

THE CHINESE PEOPLE'S INSTITUTE OF FOREIGN AFFAIRS (CPIFA)

What kind of capitalism?

**WHAT DO THE NORDIC AND THE ASIAN MODELS HAVE IN  
COMMON?**

**Can we learn from each other?**

*By Jón Baldvin Hannibalsson*

*Former minister of finance, foreign affairs and external trade  
of Iceland*

July, 2018

*I was born just before the outbreak of the Second World War, and raised in a small fishing village in North-Western Iceland, hinging on the Arctic Circle. In my early youth I spent the summers on my uncle's farm. Those were happy days. But when I look back I realize, that little had changed in our way of farming from the 13th century. No machines. No roads. No harbour. We travelled around and transported our produce, either on horseback or by sea. Even under sail or rowing along. There was one exception: The brook, running past the farmhouse, had been harnessed to produce electricity – an enterprise that signified a jump into the 20th century.*

### **1. Why are some nations rich – while others are poor?**

At the beginning of the 20th C. Icelanders were among the poorest of the poor in Europe. Around the middle of the century – having been spared the ravages of the Second World War – we had caught up to the middle rank in Europe. On entering the 21st C. we were classified by OECD nr. 6 in GDP pr. capita, globally.

In 2008, having been the first country hit by the contagious US financial crisis, our financial system lay in ruins. It was the third greatest bankruptcy in financial history – no mean achievement by a small nation. Having few friends around, we were taken into emergency care by the IMF. Miraculously, we emerged sooner and in a more robust state than most other nations hit by the crisis. We have since 2012 been on the fast track of economic growth again. I deal with this in detail in my most recent book: „The Nordic model vs. the neoliberal challenge“.

Thus Icelanders have, in the lifespan of two generations (that of my parents and myself), gone through all the stages of capitalist development, from rags to riches. But it has not been a smooth ride. All the time there has been a raging debate on which strategy to pursue: *Unrestrained capitalism* with minimum government and low taxes on the one hand; or *strong government* involvement to keep the vagaries of the market under control and to secure a fair distribution of the rewards.

In short: *laissez-faire* capitalism or a Nordic welfare state? We are by no means alone in having to make this choice. It so happens that China is carrying through the greatest socio-economic experiment in history – having had to make this choice – so far with unique success – lifting 700 million people from poverty to

prosperity in a few decades. I bet most of us can learn a lot from your experience so far.

Why are some nations poor, while others are rich? How can we eradicate poverty and secure prosperity for all? In answering those questions, a lot will depend upon the success of the Chinese experiment. But are there also lessons to be learned from the experience of the Nordic countries? That is the subject of my talk here today (and also one of the subjects of my book).

### **1. Adam Smith's invisible hand of free markets.**

„No book has had more influence on economists' thinking and economic policy – and by extension on the world population's material well-being, than *An Inquiry into the Nature and Causes of the Wealth of Nations*, by the Scotsman **Adam Smith**“.

This initial statement from the introduction to my old edition of the *Wealth of Nations* explains, why I chose to study economics at Edinburgh University in the early sixties of the last C.. Little did I know at the time – and I quote from the introduction – „that ancient *Chinese philosophers* had, unbeknownst to Smith, advanced related ideas 2000 years previously“. It would be interesting to hear more about that in our exchange of views, after my talk.

What was the essence of Smith's message? Two ideas stand out:

- (1) „By pursuing *his own interest* man frequently promotes that of society more effectually than when he really intends to promote it. Even if he intends only his own gain, he is in this... led by *an invisible hand* to promote an end, which was no part of his intention“. And „Order – not chaos – would result if individuals were left to their own devices“.
- (2) The other idea central to Smith's thinking was the notion of *equilibrium*: The economy would reach a balance between all parties „in light of the set of prices and wages that would be grounded out in the market by the pursuit of individuals' *self-interest*“. This notion of equilibrium is still the most important substantive proposition in what we call economics. It stands – or falls – by the presence and strength of competition in the markets.

Irrespective of our acceptance or rejection of those central notions of *laissez-faire* capitalism, there is no way we can deny the irresistible power let loose on the world by this system, be it for good or evil. Capitalism – wedded to the

scientific revolution – and in the service of Western colonialism, has simply transformed the world during the past 250 years. It is still at it. We are now in the grips of a *permanent technological revolution* which is changing almost all facets of our daily lives; during which AI – artificial intelligence and automation – may in the near future fundamentally change man's role in society and the nature of *work* itself.

