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Democracy and the economy [1]

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The old balance struck between rich and poor in a democracy has been circumvented, says Madsen Pirie. A third option, to borrow from the voters of tomorrow, has given politicians around the world a blank cheque to spend their way into oblivion.

Most societies have a tension between rich and poor. Many of the ancient Greek city states chose sides in wars and disputes depending on whether they were oligarchies, ruled by the rich, or democracies, which gave citizens the vote, although not women, slaves or resident foreigners.

Even within democratic societies there has always been a tension. The poor are more numerous and have more voting power; the rich have more resources and can use them to influence opinions. In many democracies there is at least one party broadly sympathetic to the interests of those with wealth to protect, and at least one committed to a broader distribution of that wealth.

Both are restrained by circumstance. If the wealth of the few is inaccessible to the many, and there are scant opportunities for people to see their lives improved, there is the possibility of social unrest and upheaval, not something most wealthy people would wish to see.

On the other hand, if the poor vote to take and distribute too much of the assets and income of the rich, they might well stop the wealth-creating process and leave the whole of society poorer. High achievers and earners need an incentive to engage in their activity; with insufficient reward they might move abroad to do it, or simply choose to do something else instead.

In many societies a balance has been maintained, with sometimes one side gaining an advantage, and then the other in turn. Some societies ruled overwhelmingly for the advantage of the rich have seen revolution; and those which have confiscated wealth in the name of equality have seen economic breakdown and ruin. Most have done neither.

Politicians in Britain have bid for the votes of the poor to win power, and have done so by promising to divert some of the wealth of the rich in their direction. They have been restrained by the need to keep the wealth-creating process functioning. Some have argued that the excessive taxation and redistribution by post-war governments went too far, such that Britain's economy sank into decline, making it "the sick man of Europe." One of the achievements of the post-'79 government was to restore incentives and opportunities, and kick-start the wealth-generating process again.

Two modern developments have impacted upon this constant tension between democratic resolution and economic expansion. One has been the spread of globalization, and with it the mobility of talent and capital.

When the achievers and earners feel that their home government is taking too large a share of their rewards, they have an increasing option to move their productive activity abroad, and sometimes even themselves. This exit opportunity has put more restraints on how much of output government feels able to appropriate and redistribute.

The EU response has been to seek for circumstances in which every country has high levels of tax and regulation so there simply are no more exits and refuges. They are restrained in this by the reality of a diverse world. If there are no business-friendly places in Europe, people will move to where there are. It would take a world government to prevent this, and there are some redistributionists who actually want this.

The other development is less benign. Limited in the degree to which they can take resources from the rich to buy votes, democratic politicians have discovered a new source of funds. Increasingly they have been taking wealth from the future in order to fund the social programmes with which they solicit the votes of the poor today. They have introduced a third group, the future, into the age-old tension between rich and poor.

They have borrowed to fund today's spending the money that will have to be repaid in the future. The future cannot escape, as the high achievers and earners can. It will not vote against the political leaders who have raided it, because it does not yet have any votes. Politicians have discovered a way of maximizing their advantage and that of their supporters without incurring the antipathy and resentment of those they take from. People in the future might well feel hostility and anger at those who burdened them with such debts, but they are not here now, and their reactions to not have to be factored into today's political calculations.

The restraints that limit what can be taken from the rich are not in place to restrict what can be taken from the future, and the result has been that many democracies now have an unprecedented overhang of debt. There is one ultimate stopping point, however: it is that the burden is now so large that many people believe the future will refuse repay it. This makes them less inclined to lend more money to governments. When that point is reached the whole house of cards comes crashing down and nations go bankrupt.

There might be a solution to this problem if cast-iron constitutional rules could be imposed to limit the degree to which governments could raid the future in order to fund their present spending. In the absence of such rules it might well be that there is nothing to stop democratic governments from destroying their economies. Indeed, the present system positively encourages them to do so.

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