

# How Germany Deflected Pressure to Spend and Even Won an Ally



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Germany backed further off a full-scale economic stimulus at a meeting of global finance chiefs, a remarkable outcome given relentless calls for action from Europe, the U.S. and international institutions.

Germany's success in deflecting the pressure suggests that Finance Minister Olaf Scholz, who came to Washington with a list of counter-arguments, got off lightly from his Group of 20 colleagues at the annual International Monetary Fund conference ending Sunday.

U.S. Treasury Secretary Steven Mnuchin, who publicly suggested Germany and China should enact growth-boosting policy measures, avoided singling out Europe's biggest economy behind closed doors, according to two people familiar with the

private discussion who asked not to be identified.

Some other G-20 delegates repeated the IMF's general stance that governments with fiscal leeway should do more to strengthen the global economy. The Treasury didn't immediately respond to a request for comment.

"The chorus here in town is especially heavy on Germany to use its fiscal space," said Robin Brooks, chief economist at the Institute of International Finance, a Washington-based trade group for the financial industry.

German officials had prepared a detailed line of defense: that Chancellor Angela Merkel's government is already investing extensively, including an extra 54 billion euros (\$60 billion) in spending through 2032 to counter climate change.

## **'Very Positive'**

Those arguments appeared to win some converts. IMF Managing Director Kristalina Georgieva said governments that have room to spend more used the meetings in Washington to make their case.

"What was very positive to hear during the meetings is countries with fiscal space are actually taking measures to stimulate the economy," Georgieva told reporters on Saturday. "Germany for example is putting forward a very sizable climate investment strategy that would bring significant growth and investment. They are also looking into what more could be done if necessary."

With a partial U.S.-Chinese trade agreement in sight and a Brexit deal on the horizon, Scholz was emboldened in his defense of a decade of fiscal prudence in Germany. He expressed growing confidence in the government's projection that Germany's slowdown will be moderate and temporary.

"I think we did a lot," he said in a Bloomberg Television

interview. “The more important question is what will happen to the global economy.”

## **Don't Rush It**

A “rushed fiscal response” isn't warranted as growth is expected to revive at the end of the year and success in China-U.S. talks would deliver an “immediate boost” to the economy, Scholz told reporters.

For all the artful dodging, Scholz faced a broad front of finance ministers, central bankers and economists pointing at Germany to do more. On Thursday, the government in Berlin cut its 2020 growth forecast to 1% from the previous 1.5%. Data due next month may show the economy slipped into recession.

To shift the blame game on slow growth and inflation away from central banks, former European Central Bank official Lorenzo Bini Smaghi said governments, including Germany, have a role to play in stepping up borrowing and spending to support growth.

“If fiscal policy in Germany and other countries are not willing to do that job, it is too easy to blame the central bank,” he said on a panel.

Low or negative interest rates in many countries leave little room for monetary policy, South African Reserve Bank Governor Lesetja Kganyago said in an interview.

“Countries with fiscal space must utilize the fiscal space,” he said.

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# Eurozone's €140bn interest windfall could allow spending boost



LONDON (Reuters) – Record-low borrowing costs and falling debt payments could give the euro zone a 140 billion-euro windfall by the end of 2021, freeing cash for projects ranging from new roads to climate protection.

This year's slide in borrowing costs has put the bloc's finances in a far stronger position – cutting the interest rates it pays, allowing governments to cheaply refinance older debt, and above all leaving them with cash in hand.

That's bolstering the case of those who argue the euro zone can and should spend its way out of economic doldrums. With Germany teetering near recession and the European Central Bank's monetary policy looking maxed out, many now regard government spending as the key to lifting growth and

inflation.

At current yields, euro zone governments will save an average 0.10% of gross domestic product in interest this year, or almost 12 billion euros, Frank Gill, senior director in the sovereigns team at ratings agency S&P Global, estimates.

Savings would rise to 0.25% of GDP in 2020 and 0.80% in 2021, Gill says, noting this was above already expected savings, and the long tenor of euro securities means debt savings increase over time.

The savings would total around 140 billion euros – to put that in context, pent-up demand in Germany for public investment amounts to 138 billion euros, state-owned development bank KfW estimates.

“It is very significant, this is a windfall really,” Gill said. “Since 2013-14, the decline in interest expenditure to GDP, especially in places like Italy and Spain, has given governments some breathing space.

“(Savings will be )much greater for those sovereigns which have seen larger yield compression, namely, Italy, Portugal, and Spain, and the savings snowball over the next two years.”