Despite his epic critique of capitalism in its early phase of industrialization, **Karl Marx** could not hide his admiration for the way this wealth-creating machine smashed all resistance in its way; and gobbled up the earth's resources in the expansionary phase of colonialism. Nonetheless his conclusion was, that due to its inherent contradictions, the capitalist system was doomed to destroy itself. The concentration of wealth in the hands of few, amidst the poverty of the masses, would finally find its solution in a proletarian revolution. *Proletarians of the world, unite!*

The revolution did indeed break out as Marx prophesied, but where it was least expected: in a backward feudalistic state on the banks of the Volga, but not in the developed industrial states. Why didn't the marxist prophecy about the proletarian revolution in the industrialised West ever happen? It was because the unforeseen power of *democracy* was applied to *tame the beast* of capitalism, not the least through the action of mass movements, such as socialdemocratic parties and labour organisations.

Nowhere in the world has this succeeded as well as in the Nordic countries. That's why, having persistent doubts about the smooth running of free markets and being suspicious of the inherent tendencies of unrestrained capitalism towards monopoly, intolerable inequality and other *market failures*, I decided, to pursue my studies at Stockholm University, the Mekka of Socialdemocracy.

### **3. The Nordic Model – or how to tame the beast of capitalism**

What distinguishes the Nordic model from other societal types, moulded in the 20th C., emerged from the tough class conflicts, generated by *the Great Depression* in the thirties of the last C.. In the West we observed the *market failure* of unbridled capitalism of the American type, which caused the Great Depression. In the East we observed the Soviet experiment, based on abolition of private property and nationalization of the means of production. Central planning in a command economy replaced private property and markets. Gradually a one party state, turned into a police state, where democracy and the

rule of law had no place. The experiment endured only for 70 years and ended in dismal failure.

Nordic socialdemocrats rejected both formulations: *Unbridled capitalism* and the *totalitarian state*. We demarcated the „*third way*“. We recognized the usefulness of market solutions – where applicable – for the efficient allocation of resources under competitive conditions. But markets were subjected to control and surveillance by the democratic state, in order to prevent *market failure* (monopoly, oligopoly, concentration of wealth and inequality) – in the name of the general interest.

For the provision of education, health-care and basic services (energy, water and public transport) we generally rejected private enterprise for profit and offered instead public service by the state or municipalities. We applied the tools of the democratic state to restrain speculative profiteering and to secure greater *equality of income and wealth* than would have resulted from the play of unrestrained market forces.

In a market system the power of the owners of capital is indisputable. Employers wield implicit *political* power as well. The owners of capital and those who run companies and businesses, give ample financial support to political parties to take care of their interest. If those political parties acquire the power of the state as well, it invites the danger of capitalist hegemony – *crony capitalism*.

*A distinguishing characteristic of the Nordic model is that right-wing parties (representatives of capital) have been in a minority most of the time. The political arm of the labour movement – the socialdemocratic parties – have been a majority, or in a leading position, for decades. This did not happen anywhere else in Europe or America.*

Even though alliances of right-wing parties have temporarily acquired parliamentary majority, they have nowhere in the Nordic countries gained sufficient support to dismantle the welfare state. Socialdemocracy has been the dominant ideology in those societies.

The major building blocks of the welfare state have by now become familiar: Social insurance (sickness - , accident- , disability- ,old age - , and unemployment insurance ); free and equal access to quality healthcare and education, paid for by progressive taxation; active labour market policies to uproot unemployment and provision of affordable housing for all. Equality of

the sexes and support for families with children is duly emphasized. All of this is considered to be part of human rights – *not as alms to the poor*. The result is a society where equality of income and opportunity is greater and better protected than anywhere else.

The Nordic model, forged in the ideological conflicts of the 20th C., seems to have withstood the *test of globalized competition* in the 21st century with flying colours. Soviet-type communism has been relegated to the dustbin of history. Unbridled capitalism – or market-fundamentalism – under the commandments of neoliberalism, is lurching from one crisis to another. It has survived only because of the greatest *rescue operation by the state* in history; and remains, for the time being, in intensive care by the state.

Neoliberalism – the revival of the *laissez-faire* ideology – began as a *revolt against the welfare state*, during the last decades of the 20th C. According to the neoliberal creed, the welfare state, due to its high taxes, is doomed to become uncompetitive. The system is said to destroy all incentives for individual advancement and the entrepreneurial spirit. It is said to foster the mentality of „takers“, but punish the creativity of the „givers“ (to quote Republican presidential candidate, Mit Romney). The system is said to be devoid of dynamism and hence be doomed to stagnation. And finally the paralysing inertia of overgrown bureaucracy is said to stifle individual freedom and end in totalitarianism. (**Hayek**: The Road to Serfdom).

