

The Authoritarian Challenge to Democracy – a View from an Economist



Author Naoyuki Haraoka

By Naoyuki Haraoka

China & Russia's Vaccine Diplomacy in the Pandemic

China claimed it was successful in containing the spread of Covid-19 infections in 2020. It used its authoritarian power to impose a complete lockdown of major cities and rigorously restrict individual freedom of behavior, such as in going out for shopping or traveling. Even by the middle of the year, China had triumphantly said it had contained the virus and had started focusing on an economic recovery. It seemed to want to declare that its authoritarian regime was working better than democratic governance. China has also been using its foreign policy to boost its political influence on developing nations, in particular those seriously hit by the pandemic.

Since the beginning of the pandemic in early 2020, China and Russia have been providing masks and other Personal Protective Equipment (PPE) for hard-hit countries. And now they are providing them with their own vaccines. While rich nations are trying to get vaccines from Western companies, low- and middle-income nations in Latin America or Africa or the Middle East are depending upon China and Russia for vaccine supply. China, with vaccine delivery contracts with those countries, started delivery through cooperation channels from its Belt and Road Initiative (BRI). Health was only one of the many sub-topics of the BRI, but in the pandemic it is now the main focus.

Meanwhile, Russia is now trying to improve its status from a nation condemned for the unlawful act of annexing Crimea in 2014 to a vaccine provider and liberator from the pandemic. Both nations' actions on vaccines have been quick, in contrast with the slower WHO program of vaccine procurement for poorer nations. Such rises in authoritarianism pose particular challenges to democracies and the international liberal order. The possibility of democratic governance being undermined by these challenges has led to increased concerns among business and policy practitioners in democratic nations.

Increasing Inequality & Social Divide in Developed Democracies

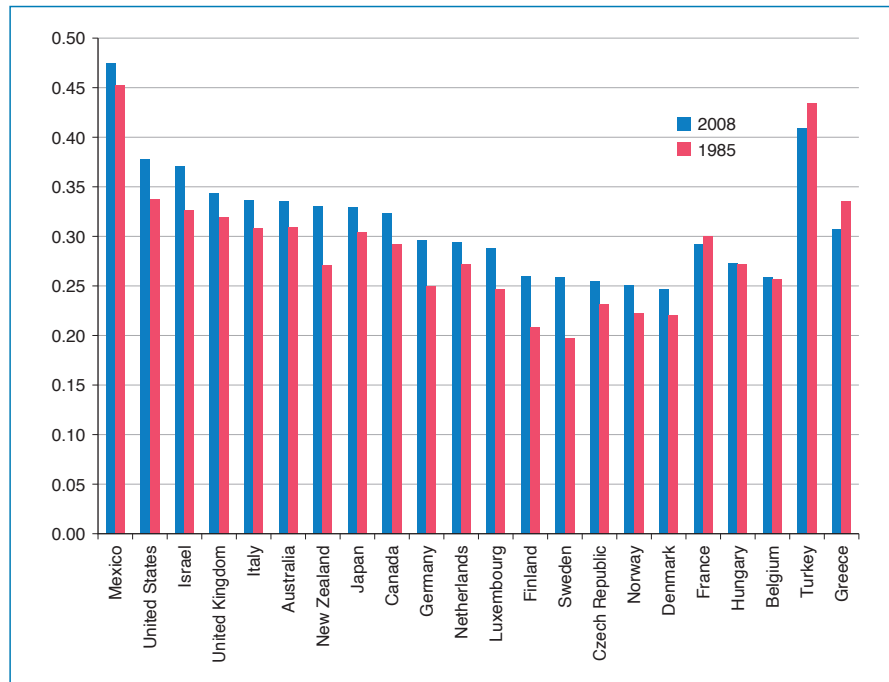
In recent years, more nationalistic and anti-globalist sentiments have been increasing in many democratic nations. In the United States, in particular, former President Donald Trump adopted a more adversarial foreign policy, even sometimes against US allies,