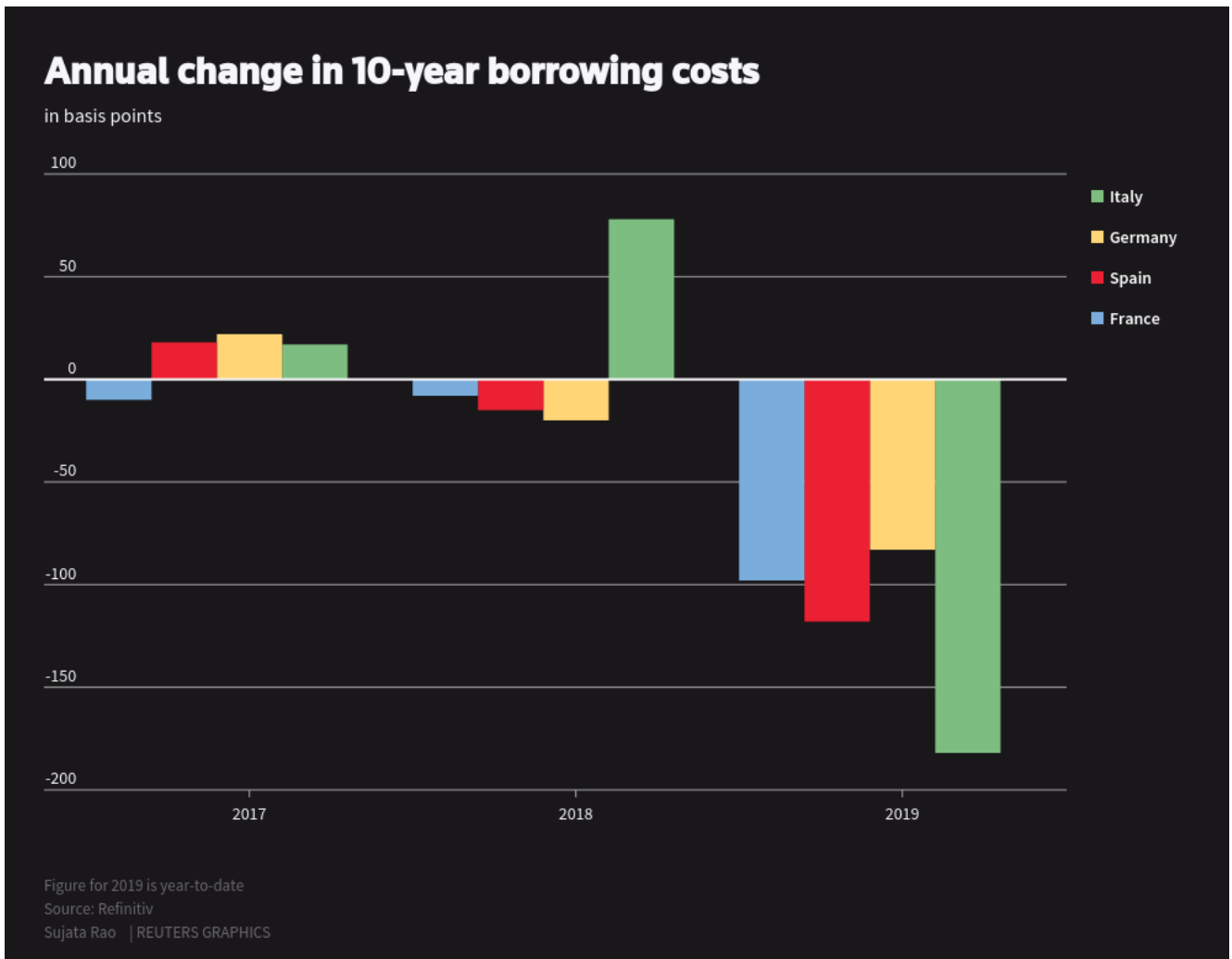
According to Societe Generale, a 10-basis-point drop in bond yields translates into roughly a fall in interest payments of 0.35% of GDP for Italy, 0.27% in Spain, 0.22% in France and 0.16% in Germany.

From environment projects in Germany to greater education and welfare spending in Italy and infrastructure improvements across the euro zone, the fall in borrowing costs could finally spell the end of austerity.

Ten-year bond yields, the usual reference rate for borrowing costs, have fallen by half to two-thirds this year. With the ECB resuming rate cuts and dropping time constraints on asset

purchases, yields have little impetus to rise.

(Graphic: Annual fall in 10-year EZ borrowing costs , here)



Until now, euro zone monetary stimulus has effectively been counteracted by stringent budgets. ECB President Mario said last week that if fiscal measures had been in place, they would have complemented central bank policy and boosted growth.