#### **4.A super model to be emulated?**

The main fault with this doomsaying is that it has very little, if anything, to do with reality. The facts speak for themselves. Innumerable reports on the performance of nation states in the tough competition of the globalized era are there to prove it. No matter which criteria we apply, the Nordic countries, without exception, are in the top rank. This is no less true about economic criteria than others:

*Economic growth, productivity per hour of work, R&D, technological innovation and implementation, creation of high-tech jobs, participation in the labour market – especially by women, equality of the sexes, the level of education, social mobility, health and longevity, quality of infrastructure, absence of poverty, access to unspoiled nature and the quality of life in general. And greater equality of income than anywhere else. Deep rooted and vibrant*

*democracy. Where is it easiest to establish a company? In the US? No, they are number 38 on the list. Denmark is number one!*

Belonging to a 3rd generation of socialdemocratic leaders in my country, there is no way I can claim impartiality. But if you don't believe me, I can present to you a star witness, namely the English-American weekly „*Economist*“. In February 2013 they published a special survey on the state of the Nordic model. The authors came to the conclusion, against their own expectations, that the Nordic model had turned out to be – during the era of globalization – *the most successful socio-economic model on the planet*. It combined *both efficiency and equality*. It was both one of the most competitive and the most egalitarian societies on earth. This, according to neoliberal theory, had hitherto been considered to be a contradiction in terms.

The Swedish socialdemocratic leader, **Olof Palme**, never tired to remind us that, by eradicating poverty and realizing equality of opportunity, we are in fact expanding the realm of *individual freedom*. The authors of the *Economist*'s survey admit as much, when they said: „The Nordics also have a strong record of drawing on the talents of their entire population: They have the World's highest rates of social mobility. In a comparison of social mobility in eight advanced countries... the Nordics occupied the *first four* places. America and Britain came last.

And the *Economist* goes on: „The Nordics have also largely escaped the *social ills* that plague America. On any measure of the health of a society – from economic indicators, like productivity and innovation to social ones, like inequality and crime – the Nordic countries are gathered near the top“. In other words: The Nordic welfare state has replaced America as the „land of opportunity“. In conclusion *The Economist* said: „Those societies are by most accounts the most successful ones so far, in combining general prosperity, social justice and environmental protection“. Not a bad record, don't you agree?

## **5. Why has extreme inequality become a global problem during the neoliberal era?**

After this surveillance of options for economic development strategies, it seems the point of departure, between neoliberals and socialdemocrats, is about the *role of the state* in a civilized society. This was so already in the wake of the Great Depression in the 1930ies. And this is so now with a vengeance, today, in the age of globalized, financial capitalism. This is where the *dividing lines* lie in

the near future. It seems that on this fundamental issue we, Nordic socialdemocrats, have more in common with the strategic thinking behind the Asian/Chinese model than with Anglo/American neoliberalism.

We emphasize that the primary duty of the democratic state is to uphold the „rule of law“ and „equality before the law“. This is crucial. Wealth begets power. The accumulation of wealth and income in the hands of a tiny privileged elite, inevitably becomes a direct threat to democracy. The super rich gradually acquire the power to bend the rules of the game in their favour. *Democracy gets captured by plutocracy*. This is what we are witnessing in the United States those days.

Markets are not subject to natural laws. They are man-made. Markets are nothing but a set of rules, defined and enforced through politics. If the rules are rigged in favour of the super rich, it undermines not only the democratic system, but the rule of law itself. The underlying forces of rapidly growing inequality are to be found in a financial system out of order and out of control. Let us take a few examples:

- According to neoliberal theory (and mainstream economics) the sole responsibility of CEOs is to maximize shareholders' value (no matter that they change from day to day and even by the hour on the stock-exchange). For this they need incentives, not only salaries up to 400 times the average salaries of their employees but exorbitant bonuses to boot. This concentrates their thinking on short-term rewards (stock-prices and dividends), but discourages long-term planning and investments. This means, among other things, that financial income, which mainly accrues to the super rich, has increased steadily as a share of total income.
- This financial sector has in recent years grown six times faster than the real economy. This is one of the reasons why the share of capital as compared to the share of labour, in the global GDP, has increased drastically.
- In the UK the major banks stoked the fires of the bubble economy – which burst in the crisis – in an orgy of speculative frenzy. More than 60% of their lending went into trading shares and bonds on the Stock Exchange and into real estate speculation. Only 8% went into productive investment. Although 67% of new job creation stems from SMEs, they receive only a fraction of lending.