believing that US national interests had continued to be hampered by his predecessor Barack Obama's concessions to the rest of the world in disseminating globalization among nations. A typical example is trade. Trump said that these concessions had expanded the US trade deficit, and so he adopted a more protectionist policy, including raising tariffs against some nations. In the domain of national security, he also requested that US allies shoulder a greater burden and responsibility in defending themselves. His foreign policy was thus an "America First" policy. In Trump's view, the argument that policies to maximize the benefits of globalization would always achieve the best outcome for any country, which had prevailed since World War II, was not valid anymore. Trump supporters pointed to rising income inequality in the nation in recent years and believed this inequality at least partly stemmed from globalization, which they claimed benefitted only the rich elites working in global business and not the middle class or working class. The increase in immigration as a result of globalization and the risk to their own jobs was an additional source of frustration. These factors formed the basis of their support for Trump. The [Chart](#) shows that in most of the major developed democracies income inequality is rising, as seen in the increasing Gini Coefficients among most of the OECD economies.

The end of the Cold War in the late 1980s was considered a victory of capitalism and even before that, at the beginning of that decade, the idea of "leaving everything to price mechanisms" to resolve all economic issues was dominant in advanced democracies. This trend was well represented by Ronald Reagan and Margaret Thatcher. The 1980s became the era in which the jargon "globalization" implied capitalist nations' eternal prosperity on the basis of free trade and investment, an international economic policy version of *laissez faire*. However, since then until the 2010s, very few politicians in advanced democracies had noted that income inequality was increasing and there were more voters than ever who felt isolated and frustrated by the lack of their politicians' understanding of their real concerns and views about economic trends, as represented by globalization and the digital economy. They lost confidence in the political elites that were merely promoting the merits of globalization and a knowledge-based society where IT, non-skilled labor saving technology, had started to play a key role. These poor and isolated people eventually began severely criticizing these intellectual leaders for having advocated for globalization or innovation only for their own interests. It is hard to judge objectively how far this anti-intellectualism has been expanding all over the world. It is not limited to the US. But

CHART

Gini Coefficients of income inequality



Note: The updated Gini Coefficients (data showing income inequality) are added to the G7 nations as follows:

US (2017) 0.39 higher than in 2008

UK (2018) 0.366 higher than in 2008

Italy (2017) 0.334 almost same as in 2008

Japan (2015) 0.339 higher than in 2008

Germany (2017) 0.289 almost same as in 2008

France (2018) 0.301 higher than in 2008

Canada (2018) 0.303 lower than in 2008

Except for Canada, G7 nations' Gini Coefficients have continued to increase until recently since 2008.

Thus income inequality continued to rise among those nations.

Source: Compiled by the author based on OECD data

here in Japan as well, we are now seeing the increasing popularity of media pundits more inclined to speak their minds in simple and frank language rather than giving the usual objective and neutral observations.

The current coronavirus pandemic will further accelerate income inequality and social isolation, and this could exacerbate social divisions and political instability. The inauguration of Joe Biden as US president in 2021 is not likely to resolve these divisions, despite his calls for “unity” of American society. The political influence of all those people who supported Trump cannot simply be ignored even now. In this regard, the US government will have to continue to prioritize its domestic interests rather than international policies.

Relevant Political Regimes

Authoritarian regimes will not be the answer to a crisis like the pandemic, even if it seems initially that they are containing the pandemic. No administrative system based on rigorous hierarchical decision-making will work well in times of uncertainty, as it will be difficult to find solutions for a crisis only with one or two ideas stemming from the top of the hierarchy. Democracy would provide a variety of views on possible solutions and this diversity could modify uncertainty. In the current pandemic, for example, the role of the heads of local governments has been more important than ever in mitigating the spread of virus infections. Central government decisions for containing the pandemic have been well supplemented by local governments. Among the policy advisors to the central government in a democracy, there is a diverse group of experts such

as epidemiologists, medical experts, economists, and psychologists.