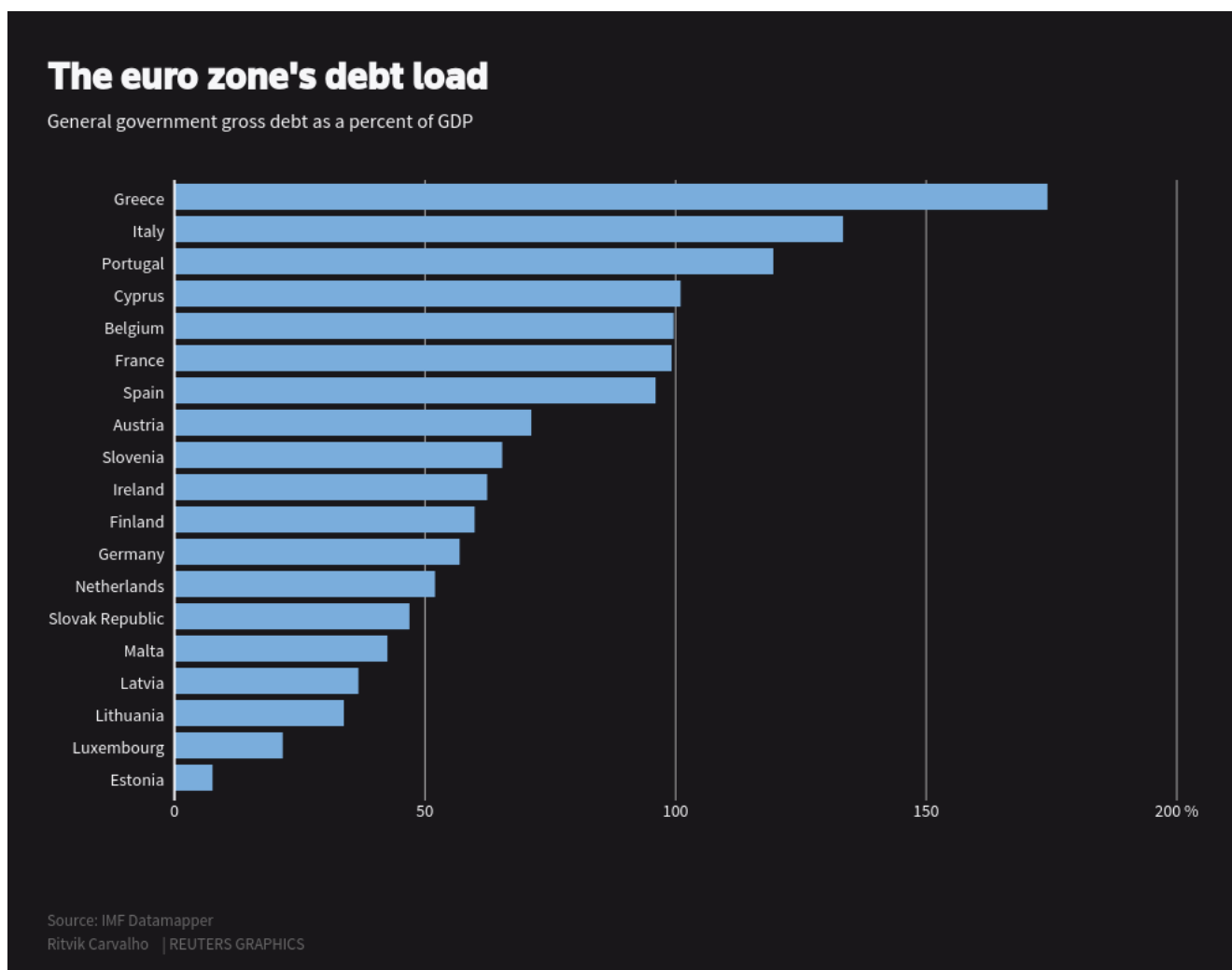
Globally too, there is a perception that central banks are nearing the limits of what they can achieve. Former U.S. Treasury official Lawrence Summers calls it “black hole monetary economics”, where small rate changes and aggressive stimulus strategies have only limited impact.

Jorge Garayo, senior rates strategist at Societe Generale, noted that U.S. President Donald Trump’s fiscal spending plans

had boosted inflation expectations in 2016.

“That had a much bigger impact than QE (quantitative easing),” he said. “With diminishing returns from monetary policy easing, the only thing that could push (Europe’s) inflation expectations sustainably higher is if we go through a credible fiscal stimulus, most likely coordinated in some way.”

(Graphic: The euro zone’s debt load, here)



## OPPORTUNITY KNOCKS

Euro zone governments have been saving on interest for years as ECB QE drove down yields. The savings amounted to almost 2% of GDP since 2008, Unicredit estimates.

The question is, will the budget room now being created persuade fiscal hawk Germany to drop its opposition to more

saved over 160 billion euros in interest since 2008. This year's windfall, following a 70-basis-point slide in 10-year yields, may exceed 5 billion euros, Reuters has reported.

Stewart Robertson, senior economist at Aviva Investors reckons if Germany's 10-year bond yields stay around -0.50% and it can raise debt at this level for four to five years, it would save some 15 billion to 20 billion euros annually.

There are caveats. Lower yields can take years to feed through. Benefits accrue only when yields fall and stay low for some time. Persistently low yields would also signal economic weakness, in turn threatening tax receipts.

## **ITALIAN JOB**

Italy, one of the bloc's most indebted members, probably has most cause to celebrate low yields. Desperate to revive its sluggish economy, it has frequently clashed with EU authorities for overstepping spending limits.

Now, though, the tumble in its 10-year borrowing costs, to 0.9% from 2.6% in early 2019, is defusing concern over its 2020 budget, due to be submitted next month.

Assuming unchanged yields, Rome can save up to 20 billion euros a year in interest payments, or 1% of annual economic output, Pictet Wealth Management strategist Frederik Ducrozet calculates. That assumes interest payments are spread over the years and yields stay low.

The government hopes to use that budget leeway to avoid an upcoming sales tax increase. Ducrozet noted the Bank of Italy is also profiting from its 400 billion euros of bond holding, most of it bought under ECB QE. That will partly be redistributed to state funds.

"In plain English, the Treasury is saving money on all fronts, probably over 1% of GDP on an annual basis," Ducrozet said.



“If the political situation were to improve for whatever reason – arguably a big IF – the fiscal picture would improve dramatically.”

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## Turkish economy shrinks only 1.5% in Q2 as recovery beckons



By Behiye Selin Taner and Ezgi Erkoyun

ISTANBUL, Sept 2 (Reuters) – The Turkish economy contracted less than expected in the second quarter, 1.5% year-on-year, as it looks to shake off the effects of a recession brought on by last year’s currency crisis.

Compared with the first quarter, gross domestic product grew at a seasonally and calendar-adjusted 1.2%, its second positive reading in a row, the Turkish Statistical Institute

data showed.

Turkey's economy has a track record of more than 5% growth, but inflation and interest rates soared [tmsnrt.rs/2k8VNHl](https://www.tmsnrt.rs/2k8VNHl) after the Turkish lira lost some 30% of its value last year and domestic demand fell sharply as it tipped into recession.

