed, where corruption or state capture lives hand in hand with strong income growth, it is often accepted by citizens.

During the East Asian miracle, for instance, corrupt crony capitalism was widespread, but high growth ensured overall contentment. It is certainly true that in some countries, such as Brazil, entrenched corruption contributed to disaffection with elites and support for populist responses. Yet it is not clear that corruption can meaningfully explain the recent rise of populism, if only because corruption has been a regular feature of the political economy of many emerging markets for decades. Corruption is tolerated so long as the state is able to get things done; it is when the state falters that complaints about corruption and demands for populist responses arise. The inability of ruling parties in recent years to deliver functional services, internal security, and more equitable economic growth have driven increased support for newly elected, and currently serving, populist rulers.

### **Accountability and legitimacy beyond liberal democracy?**

In principle, liberal democracy is expected to provide societies with accountable and legitimate governments, leading to policies that reflect voters' well-informed and considered preferences. In practice, however, the "romantic folk-theory" that rational voters use elections to ensure governments adopt their preferred policy outcomes appears to be largely a myth.<sup>10</sup> Voters frequently fail to demonstrate strong preferences or good foresight, and often choose parties and candidates on the basis of identity or partisanship more than a careful evaluation of policy positions. Elections often turn on events largely beyond the control of incumbent politicians, such as a run in the stock market or even the weather.

If electoral mechanisms are often an imperfect and incomplete means of achieving accountable and legitimate government, are there alternative means for achieving these objectives? Today governments are experimenting with new approaches to achieve accountability and legitimacy without necessarily adhering to liberal democratic models.

For instance, in China the Communist Party instilled reforms to make its vast bureaucracy more competitive and responsive to business needs through "directed improvisation" between party bosses and local officials.<sup>11</sup> Additionally, the Chinese concept of social credit (*shehui xinyong*) serves not only to localize governance, but also influences market behavior of citizens and corporations alike. China's citizens are also able to exert some influence over bureaucrats through informal accountability mechanisms organized around solidary groups, such as churches and temples.<sup>12</sup> Such measures of diagonal accountability engage citizens more directly in governance processes, relying on a "fire alarm" model of oversight that asks citizens to identify problems.<sup>13</sup>

Moreover, technological advances that lower the cost of transmitting information may make it easier for non-democratic regimes to encourage both accountability and legitimacy. Digital governance tools allow governments to elicit citizen opinions and respond quickly to demands for change, outside of electoral channels. These advancements can benefit both liberal and illiberal regimes to not only improve accountability, but also bolster legitimacy.

Other countries with even weaker formal institutions are also experimenting with novel governance mechanisms. For instance, in Afghanistan there have been successful attempts to build accountability through community-level institutions that encourage feedback loops between citizens and governments, even absent the formal underpinnings of a liberal democratic state. Overall, there are many informal and indirect means that even non-democratic governments are using to respond to and engage with their citizens.

Similarly, competitive liberal democracy may not be the only route to state legitimacy in the 21st century, as Fukuyama had earlier assumed. Ruling governments may be able to retain widespread legitimacy through effective performance, rather than by facing voters. Numerous one-party states—both de jure (China, Vietnam) and de facto (Singapore, Ethiopia)—have held on to power by delivering material gains to their populations. In other more clientelist regimes, particularly in the Middle East, governments have clung to power by distributing rents to powerful interest groups—buying off citizens, rather than getting them to buy-in to the state’s authority. Of course, when governments attempt to achieve legitimacy through economic performance or distributing rents, rather than through democratic principles, their legitimacy may be tenuous and quickly evaporate in the face of economic pressures.

To be clear, none of this is meant to imply that democracy isn’t important, or that non-democratic countries are equally responsive to their citizens. But it highlights the need for a more careful consideration of what constitutes accountability and legitimacy for modern states. While democracy is both inherently and instrumentally valuable, the fact that some non-democratic countries are able to achieve some measures of accountability and legitimacy suggests that demands for democratization may be less powerful than we would otherwise expect.

### **Individualism versus the power of group identities**

In the simplified neoliberal political model, rational individuals vote based on their own preferences, while politicians vie to convince them they can best implement their preferred policies. Yet in both consolidated and newer democracies, political contestation has proven much more complicated. Voters often define their interests not as individuals within one common nation state, but as members of a particular identity group, in contestation with other groups. This can redefine social cleavages and axes of political contestation, and may decrease politicians’ motivations to appeal to swing voters. In former colonial countries, where political boundaries map imperfectly alongside pre-existing national or ethnic geographies, these issues have long played an important role in politics. This calls into question neoliberalism’s focus on the individual as the most important level of analysis for understanding political contestation. At the same time, stark increases in economic inequality and the resurgence of identity politics may be responsible for a reframing of political discourse away from economic issues towards distinct group interests, as Fukuyama has recently argued.<sup>14</sup>

If politics is contested not among individual, rational self-interested voters but instead among organized groups and communities, what does this imply for the future of democracy? A key question is what form such groups will take, and how they will define their membership and interests.

In the past, organizational groups and unions often served as a key focal point for defining voter interests and identities. Yet the membership and political influence of unions and similar groups have seen a steady decline in recent decades, often facilitated by neoliberal policy changes. In their place, identity-based politics and organizations have found new prominence. The challenge today is to revive organizational structures that can channel group-based politics into inclusive, cohesive, non-discriminatory policy outcomes.

