Democracy failure

The root of the global economic crisis is political

By John Keane

Eighteen months into the deepest economic slump since the Great Depression of the 1930s, one thing is abundantly clear: the world economy is once more suffering the incalculable shock effects of a massive market failure.

The bursting of the global credit bubble, predictably, is paralysing virtually all market sectors in all countries, even those (like Japan) that took earlier measures to fit 'bank proof' shock absorbers to their economies. The scale of corporate debt issuance and 'securitisation' – the risky bundling of debts on such things as mortgages and credit cards – is causing shock. Panicked reactions and contradictory stopgap measures are multiplying. Trying to calm jitters, the International Monetary Fund's Dominique Strauss-Kahn has recently pronounced that the world now faces a 'great recession'. Suddenly, as if through overnight conversion, politicians rail against 'greedy' bankers and corporate fat cats. Scapegoats – Bernard Madoff, Sir Allen Stanford – have become household names. So have words like 'bail out', 'toxic debt' and 'rescue packages'. Of significance – Obama's 2009 budget points in this direction – is the appearance of first-stab efforts to formulate redistributive policies that protect citizens against unemployment, loss of savings, deteriorating public infrastructure and other effects of the bursting bubble.

Such moves against the old free market consensus resemble slamming shut the gates after the horse called Equality has bolted. Among the documented effects of the credit bubble is that most democracies experienced a 30-year widening of income and wealth inequality. The whole trend – toward hourglass-shaped societies – has been bad for democracy. It has spawned an underclass. Middle-class people were deluded into thinking they were growing richer by the day. The spirit of solidarity so necessary for citizenship was corroded by market selfishness. The present bursting bubble is deepening these undemocratic trends. In poor countries, according to the World Bank, only a quarter of governments have the resources to cushion their citizens against the great recession; net capital flows in their direction have fallen to less than a fifth of the level two years ago. In richer countries, where 'de-leveraging' is rife, mortgage defaults among the poor are rising. Pension funds are threatened. As companies slash dividends, preserve cash and reduce employment, trade unions find themselves challenged. Bank bailouts and other mega-forms of government intervention are sharpening the sense of many citizens that while the rich get billions the people get pennies. Then there is the most worrying threat to equality posed by the bust: that when the huge rescue package bills are finally presented, governments will try to rebalance public finances through spending cuts and increased taxes that have further socially regressive effects.

To the extent that democratic institutions have failed to live up to their own standards of citizen equity we can speak of democracy failure. But there is a more troubling sense in which countries such as Britain and the United States have suffered democracy failure. Since 1945, when there were only a dozen democracies left on earth, a major sea change took place in the real world of democracy. Monitory democracy was born. A clue to its novelty is the invention of scores of power-scrutinising mechanisms – human rights organisations, summits, forums, integrity commissions, participatory budgeting and citizens' assemblies – whose combined effect has been gradually to alter the political geography and everyday dynamics of democracy as we know it. Democracy is coming to mean much more than periodic elections – though nothing less. It means the permanent public scrutiny and restraint of power, wherever it is exercised in the domestic and cross-border fields of government and civil society. The historic struggle for one person, one vote is over. In the

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Die Finanzkrise ist ein Versagen der Demokratie

Die aktuelle Finanz- und Wirtschaftskrise zeigt: Dieses Marktversagen ist auch ein Versagen demokratischer Vertreter und Institutionen. Um künftige Krisen zu vermeiden, müssen neue Regulierungsorgane geschaffen werden. Die Schlüsselfrage hierbei ist, ob Regierungen und Märkte für ihre Taten öffentlich verantwortlich gemacht werden können.

new age of monitory democracy, elections still count, but parties and parliaments now have to compete with thousands of monitory organisations and networks that try to keep power on its toes. The old meaning of democracy as the periodic election of representatives based on the rule of one person, one vote, is being replaced by democracy guided by a different and more complex rule: one person, many interests, many votes, many representatives, both at home and abroad.

The key exception to this unfinished trend that began in 1945 is the failure of monitory democracy to penetrate the banking and credit sectors of the global economy. Authorities like central banks and the IMF never publicly questioned the false belief that selling credit risk to third-party investors would disperse credit risk. Bankers, often lacking professional qualifications, biased by their own company training programmes and happy to collect handsome 'slice and dice' fees, seemed ignorant of their risky structured products and the quantitative models they embraced. National governments nurtured the unsustainable credit culture. Journalists unspecialised in the field seemed neither to care nor to understand the dangers attached to new-fangled debt instruments, such as collateral debt obligations and mortgage-linked securities. Worst of all, cross-border leveraging of capital went unchecked – an astonishing fact when it is considered that in most other sectors of the global economy regulatory bodies like the IMF, the World Bank, the United Nations Convention against Corruption and the G8/G20 were deemed necessary for protecting local economies from the bubbling anarchy of market failure.