Measured annually, Turkey's economy has contracted for the past three quarters. A Reuters poll forecast a 2% year-over-year contraction in the second quarter, leading to zero growth in 2019.

Consumption in the latest quarter was stronger than economists predicted and net exports, helped by the weak lira, also limited the annual contraction, suggesting a recovery may have taken hold.

"We think the rise from the bottom started as of Q2," wrote Muammer Komurcuoglu, economist at Is Yatirim. "But the recovery is fragile for now and the extent of it will be determined by the course of central bank interest rate cuts and global risk appetite."

The lira strengthened beyond 5.80 to the U.S. dollar after the data, from 5.8175 immediately before. It stood at 5.8130 at 0832 GMT.

Last year's currency crisis, brought on by a diplomatic row with Washington and doubts about the independence of the central bank, ended years of a construction-fuelled boom driven by cheap foreign capital.

The lira is down another 9.6% so far this year, but a dip in inflation in recent months opened the door for the bank to slash rates below 20% in July and begin a monetary easing cycle. Business investment, held down by high borrowing costs and currency uncertainty, fell in the second quarter to help keep overall year-over-year GDP negative. Industrial

production weakened significantly in June.

But other data suggest a turnaround in the Middle East's largest economy despite risks ahead, including a trade war that could lead to a global slump.

A PMI business survey published separately on Monday showed that after 17 months of contraction Turkish manufacturing activity declined only modestly in August, suggesting firms may be readying for a return to growth.

The government also made revisions to GDP data going back to early 2017 – including a slightly smaller annual contraction of 2.4% in the first quarter of 2019 – which generally showed a bit stronger past performance.

Jon Harrison, head of emerging markets macro strategy at TS Lombard, said he still expects the economy to contract this year.

The GDP data “confirms that growth is not doing very well and although it is moderately better than expected ... concerns are still there about whether there will be an overshoot of monetary policy, and a renewed depreciation in the currency,” he said.

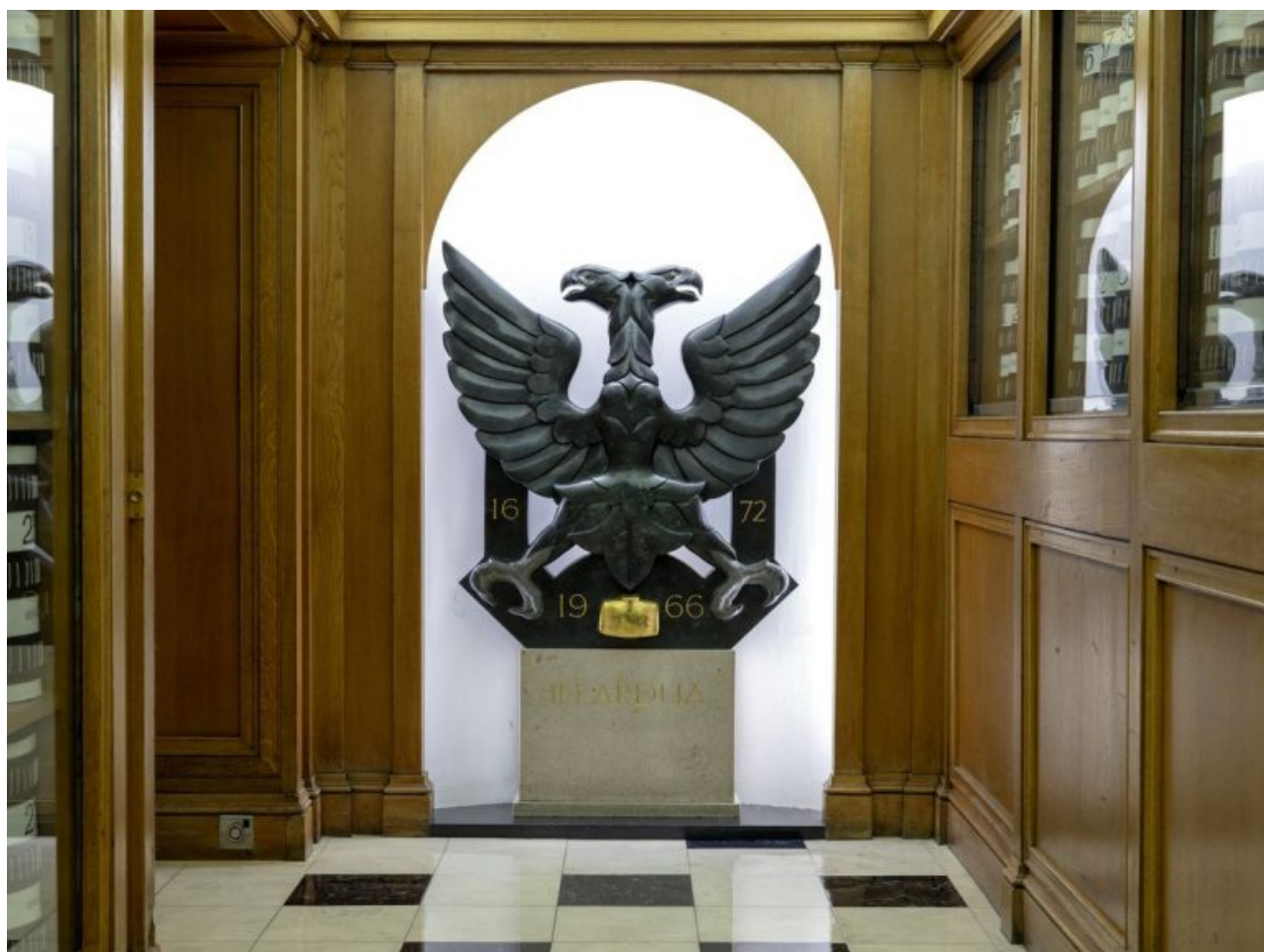
Additional reporting by Birsen Altayli and Tom Arnold; writing by Jonathan Spicer; editing by Larry King

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## **The British Banking Dynasty**

# That's Even Older Than the Rothschilds



C. Hoare & Co. has been in business for more than three hundred years, and the family that founded it is still running the show.