If authoritarian regimes appear to have been successful in containing the pandemic so far, in the long run they will not be successful in achieving peace and prosperity in the post-pandemic era. They severely restrict individual freedom and oppress basic human rights, and thus seriously damage human welfare. Their lack of diversity of views will limit their abilities in moments of rising uncertainty, when trust in leadership is vital. Leaders of authoritarian regimes often behave like dictators and their decision-making process is not transparent. Thus they cannot be trusted.

Encouraging Evolution of Capitalism

How to address these issues of authoritarianism and democracy? My answer is to encourage the evolution of capitalism. As mentioned, while authoritarianism is rising and threatening democracy, democracies themselves face internal challenges, such as the populist backlash due to rising inequality and people's sense of isolation. I believe that the promotion of evolving capitalism would help restore social and political stability.

We can see the beginning of the evolution of capitalism in the expansion of ESG investments in recent years. ESG refers to Environmental, Social and Governance investing. For a company to achieve long-term sustainable growth, it will need to be actively engaged in these three activities. Today, mainstream investors invest in companies considered to have high ESG values.

To be more specific, Environmental means active use of renewable energy sources as well as active efforts for mitigation of global warming gases; Social means respect for workers' human rights and diversity or work-life balance; and Governance means active disclosure of a company's information and diversity of its executive board. In other words, companies pursuing ESG would pay more attention to a variety of stakeholder interests rather than only to shareholders' interests. They would correct excessive shareholder-oriented management and instead take care of the employees' interests or social and environmental issues for the benefit of the nation or the whole world. In the market, individual investors increasingly believe in more return and less risk from investment in such ESG-oriented companies. The US business leaders association Business Roundtable redefined in August 2019 "the mission of business corporations" as respecting all the stakeholders' interests instead of only shareholders' interests, as previously adopted in 1997. The World Economic Forum in Davos in January 2020 reconfirmed a stakeholders' interest-oriented capitalism which had been advocated by Klaus Schwab, the host and the founder of the forum.

This trend was born and developed with the enhanced perception of sustainability. If social and environmental instability erode the base of the sound development of capitalism, capitalism itself will be damaged. So the evolution process of capitalism started.

Looking at international trade, it would be better to reconsider the existing dominant notion that full trade liberalization would always achieve the best outcome for all the economies in the world. For example, in discussing the quality of a Free Trade Agreement (FTA), it has been considered that the higher the proportion is of items with zero tariffs to the total items covered by the FTA (what we call the rate of trade liberalization), the better the FTA, and all trade policy economists have agreed on the need to pursue such high-quality FTAs as an ideal model of free trade to maximize the benefits of globalization.

This notion is based on the theory that trade liberalization will always accelerate economic growth. But economic growth can be affected by many factors, such as macropolicy, innovations, industrial policy, and so on, and it would be difficult to pinpoint the impact of trade liberalization. One thing that is clear about trade liberalization is that there will be winners and losers from it. While competitive industries in the global market would benefit from trade liberalization, there will also be industries that will lose due to increases in imports and workers in those sectors will suffer unemployment as a result. It is natural to assume that labor and capital in such declining industrial sectors could not transform into winning sectors immediately. It could take years for them to be able to do so, even if trade liberalization is successful in achieving high economic growth nationwide that could also benefit the losers. Research has shown that it would take around 10 years for a country to achieve high economic growth after trade liberalization measures have been taken.

Another economic consequence of trade liberalization policy based on this theory is that while in rich countries there would be an increasing income gap between high-salary workers and low-paid workers, in low- and middle-income countries this gap would diminish. According to the theory, in wealthy developed nations there would be a comparative advantage of trade in sectors with high-end labor like high value-added high technology sectors, and free trade would expand those sectors and benefit its workers, resulting in an increasing salary gap. Meanwhile, in low- and middle-income developing nations, their comparative advantage in trade is in the low value-added sectors and low-end labor intensive ones. Free trade would thus benefit low-end labor and the salary gap in those developing nations will diminish.