The true cause of our present difficulties is that democracy slept through the making of a deep crisis. Democracy failure bred market failure. Unelected regulatory bodies and elected politicians, parties and whole governments let their citizens down. The self-regulation model palpably failed; empowering bodies like Moody's and Standard and Poor's and the UK Financial Services Authority to look after the credit and banking systems resembled putting alcoholics in charge of a wine bar full of celebrating bankers. There were few or no monitory bodies to blow whistles or sound alarm bells. Brave individuals who did so were ignored, silenced or sacked. The consequence: banks, investment firms and hedge fund operators, shrouded in secrecy, were allowed to pursue reckless adventures that brought the world's banking and credit institutions to the edge of a cliff.

The symptoms of democracy failure are palpable. Almost everything that matters to citizens is suddenly rising or falling, as in a wild day at the stock exchange. Full-time (professional) jobs are disappearing; short-time working and part-time employment, especially among women forced to supplement household income, are generally rising. So too are levels of household debt and families' felt sense of material insecurity; for the first time in a generation, the size of the middle class is shrinking, along with hopes that its children will in future be better off. Levels of state debt have reached all-time highs. In some circles, there is nervousness about the long-term viability of the greenback – the global currency of the global power which runs a current account deficit of more than 6 percent of GDP, a level normally linked to a government about to suffer a foreign exchange crisis. The veto power of the Chinese government, its ability to stop purchasing Treasury bonds, and thus to pull the plug on the United States and tip the world into a tumble, is meanwhile growing. More immediately worrying is the way frustration and anger with parties, politicians and governments are mounting, particularly in highly vulnerable countries, such as Iceland and Latvia, whose democratically elected governments collapsed under pressure from distress, despair and irruptions of public violence.

China is obviously a key player in handling the crisis. We shall see what happens there: whether the signatories of Charter '08 impeccably timed their demands for monitory democracy, or whether instead the Party authorities can handle the (poorly reported) growth of private and public anger, perhaps even by using current American weaknesses to accelerate the drift toward bipolarity in world politics. We'll also see whether the fragile institutions of moni-

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Summary

The world economy is suffering the incalculable shock effects of a massive market failure. But arguably the root cause of our present difficulties is that democracy slept through the making of a deep crisis. Democracy failure bred market failure. Unelected regulatory bodies and elected politicians, parties and whole governments let their citizens down. The market self-regulation model palpably failed. An urgent priority is to invent new monitory bodies. The key question is whether governments and markets are held publicly accountable for their actions by citizens and their various representatives.

tory democracy can survive this crisis. The French historian Emmanuel Todd, concentrating on the rise of Berlusconi-style governments, forecasts its death. That seems premature, if only because the prediction understates the novelty of our times. During the build-up to the last Great Depression, democracy arrived late on the scene; in consequence, it failed badly in countries as different as Chile, Poland and Japan. This time around things may turn out differently. Monitory democracy is more shockproof than old-fashioned representative democracy; and much now depends on shocks unknown, choices unmade and policies unformulated.

This is the most worrying effect of democracy failure: the scale and depth of the bursting bubble are simply unknown. Warren Buffett has rightly noted that naked swimmers will only be spotted when the economic low tide comes. We know neither the extent of leveraging that has taken place nor the measures needed to rein in its lethal effects. And we have no ready answers to the toughest question: whether the credit culture that mushroomed for three decades, fed by deregulation, the meteoric rise of China and India and the anchor role of the United States, itself both the backbone of the global currency system and the world's biggest debtor country, is any longer sustainable, environmentally or in market or political terms.

No doubt there are democratic opportunities amidst the ruins. Sensitivity to the fact of market failures is rising. Market-based solutions are for the time being unfashionable. Responsible government and redistributive policies are back on the political agenda. But whether and how citizens and their representatives can survive the current onslaught of unchecked power from above is less clear. Culpable governments need to be thrown from office, as has happened in Iceland. Yet monitory democracy – the best weapon so far invented against folly and hubris – must also be strengthened. It follows from the analysis of democracy failure that blind trust in either markets or government regulators is folly, and that an urgent priority is to find more open and equitable ways of preventing future breakdowns of credit markets, which are bound to remain the drivers – and potential depressors – of markets in general. The question is not just whether governments are too big or too small or whether they work (the words used by Barack Obama in his inaugural address). The question is also whether both governments and markets are held publicly accountable for their actions by citizens and their various representatives.

The quest to abolish folly and hubris from capital markets may never fully succeed. Risk taking and promise making in the banking and credit sectors are by definition neither fully predictable nor capable of transparent regulation. But given the pickle we are in viable new monitory bodies are urgently needed. The College of Supervisors and other reforms proposed for the EU by Jacques de Larosière certainly count as examples. Proposals by the US Congress to empower a new governmental authority to scrutinise and address potential systemic market risks run in the same direction. So would a first-ever global regulatory structure in the fields of banking, insurance and securities – a credible forum (perhaps administered jointly by the IMF and a revamped Financial Stability Forum) that would crack down on fraud, foster best practice through open-minded counsel and provide a means by which those hurt by this crisis may seek redress.

Whether in fact new institutions will be built, or built quickly enough, is for the moment quite unclear. Just one thing is absolutely certain. Given that the root cause of this crisis is political, the solution has to be political, this time by finding the best remedy for democracy failure in the strengthening of democracy itself.

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