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Capitalism and democracy: what if we have it backwards?

It's fashionable on the left to suggest that capitalism and democracy are now incompatible. But maybe the opposite is true

For most on the left the story of the last decades goes something like this. During the postwar era the 'primacy of politics' was the rule: democratic governments, particularly in Europe, actively shaped economic outcomes in response to the needs of their citizens. During the late 20th century this postwar order began to decay and today markets dominate politics, leaving democratic governments unable to shape economic outcomes and respond to the needs of citizens. Instead, 'footloose' capital and businesses are in charge.

Thomas Piketty, for example, has influentially argued that capital follows its own laws, which democratic governments are unable to counter. Wolfgang Streeck similarly asserts that capitalism inevitably subverts democracy; it is, as he puts it, a 'utopian' fantasy to assume they can be reconciled. Claus Offe concurs, asserting that today 'markets set the political agenda' and 'citizens have lost their ability to influence government'.

But suppose this is wrong? Suppose democracy is as 'in charge' now as it was during the postwar era? Suppose our current economic order was not the result of the ineluctable dynamics of capitalism or markets, but rather the consequence of purposeful policy decisions made by democratic governments? And suppose that the most important drivers and beneficiaries of these decisions were not 'footloose' corporations—but rather people like the readers of?

Provocative new book

Such an alternative narrative can be gleaned from a provocative new book by two well-known and influential political economists, Torben Iversen and David Soskice, entitled *Democracy and Prosperity. Reinventing Capitalism Through a Turbulent Century*. According to them, the story

of the last decades goes something like this.

The emergence of new information and communications technologies during the late 20th century made a new economic order possible but not inevitable. In order for capitalism to be transformed, massive reforms were necessary. For example, in comparison with Fordist-industrial economies, knowledge-based economies require constant innovation and risk-taking as well as a highly educated and flexible workforce. And these, in turn, require government policies that encourage competition, promote new financial products and expand higher education.

Such reforms entail massive regulatory and institutional change and thus can only be accomplished by states with high levels of capacity and legitimacy, which is why the transition to knowledge-based economies happened first and has gone the farthest in advanced democracies. Middle-income countries, with weak and often undemocratic states, are generally unable to implement such reforms. And dictatorships such as the Soviet Union, 'which arguably had the centralized scientific computing expertise in the 1970s and 1980s to evolve into a knowledge economy', also have difficulty doing so, since the necessary reforms would require leaders to relinquish political and economic control.

If 'footloose' capital didn't drive the transformation of capitalism or government decisions more generally in recent times, who did?

So far this story, perhaps ironically, tracks one familiar to most readers of *Social Europe*—that told by Karl Polanyi in *The Great Transformation* (although Iversen and Soskice oddly do not mention him). Just as Polanyi argued that the transition to capitalism was not the result of the ineluctable expansion of markets, but rather the consequence of concrete political decisions, Iversen and Soskice argue that the transformation of capitalism in the 20th century was the result of decisions made by democratically elected governments.

But they go further. Not only do Iversen and Soskice reject the idea, increasingly fashionable on the left today, that capitalism and democracy are incompatible. They argue that they are dependent on each other, since without strong, legitimate states capitalism could not constantly reinvent itself.

And democracy is not merely the 'the executive committee', as Lenin would have it, of footloose firms—most analysts vastly overstate their power, Iversen and Soskice contend. Unlike low-skill companies, which can easily move between locations, knowledge-based firms are dependent

on particular regulatory, financial and educational environments, as well as highly-educated workforces which are difficult to relocate, especially to other countries. This geographic embeddedness means that although knowledge-based firms 'may be powerful in the marketplace [they] have little structural power, and competition makes [them] politically weak'.

Middle-class demands

If 'footloose' capital didn't drive the transformation of capitalism or government decisions more generally in recent times, who did?

Politicians want to win elections and to do so they must convince citizens—particularly those most likely to vote and participate in politics—that they are responsive to their interests. And so 'expansions in higher education, financialization, liberalization of trade and F[oreign]D[irect]I[nvestment], inflation targeting, and strong competition rules were all ultimately instituted or reinforced', due to politicians' desire 'to address middle-class demands for improvement in living standards'.

But as capitalism was transformed, so too were classes and the relationships among them (here we get a dash of Marx added to our Polanyi). Knowledge-based firms are highly clustered in urban areas, where similar firms and highly-educated workers are located, and have highly segregated workplaces that allow for little mixing between middle and working classes. Low-skilled workers have meanwhile become increasingly concentrated in low-productivity service-sector occupations. Thus advanced capitalism produces a new middle class, whose life experiences and interests differ greatly from those of the old middle and working classes. And because the new middle classes are highly concentrated in particular urban areas, new class conflicts have led to new geographical ones (big cities versus peripheries). The political consequences of this are profound.

Populism thrives, in other words, where democracy does not provide opportunities for all.

Their embeddedness in cosmopolitan cities, extensive education, diverse social contacts and so on make the new middle class more socially progressive than the old middle and lower classes. Again, channelling Marx, Iversen and Soskice insist that 'social progressives and populists are rooted in different parts of the economy'; it is incorrect, therefore, 'to detach their values from underlying economic reality'. Iversen and Soskice thus reject the dominant tendency in analyses of US

politics—increasingly prevalent in analyses of Europe as well—to focus on social attitudes or a 'cultural backlash' when trying to explain contemporary voting patterns or political trends, since such analyses miss the deeper structural causes of contemporary problems.

But if their position in the knowledge economy makes the members of the new middle class socially progressive, it can also make them less economically progressive, since neither their interests nor life experiences overlap greatly with those of the old middle and lower classes. Herein lies the primary reason why the rising inequality accompanying the transformation of capitalism has not been effectively countered by increased redistribution: the old middle class is hostile to the poor and the rising middle class is uninterested in the plight of the declining middle class—it is the workings of the democratic system rather than the political power of capital that is to blame.

Transformative change

So where does this all leave us? With reason for hope, since democracy has the power to effect transformative change. And since it is primarily voters, particularly the economic 'winners', and the coalitions among them, rather than business, that determines what governments do, increasing support for and coalitions in favour of redistribution is the prerequisite for such change.

Key here is social mobility. Mobility ties the interests of members of different classes together—those at the lower end can expect that they or their children will move up and those at the higher end can't be sure that they or the children won't move down. In a high-mobility world the 'interest gap' between classes diminishes and messages that 'we are all in the same boat' or of 'class cooperation' make more sense. In contrast, when social mobility is low, the old middle and lower classes become susceptible to populists who 'attack symbols of the new economy, an economy they and they children feel' they have been permanently left out of.

Populism thrives, in other words, where democracy does not provide opportunities for all. Iversen and Soskice present very interesting data on the difference between populist attitudes and populist voting and show that 'where barriers to good education and upskilling are low populist values are much less prevalent'. (They also argue that there is a very strong tendency for the low-skilled to vote populist, even after controlling for values.) And broadening opportunity means first and

foremost expanding access to and improving the quality of education, since education determines whether 'losers' and their children have the opportunity to become 'winners' through the acquisition of new skills.

Many on the left will surely disagree with aspects of Iversen's and Soskice's analysis. But debates about how capitalism develops and the conditions under which democracy can reshape economic outcomes to benefit the broad majority of citizens are absolutely crucial if the left is to thrive and populism to be countered. Hopefully, Democracy and Prosperity will help spur this debate along.

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