By  
Tom Metcalf

In the U.K. there's old money, really old money and then there's C. Hoare & Co.

The London firm was started in 1672 by Richard Hoare and has tended to the affairs of diarist Samuel Pepys, poet Lord Byron and novelist Jane Austen. That's almost a hundred years older than the famous Rothschild dynasty, which was founded in the 1760s. After more than three centuries of continuous operation, the family still runs the show, overseeing about 4.4 billion pounds (\$5.6 billion) of deposits and sticking to

a traditional way of doing business.

“You go in and you talk,” said Islay Robinson, chief executive officer of Enness, a mortgage broker with dozens of high-net-worth clients who have borrowed from the bank. “They lend their own money and tend to be able to come up with solutions that other banks can’t.”

The last of the 10th generation of partners retired last year, leaving the bank in the hands of six partners from the 11th generation who have continued its evolution. In March, they opened the first outpost outside London: a Cambridge office designed to serve existing clients but also attract entrepreneurs in a region known for bioscience and technology ventures.

Blending old with new has become vital for C. Hoare, rival Coutts and smaller competitors such as Raphaels and Weatherbys as they vie to serve wealthy clients. Independent banks are also striving to reconcile their highly tailored services to an industry where the prevailing trends are consolidation and rising regulation.

“It’s a constant tension because part of what makes us completely different to the clearing banks is that we are smaller and more personable and more human and more relatable to customers,” partner Alexander Hoare, 57, said during an interview in a meeting room festooned with cartoons. “We don’t want to be herded and we don’t want to grow. We want to be special.”

C. Hoare is certainly different. The firm is an unlimited liability partnership, meaning the personal assets of the partners are fair game for creditors. Since at least 1994, the dividend has been fixed at 50 pounds per share or 6,000 pounds total. That’s for a business with 26 million pounds of profit in the 12 months through March 31, 2019.

The restraint has built a valuable enterprise. The

partnership's latest accounts show a book value of about 370 million pounds, putting the family among the U.K.'s richest on paper. But the Hoares said they have no interest in selling.

"If people were in it for the liquidity event, it would have been sold a long time ago," said Rennie Hoare, 33, who became a partner last year.

His ancestor Richard Hoare first started to trade at the "sign of the golden bottle" in 1672 (it took another century for street numbering to be invented). He rose to dominate the City of London, dabbled in politics and was knighted by Queen Anne.

Succeeding partners furthered this success, so many of whom were named Henry that they accrued epithets like "Henry the Good," "Henry the Magnificent" and "Fat Harry" to distinguish them. While the family dodged the pitfalls associated with the third generation of ownership, the seventh generation's speculative investments proved more problematic, with partner Henry Junior putting money into ventures such as a steam-engine enterprise and a company in Canada that was supposed to revolutionize the leather trade with treated hemlock, according to a family history. The collapse of his personal finances forced him to resign in 1874.

"Our seventh generation got way too wealthy and burnt through a fantastic fortune," Alexander Hoare said. "There are two things that can destroy a family business: the business and the family, and they both have to be kept in order."

Hiccups aside, the firm's longevity speaks to the enduring strength of family businesses. A 2018 Credit Suisse Group report found that such businesses have outperformed the broader equity markets in the past decade. Certainly Hoare's conservatism proved an asset during the global financial crisis, when the strength of its balance sheet attracted a steady inflow of funds from troubled lenders like Royal Bank of Scotland.

“During the financial crisis, the smaller banks did extremely well,” said Caroline Burkart, an associate partner at consulting firm Scorpio Partnership. “These family- and partner-owned firms were regarded as a safe haven.”

C. Hoare’s unbroken ownership also gives its partners perspective, with three centuries of experience helping make the perplexities of events such as Brexit seem less foreboding.

“In banking, the cycles do come around,” said Bella Hoare, 50. “The reason we had a good crisis is that we hadn’t forgotten the last one. My father’s father had taught him the lessons from the 1929 crisis.”

They’ve also seen plenty of their rivals disappear, one reason why they’re careful in selecting partners. There are more than 2,000 living descendants of Richard Hoare and the sifting process to find suitable financiers starts pretty much the day a Hoare is born, current partners said. At the same time the bank employs a CEO from outside the family with Steven Cooper joining in January from Barclays Plc.

That blend of nepotism and professionalism mirrors the path between tradition and modernity the partners say they are walking to position the bank for the next era, which included selling the bank’s wealth-management arm for 72 million pounds in 2016 to focus on its core banking business.

While the bank strives for personalized service, its structure and size magnifies the burden of regulation and compliance, and missteps are costly. Soon after selling the wealth-management business, the bank discovered it hadn’t included the required wording in statements sent to clients, requiring it to refund more than 12 million pounds of interest.

“The sad truth is that the day of the gifted amateur is well and truly over,” Alexander Hoare wrote to his clients in January 2018. “The bank is compelled to look increasingly like

all other banks in terms of processes, controls and bureaucracy.”