However, in reality, wages do not respond to labor demand and supply in a flexible manner. This wage rigidity would prevent this

theory from being realized in practice. Even though the demand for low-end labor in developing nations increases by international trade, wages would not respond to this increase in demand for low-end labor. Labor in other sectors would not move to the sectors with comparative advantage quickly as a result of international trade. Production factors such as labor and capital exist in rigid rather than flexible markets. Thus wage inequality in a developing nation would not diminish so much. Meanwhile, in a developed nation, the high-end labor force with academic underpinnings tends to concentrate on the high-tech sectors and with enriched education and human resource development programs, labor mobility could be higher than in a developing nation. So in a developed nation the salary gap could increase, as the theory says.

On this issue, according to the book *Good Economics for Hard Times* (2019) by Abhijit Banerjee and Esther Duflo, MIT professors and winners of the Nobel Prize for Economics in 2019, a young economist at MIT in 2010, Petia Topalova, wrote an important paper titled “Factor Immobility and Regional Impacts of Trade Liberalization” (*American Economic Journal*, 2010), in which she analyzed numerical evidence of the regional impacts of large-scale trade liberalization implemented in 1991 in India, and concluded that the rate of the decline in poverty was slower in the regions most seriously affected by trade liberalization than in any other regions. This finding is contradictory to the theory.

Intuitively, whether in a developed or developing nation, it is more convincing to say that trade liberalization would create winners and losers in the short term at least, as labor and capital would be less mobile and it would take a long time for them to move to sectors with a comparative advantage. With economic growth not being enhanced very quickly as a result of free trade, it would be difficult to reduce this inequality between winners and losers in international trade without relevant policies. For example, Trade Adjustment Assistance is a federal program by the US government to try to reduce the damaging impact of imports on certain sectors of the US economy. This is one way to achieve redistribution of the benefits of globalization between the winners and the losers.

A trade war employing competitive tariff hikes among trading partners would be detrimental to the global economy as it would force consumers to pay for the cost of protection. However, in FTAs, certain items in need of time to structurally adjust to trade liberalization are often subject to gradual step-by-step tariff reductions over five or 10 years or even longer. This is reasonable, since with this policy sectors declining due to trade liberalization could afford to adjust to the rise in imports. In this light, good FTAs may not necessarily pursue higher rates of trade liberalization. For example, less ambitious FTAs like the Regional Comprehensive

Economic Partnership (RCEP), in terms of the rate of trade liberalization in their tariff reduction schedule, would be better than the more ambitious Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

Looking at today’s trade policy agenda, there are many areas where we need new multilateral rules, as domestic policies are having an increasing impact on trade, such as competition policies, patent policies, and national security policies. In particular, the emergence of the digital economy is enhancing the need for new rules on data security and sensitive technologies in terms of national security. The CPTPP, including new rules on domestic policies, could provide a good prototype of new rules for those issues. While pursuing inclusive growth, trade policies should be built upon such a rules-based regime.

Conclusion

“Better globalization” to achieve inclusive growth would be my answer to counteract the authoritarian regimes starting to increase their influence in global governance. Mitigating inequality and loneliness must be at the center of such better globalization. We could call this “humanistic globalization” as well. Capitalism must evolve to be more humanistic by taking concerns about inequality and isolation into consideration.

There are a couple of lessons for economists in trying to achieve this. One is that we should take a holistic approach rather than a siloed one. Today our economy and politics are increasingly interlinked. Economists looking at only the economy and ignoring political movements stemming from increasing inequality and isolation among people would not be able to produce realistic prescriptions for the economy. They must learn from political realities to propose well-balanced and realistic policies.

The other is that a more evidence-based approach would be necessary in policy-making. The analysis of Topalova mentioned in the previous section tells us that theories can be wrong in the real world. We have to believe in evidence and not theory. With excessive preoccupation with authoritarian theories, economists will follow the wrong path, just as authoritarian politicians do who value only a single idea. Good economics must always stem from a fact-based objective approach rather than from a theory, no matter how attractive and mathematically elegant it may appear.

JS

Naoyuki Haraoka is editor-in-chief of *Japan SPOTLIGHT* & executive managing director of the Japan Economic Foundation (JEF).