- This financial system no longer serves the needs of the productive economy or ordinary households. It has become the conveyor-belt for inequality of wealth and income. The argument that oversized banks are „too big to fail“ is then used to justify massive *bail-outs* by taxpayers. Subsequent indebtedness is in turn used to justify austerity policies in a recession – a medicine even worse than the disease. No wonder the former director of the Bank of England, Mervyn King, has described this system as „the worst imaginable“.
- This proliferation of capital income accrues mostly to the super rich. My country is a case in point. In 1995 financial income was ca. 2% of total income reported. In 2007, the year before the crash, it had reached 25% of reported income. In 1995 financial income was 10% of the total income of the 1% richest. In the year before the crash it reached 80% of their income. For the rest of the population, financial income was in the range of 2-8%. Despite the fact that financial income was taxed much lower than earned income, the business elite hid a lot of their wealth (and hence income) in tax havens.
- Almost half of global trade is by now conducted by multinationals in command of the productive chain from resources to retail. Those multinationals can themselves decide, where they report their headquarters for tax purposes, forcing nation states into a „tax competition to the bottom“.
- According to some estimates, so-called tax havens, hiding real ownership or avoiding taxes altogether, by now represent the third biggest economy of the world. So much for the rule of law and equality before the law. This is a primary example of how the rules of the game are rigged in favour of the super rich.
- This indicates that, during the neoliberal era, the power and political influence of capital versus the interests of labour, has grown beyond democratic control. The result is increasing polarization of societies between the financial elite and the general public. There is growing insecurity, anger, frustration and lack of trust in democratic institutions. *The system is unsustainable.*  
(In my book I set forth a series of proposals on how to reform this out-of-control system and return it back to normalcy).

## 6. A social contract

In a capitalist market economy there is supposed to be an unwritten but underlying *social contract* that must be complied with, if we are to maintain a minimum of public trust and social cohesion. One of the basic rules is this: You are free to seek maximum profits and reap rich rewards as long as you risk your own money and play by the rules. And, it should be added, as long as you pay your taxes and other dues to the society which, after all, made you rich. Listen to what Warren Buffet, one of the world's richest men, once said about his billionaire status: „*What would have become of me had I been born in Bangladesh?*“

This is why most people accept a certain degree of inequality as a just reward for enterprise, innovation and the willingness to take risks. But if those basic principles are all turned upside down: if the huge profits in boom times are privatized and even tax-evaded, but the losses in hard times are nationalized, then the *social contract* of capitalist society is no longer valid. Then we are no longer merely dealing with the consequences of a financial crisis. The financial crisis is then undermining the pillars of the market-based society itself. Then we have a *systemic crisis* on our hands.

*This is the greatest challenge to democratic governance since the fascist insurgency in Europe in the interwar years. It was the weakness of parliamentary democracy in dealing with the consequences of the Great Depression that led us directly to the killing fields of the Second World War. Are we really doomed to repeat all those mistakes again? When will we ever learn?*

## 7. The revolutionary and the reformer.

When your great leader, **Deng Xiao Ping**, initiated the profound transformation still going on in your continental sized country, he was famously quoted as saying: „It does not matter if the cat is black or white – if it catches the mice“. This is of course a riddle, subject to interpretation. This is how I understand it: If harnessing the creative powers of self-interest – in the words of Adam Smith – helps allocate resources efficiently and create wealth, it should be allowed to do so. But if it takes the regulation and surveillance of the democratic state to prevent market failures and distortions, or the concentration of wealth and income in the hands of a tiny elite – it is our *duty* to do so.

The Swedish socialdemocratic prime minister for a quarter of a century – and arguably our greatest reformer – **Tage Erlander**, famously said: „*The market is indeed a useful servant, but an intolerable master*“. It sounds as if the two of them, the Chinese revolutionary and the Swedish reformer, could have agreed on those fundamentals. Perhaps they were kindred spirits, after all?

## **ANNEX: PROPOSALS FOR REFORM OF THE FINANCIAL SYSTEM**

- Restore **the firewall** between traditional banks, which serve the productive sector and society at large, on the one hand, and the „shadow-banks“ (investment banks, hedge funds etc.) on the other hand.
- Savings – deposits guarantees – should be extended only to traditional banks.
- Megabanks should be broken up under laws against monopoly.
- Super salaries and bonuses in the financial sector should be restricted or else taxed away.
- The current conflict of interest between financial institution and **rating agencies** should be abolished. Investors should themselves pay for the service.
- A state owned investment bank to finance neglected longterm investment in infrastructure (energy, transport etc.) should be established
- Stop immediately „**tax-competition-to-the-bottom**“ between nation states by coordinating corporate taxes and taxes on financial income.
- **Close the tax-havens – period.**
- Make sure that multinational corporations pay their taxes, where income is earned. Else impose a „minimum tax“ on multinationals.
- Introduce the **Tobin tax** (on financial transfers across borders), both for revenue and as a policy tool.
- The European Central Bank (ECB) should be invested with full powers as a central bank, as a lender of last resort to member states and a dealer in state bonds. The ECB’s mandate should be extended to **full employment and economic growth**, not only inflation – like the Federal Reserve.
- A banking union be extended to EU-member states for a common savings-deposits guarantee system, to prevent capital flight.
- Fiscal and monetary policy within the EU be institutionally coordinated.
- The state should own and run at least one „socially oriented“ bank
- The Icelandic Central Bank should be given authority and the relevant tools to control speculative investment related to exchange rate-fluctuations and interest rate differentials.