A typical client needs about 5 million pounds in U.K. assets to bank with C. Hoare. Another barrier to entry is the meeting with a partner, which enables the family to find like-minded clients they can build relationships with.

“Banking with us is definitely more expensive than banking on the high street,” Bella Hoare said. “However, our customers believe that they are getting value for money because we can do something that for another bank wouldn’t be possible.”

There are other perks, too. Clients visiting the 37 Fleet St. office are reminded it’s Britain’s oldest surviving independent bank.

Muskets purchased during the Napoleonic wars to defend the bank adorn the entrance hall, cashiers work behind a 19th century oak counter and an adjacent waiting room looks onto an enclosed garden a world away from the City’s hubbub.

You can partake in a three-course meal with your relationship manager and attend evening talks. The building also houses a museum displaying artifacts and a framed family tree linking today’s partners to founder Richard Hoare.

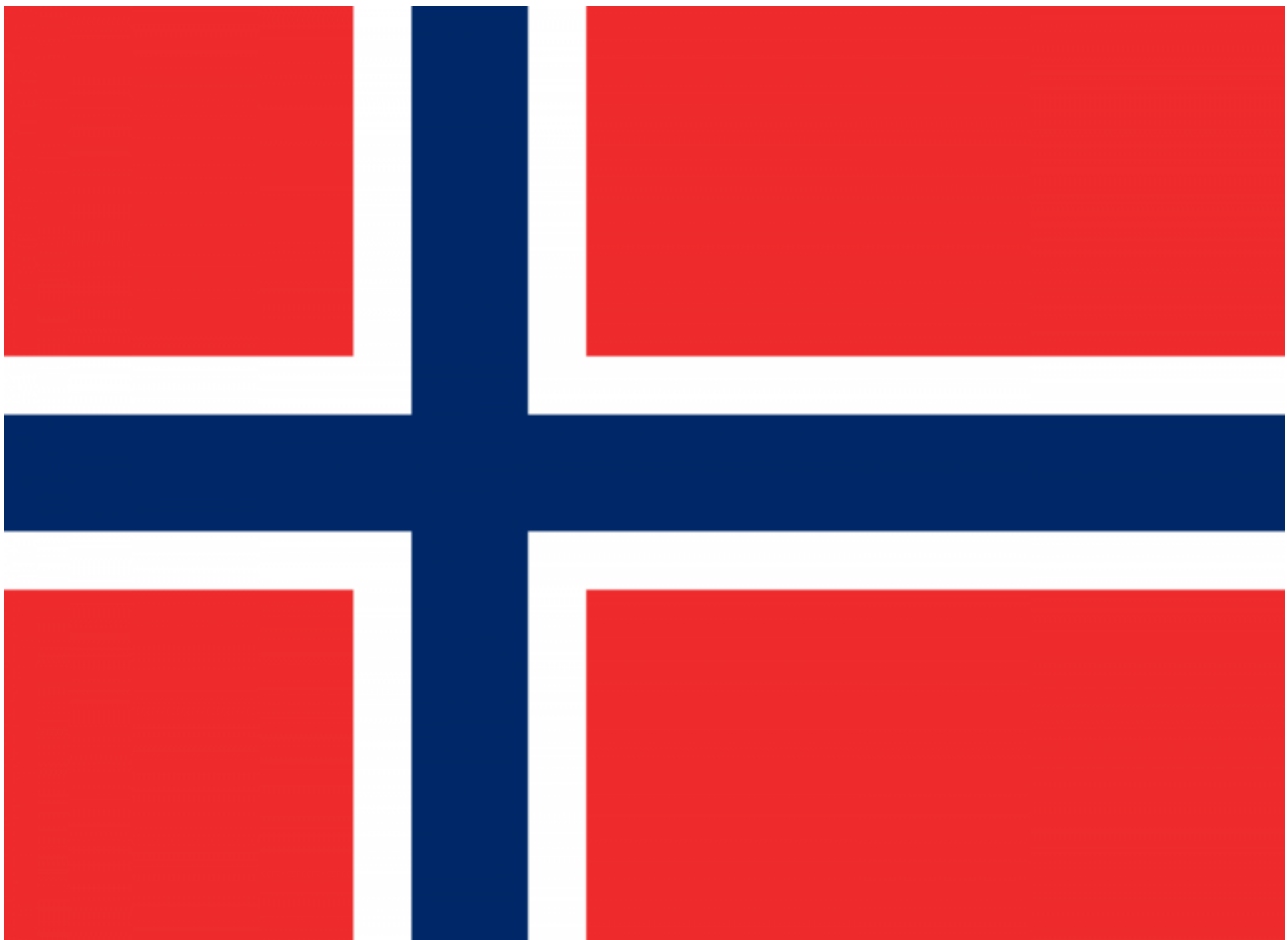
“Look, 95% of our energy is on the hurlyburly of the modern world,” Alexander Hoare said. “Preserving the memory is nice to have at the end of the day. It is the icing on the cake.”