## **Will a new political model emerge as viable alternative to capitalist liberal democracy?**

Fukuyama’s history is continuing in an unexpected fashion. The old holistic struggle between liberalism and communism and the more recent struggle between Keynesian liberalism and neoclassical neoliberalism seems to be on the verge of being replaced by new divides. On the

one hand, authoritarian capitalist models combine single-party politics and deep links between the government and the private sector, with integration in the global economy and at least some reliance on market-based mechanisms to allocate resources. On the other, neo-nationalist models are built on a sense of exclusive community and a belief of unavoidable conflict in a Darwinian world. Do either of these models represent a serious long-term challenge to capitalist liberal democracy?

The economic success and political stability of many authoritarian capitalist countries has generated considerable interest in replicating this model. China, of course, is the most prominent example of this approach; yet China is also *sui generis*, and it is not clear to what extent countries with smaller internal markets can mimic China's policies. There are a number of other countries, however—including Singapore, Vietnam, and Ethiopia—that also adopt some measures of authoritarian capitalism. These countries all seek to engage in the global economy while keeping strategic industries under government control. As China and other authoritarian capitalists engage in more outward foreign investment and build economic links with other developing countries, the appeal of this model may spread.

The recent rise in neo-nationalist politics, meanwhile, appears to be a response to perceived excesses of globalization and cosmopolitanism. These trends may constitute a new ideological battle, as the animosity of the neo-nationalists towards the liberals is much stronger than the animosity that existed within the various strands of liberalism. Note that the neo-nationalists want to get rid of all types of liberalism, not just neoliberalism. Defending liberalism against neo-nationalism is not defending the particular brand called neoliberalism. Neo-nationalists are not liberals and have their roots in ideas that are fundamentally illiberal. Many of their ideas can be found in the writings of Carl Schmidt (see Mark Weiner) who joined the Nazi party in Germany in 1933. For the neo-nationalists, nation-states are in a constant struggle with each other: there is room for “deals” to be made, but there is no room for the international norms and rules of a liberal world order. The individual has to conform to the national community, and these communities are in constant struggle with each other.

While many authoritarian capitalist countries have embraced globalization, neo-nationalist ideology presents a deep challenge to globalization and international cooperation. Authoritarian capitalist and liberal democratic countries may be able to coexist in many international fora, but this will be more difficult for neo-nationalists. While it is a coherent ideology, it tends to lead to devastating conflict.

What comes next will most likely be a more chaotic international order, where hybrid democracies pursue a *mélange* of economic and social policies that are politically expedient and beneficial. In many ways, we have already arrived at this future. How well it will function remains an unanswered question.

## **A huge challenge for developing countries**

This is the background for the policies and strategies developing countries can adopt. They face a new world with very uncertain political outcomes and behaviors. It is a world where a few globalized firms are as large as medium sized economies, and where anti-monopoly policies must have international dimensions. It is a world where new-technologies define new markets.

This pending disruption comes at a moment in history when, after long struggles, developing countries have finally won greater equality within the multilateral system. Yet multilateralism and international cooperation are breaking down because of the powerful rebirth of nationalism around the world. On the domestic front, winner-take-all practices seem to overwhelm the checks and balances of western democracies. Few predicted that just a few

years ago, when globalization seemed ascendant. The new dominant fault-lines seem to lie between democratic liberalism, neo-nationalism, and authoritarian capitalism. Developing countries will have to choose how to maneuver in such a world, evaluate competing political models, and adapt to circumstances where cooperation has become more difficult.

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<sup>1</sup> See, for instance, the World Bank's 2017 World Development Report on Governance and the Law.

<sup>2</sup> Weiner, Mark. "Trumpism and the Philosophy of World Order." *Project Syndicate*. July 23m, 2018. [www.project-syndicate.org/commentary/trumpism-is-carl-schmitt-in-action-by-mark-s--weiner-2018-07](http://www.project-syndicate.org/commentary/trumpism-is-carl-schmitt-in-action-by-mark-s--weiner-2018-07)

<sup>3</sup> See in particular Seymour Martin Lipset, "Some Social Requisites of Democracy." *American Political Science Review* 53, no. 1 (1959); pp. 69-105.

<sup>4</sup> Quinn Slobodian, *The Globalists*, Harvard University Press.

<sup>5</sup> See "Hungary's unorthodox economic policies" <https://financialobserver.eu/ce/hungarys-unorthodox-economic-policies/>

<sup>6</sup> See Acemoglu, D., Johnson, S., Robinson, J., and Yared, P. (2005) Income and Democracy *American Economic Review* 2008, 98:3, 808–842. <https://economics.mit.edu/files/9037>

<sup>7</sup> See "Economic Analysis to Inclusive Growth" <https://www.brookings.edu/opinions/from-economic-analysis-to-inclusive-growth/>

<sup>8</sup> Hellman, Jones, Kaufmann 2003

<sup>9</sup> This line is an unattributed quote reported by Duncan Green <https://twitter.com/fp2p/status/1071056766908157954>

<sup>10</sup> See in particular Christopher H. Achen & Larry M. Bartels, *Democracy for Realists: Why Elections Do Not Produce Responsive Government*, Princeton University Press, 2016.

<sup>11</sup> Yuen Yuen Ang, *How China Escaped the Poverty Trap*, Cornell University Press, 2016.

<sup>12</sup> Lily Tsai, *Accountability Without Democracy: Solidary Groups and Public Goods Provision in Rural China*, Cambridge University Press, 2007.

<sup>13</sup> On the fire alarm model of oversight, see Mathew D. McCubbins and Thomas Schwartz, "Congressional Oversight Overlooked: Police Patrols versus Fire Alarms." *American Journal of Political Science* 28 (1): 165-179, Feb 1984.

<sup>14</sup> Fukuyama, Francis. "Against Identity Politics." *Foreign Affairs*. September/October 2018. <https://www.foreignaffairs.com/articles/americas/2018-08-14/against-identity-politics-tribalism-francis-fukuyama>