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## **Norway’s \$1tn wealth fund**



# renews private equity bid



Norway's wealth fund proposed changes to its mandate to allow it to buy stakes in unlisted companies after missing out on investments in such companies as Spotify Technology SA. The advice comes after Norway's government has repeatedly declined to let the world's biggest sovereign wealth fund in on the global private equity market, citing concerns over transparency and management costs. The fund has said it can manage those issues, and its chief executive warned earlier this year that a growing number of companies are opting to stay off exchanges, posing a challenge for investors of its size. In a letter published on Wednesday, the \$1tn fund asked the Finance Ministry to allow it to invest in unlisted shares in "large companies" that aren't yet listed, with a potential limit of 1% of its portfolio. "Companies of this type will often already have other institutional investors as shareholders," the fund said in the letter. "This, in turn,

can help generate some liquidity in the shares. Based on experience, it is reasonable to expect some of these companies to go public at a later date.” The fund is currently only allowed to invest in unlisted companies that have clearly stated they are pursuing an initial public offering. Since board resolutions on IPOs usually come at a late stage, that restriction has prevented a number of investments that would have made sense for the fund, chief executive officer Yngve Slyngstad and central bank Governor Oystein Olsen said in the letter. The fund also said that its 2012 investment in Formula One owner Delta Topco, which was later probed and much debated in Norway, showed that a company’s intention to list shares is no guarantee it will happen. In addition to a limit of 1% of the fund’s equity portfolio, the bank said its Executive Board should also issue limits on the companies’ minimum size and maximum ownership stakes, as well as guidance on which markets the fund should target. The Finance Ministry will now consider the central bank’s proposal, it said in an email. The fund’s latest bid to broaden its mandate comes after it was cleared this year to invest in unlisted renewable energy infrastructure in a series of big and smaller changes voted by Parliament. Yet the investor has itself acknowledged that adding new asset classes is becoming less and less of a hot topic after the fund soared in size over the past decade and won permission to increase its share of stocks to 70% from 60% of the portfolio. In an interview in 2017, as the fund was nearing \$1tn in size, CEO Slyngstad said that “realistically speaking, whether we should invest in infrastructure, private equity or the likes isn’t a very important question.”

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# German Companies Signal Looming Recession After Demand Plunges



German manufacturers are reinforcing concern that Europe's largest economy is headed into a recession.

A nationwide gauge showed orders at factories and services companies are dropping at the fastest pace in six years, and more companies now expect output to fall than rise over the next 12 months. That's the first time that's happened since 2014, according to the Purchasing Managers' Index from IHS Markit.

The peek into the engine room of European industry provides a damning snapshot of the economy, which shrank in the second quarter. The persistent weakness – driven in particular by mounting global trade tensions, car industry woes and slowing demand in China – doesn't bode well for the broader euro area.

European Central Bank policy makers have already started laying the groundwork to add monetary stimulus, and are

expected to cut interest rates at their next meeting in three weeks. In Germany, the government has made only tentative steps toward a fiscal stimulus program aimed at supporting growth.

“Somehow they are not looking at this data,” said Carsten Brzeski, chief German economist at ING in Frankfurt. “The German government should react. We have this stagnation of the entire economy now and we really need some fiscal stimulus.”

While the headline German composite PMI unexpectedly rose in August to 51.4 from 50.9, the index for factories remained far under 50, signaling a seventh month of contraction. Backlogs of work across both sectors fell for a 10th month and the pace of hiring slowed, with employment in manufacturing declining at the fastest pace in seven years.

## ***What Bloomberg's Economists Say...***

*“There's a little light at the end of the tunnel for Germany's economy. The PMI – a trusted gauge of economic activity – picked up a little in August. The big risk is that a fresh blow to manufacturing materializes – the U.S. goes ahead with tariffs on EU car exports, for example – or that weakness in the industrial sector spreads to services.”*

Composite figures for France and the euro area also beat expectations, and the euro rose. Bunds declined, though 10-year yields are still well below zero.

“Germany remains a two-speed economy, with ongoing growth of services just about compensating for the sustained weakness in manufacturing,” said IHS Markit economist Phil Smith. “Although improving slightly, the survey's output data haven't changed enough to dispel the threat of another slight contraction in gross domestic product in the third quarter.”

– With assistance by Matthew Miller

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## Qatari investments in Russia around \$13bn, says official



(MENAFN – Gulf Times) Amid strengthening political, economic, and cultural relations between Qatar and Russia, Qatar's investments in the Russian Federation are estimated at around \$13bn, according to an embassy official.

Rashid bin Majid Awad al-Suwaidi, first secretary of the embassy of the State of Qatar in Russia, made the statement on Monday in a meeting with Qatar Chamber officials, who received a visiting Russia delegation.

Citing the country's 19% share in Russian oil giant Rosneft, al-Suwaidi noted that Qatar's investments have witnessed a 'strong continuing in Russia.

The meeting, led by Qatar Chamber assistant director general for Government Relations Ali Busherbak al-Mansouri, discussed Qatar's participation in the St Petersburg International Economic Forum slated in Russia next year.

The forum is an annual Russian business event for the economic sector, which has been held in St Petersburg since 1997 under the auspices of the Russian president since 2005.

Al-Suwaidi said the Russian delegation's visit to Doha aims to facilitate the participation of Qatar in the forum, which is attended by more than 20,000 participants and more than 1,000 Russian companies, as well as 500 companies from other participating countries.

He noted that the importance of Qatar's participation in the forum lies in the signing of trade agreements and enhancing co-operation between participating Qatari companies and their counterparts from other countries.

The forum, al-Suwaidi said, will witness the participation of officials and Qatari delegations comprising business owners, as well as on the cultural side, considering that last year was the year of cultural co-operation between Qatar and Russia.

Al-Mansouri said the forum represents an important opportunity to discuss the strengthening of co-operation relations between the Qatari private sector and its Russian counterpart, in addition to reviewing the attractive investment climate in Qatar and promoting the Qatari economy and private sector projects.

He also noted that the forum would explore the possibility of strengthening alliances between Qatari businessmen and their Russian counterparts to establish joint ventures whether in Qatar or Russia, adding that the Chamber will encourage Qatari companies to participate in the forum and the accompanying exhibition.

Other members of the visiting Russian delegation include Ekaterin Sharbatenko, Andrei Igorov, and Diana Charmadova, who delivered a presentation about the forum and its objectives, as well as its significance to Qatar and its participating companies.

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## The inequality of nations



MILAN – The eighteenth-century British economist Adam Smith has long been revered as the founder of modern economics, a thinker who, in his great works “The Wealth of Nations” and “The Theory of Moral Sentiments”, discerned critical aspects of how market economies function. But the insights that earned Smith his exalted reputation are not nearly as unassailable as they once seemed.

Perhaps the best known of Smith’s insights is that, in the context of well-functioning and well-regulated markets, individuals acting according to their own self-interest

produce a good overall result. "Good," in this context, means what economists today call "Pareto-optimal", a state of resource allocation in which no one can be made better off without making someone else worse off.

Smith's proposition is problematic, because it relies on the untenable assumption that there are no significant market failures, no externalities (effects like, say, pollution that are not reflected in market prices), no major informational gaps or asymmetries and no actors with enough power to tilt outcomes in their favor. Moreover, it utterly disregards distributional outcomes, which Pareto efficiency does not cover.

Another of Smith's key insights is that an increasing division of labour can enhance productivity and income growth, with each worker or company specialising in one isolated area of overall production. This is essentially the logic of globalisation: the expansion and integration of markets enables companies and countries to capitalise on comparative advantages and economies of scale, thereby dramatically increasing overall efficiency and productivity.

Again, however, Smith is touting a market economy's capacity to create wealth, without regard for the distribution of that wealth. In fact, increased specialisation within larger markets has potentially major distributional effects, with some actors suffering huge losses. And the refrain that the gains are large enough to compensate the losers lacks credibility, because there is no practical way to make that happen.

Markets are mechanisms of social choice, in which dollars effectively equal votes; those with more purchasing power thus have more influence over market outcomes. Governments are also social choice mechanisms, but voting power is, or is supposed to be, distributed equally, regardless of wealth. Political equality should act as a counterweight to the weighted



“voting” power in the market.

To this end, governments must perform at least three key functions. First, they must use regulation to mitigate market failures caused by externalities, information gaps or asymmetries, or monopolies. Second, they must invest in tangible and intangible assets, for which the private return falls short of the social benefit. And, third, they must counter unacceptable distributional outcomes.

But governments around the world are failing to fulfill these responsibilities, not least because, in some representative democracies, purchasing power has encroached on politics. The most striking example is the United States, where electability is strongly correlated with either prior wealth or fundraising ability. This creates a strong incentive for politicians to align their policies with the interests of those with market power.

To be sure, the Internet has gone some way towards countering this trend. Some politicians, including Democratic presidential candidates like Bernie Sanders and Elizabeth Warren, rely on small individual donations to avoid becoming beholden to large donors. But the interests of the economically powerful remain significantly overrepresented in US politics, and this has diminished government’s effectiveness in mitigating market outcomes. The resulting failures, including rising inequality, have fuelled popular frustration, causing many to reject establishment voices in favour of spoilers like President Donald Trump. The result is deepening political and social dysfunction.

One might argue that similar social and political trends can also be seen in developed countries, Italy and the United Kingdom for example, that have fairly stringent restrictions on the role of money in elections. But those rules do not stop powerful insiders from wielding disproportionate influence over political outcomes through their exclusive networks.

Joining the “in” group requires connections, contributions, and loyalty. Once it is secured, however, the rewards can be substantial, as some members become political leaders, working in the interests of the rest.

Some believe that, in a representative democracy, certain groups will always end up with disproportionate influence. Others would argue that more direct democracy, with voters deciding on major policies through referenda, as they do in Switzerland, can go some way towards mitigating this dynamic. But while such an approach may be worthy of consideration, in many areas, such as competition policy, effective decision-making demands relevant expertise. And government would still be responsible for implementation.

These challenges have helped to spur interest in a very different model. In a “state capitalist” system like China’s, a relatively autocratic government acts as a robust counterweight to the market system.

In theory, such a system enables leaders, unencumbered by the demands of democratic elections, to advance the broad public interest. But with few checks on their activities, including from media, which the government tightly controls, there is no guarantee that they will. This lack of accountability can also lend itself to corruption, yet another mechanism for turning government away from the public interest.

China’s governance model is regarded as dangerous by much of the West, where the absence of public accountability is viewed as a fatal flaw. But many developing countries are considering it as an alternative to liberal democracy, which has plenty of flaws of its own.

For the world’s existing representative democracies, addressing those flaws must be a top priority, with countries limiting, to the maximal extent possible, the narrowing of the interests the government represents. This will not be easy.

But at a time when market outcomes are increasingly failing to pass virtually any test of distributional equity, it is essential.

Michael Spence, a Nobel laureate in economics, is professor of Economics at New York University's Stern School of Business and senior fellow at the Hoover Institution. He was the chairman of the independent Commission on Growth and Development, an international body that from 2006-2010 analysed opportunities for global economic growth, and is the author of "The Next Convergence – The Future of Economic Growth in a Multispeed World". Project Syndicate, 2019.