

Review essay: Democracy and Prosperity

Transfer

2021, Vol. 27(3) 413–420

© The Author(s) 2021

Article reuse guidelines:

sagepub.com/journals-permissions

DOI: 10.1177/10242589211035042

journals.sagepub.com/home/trs



Torben Iversen and David Soskice

Democracy and Prosperity: Reinventing Capitalism through a Turbulent Century, Princeton University Press: New Jersey, 2019; 335 pp.: 97806911827355, €24.99 (hbk)

Reviewed by: Martin Höpner, Max Planck Institute for the Study of Societies, Cologne, Germany

Democracy and Prosperity is an exceptionally provocative and thereby stimulating book, especially for progressive readers. Torben Iversen and David Soskice argue that capitalism and democracy are mutually reinforcing. Democratic capitalism has worked well and will most likely work well in the future. Globalisation is not putting into question the primacy of politics over economic matters, nor will populism challenge the symbiosis of democratic politics and free markets.

A brief summery

Iversen and Soskice's new volume should be read in the context of broader debates in comparative and international political economy. The authors belong to the 'varieties of capitalism' (VoC) school, a research strand that classifies countries according to the comparative advantages which their supply-side institutions offer to firms. Critics have argued that VoC is too much about national varieties and not enough about capitalism as such and its temporal phases (Pontusson, 2005; Streeck, 2011). With the exception of one chapter in which the authors distinguish a proto-liberal from a proto-corporatist route to democracy in 19th century capitalism (Ch. 2), the book is mostly about phases and remains surprisingly silent about varieties. This should not be held against Iversen and Soskice, as this is precisely what critics have asked for.

Democracy and Prosperity is a response to crisis theorists who argue that capitalism and democracy are contradictory and tend to undermine each other, a belief that Marxists have shared with liberal authors such as Hayek (1944) and that scholars such as Piketty (2013), Rodrik (2012) and Streeck (2014) express under today's conditions of globalised capitalism. Iversen and Soskice reply that the miracle to be explained is not why democratic capitalism is prone to crisis. It is rather why democratic capitalism has remained resilient despite all crises, especially in the context of disruptive technological change.

Democratic capitalism, Iversen and Soskice argue, is resilient because democracy and advanced capitalism mutually reinforce each other. Electorally decisive middle classes gain from capitalism's productivity increases and therefore support policies that underpin its advanced sectors. Aspirational families push their children into higher education and ask governments to build up and maintain the infrastructure required for this purpose. As the leading sectors flourish, they create even more incentives to acquire higher education. A virtuous cycle emerges that brings about the modern, knowledge-based economy.

The political preferences of middle-class voters may diverge in many dimensions. But they converge insofar as they all ask the state to manage the economy effectively. These voters want the state to impose competition upon firms, develop labour market rules from which workers profit without becoming able to eat up firms' sunk costs, and create the infrastructure that provides education, training and research. Voters, politicians, and the managers of decisive firms in the advanced sectors share a common interest in the perpetuation of the virtuous circle of the knowledge economy.

In sharp contrast to left-leaning political economists, Iversen and Soskice argue that the knowledge economy strengthens the state and politically weakens firms, rather than the other way around. Modern firms are by no means footloose. They employ workers with co-specific skills who can neither easily be separated from each other nor transferred abroad altogether. Companies set up subsidiaries abroad, but, once established, they are effectively tied to where they are. International networks of specialised subsidiaries must not be confused with globetrotting capital. This implies that firms cannot blackmail states. The spatial immobility of firms underpins the steering capacity of the state not only with regard to costly supply-side policies, but also with regard to its role as a strong redistributor.

The authors do not ignore that the rapid transition to the knowledge economy comes at a cost. A growing split between those with and those without higher education emerges, which translates into growing divergence between urban agglomerations of the new economy and left-behind rural areas. Iversen and Soskice describe this split as the driver of (mainly right-wing) populism. Nativism and populism, however, are not likely to put an end to democratic capitalism's virtuous cycle: for the decisive middle-class voters who gain from the knowledge economy, the populist programme is unattractive and will remain so. Populists are therefore not likely to attract political majorities.

Rationalist functionalism

Iversen and Soskice's approach is strictly rationalist, with a utility-maximising median voter model as the guiding heuristic. The approach is also strictly functionalist: efficiency drives change, form follows function. Within democracy, the median voter anticipates the economic functionality of reform options and supports those which push advanced sectors forward. The same functionalism applies when the authors ask why democracy was established in the first place. One of the programmatic sentences in Chapter 2 reads: the 'effect of democracy was also the reason for democracy' (p. 81). In case you are looking for a good syllabus addition in order to illustrate functionalism in political economy – here it is. Functional arguments are by no means necessarily functionalist fallacies. Readers should nevertheless be aware of the limits of the approach.

Two problems deserve consideration. First, functionalist arguments take for granted that voters and politicians are capable of calculating the implications of reform options for *future* economic efficiency, and to choose the most productive option accordingly. Iversen and Soskice describe not only educational expansion, but also the whole set of (neo)liberal reforms since the late 1970s as rational choices of the middle classes and politicians who aimed at pushing forward the emerging knowledge economy (p. 163). Parts of this set have been the liberalisation of FDI, antitrust policy, financialisation, and central bank independence. The causal chains from these parts to the functioning of the knowledge economy are long and complex, and have varying degrees of plausibility. The functional contribution of central bank independence and inflation targeting to knowledge-based growth, proposed by the authors on pp. 120–123 and p. 151, is in my view particularly

difficult to capture. Here, Iversen and Soskice retrospectively read the respective intentions into the then-existing actors.

Second, what is lacking in this kind of thinking is power – the ability to push through changes supporting a narrow self-interest even if they do not add, or take away, productive functionality to the configuration as a whole. In this functionalist understanding of economic history, things such as (unproductive) over-financialisation can hardly exist. Financialisation may productively contribute to the knowledge economy if, for example, their protagonists seek housing credit. So far, so good – but what about high-frequency trade in milliseconds, what about the complex financial instruments (CFIs) that have actually become so complex that no agency can judge them anymore? Have they really been functional contributions, chosen by middle-class voters, to economic efficiency?

Furthermore, the extent of political-economic matters that have been entirely taken out of the democratic sphere and therefore proceed behind the backs of voters – the Hayekian dream – is on the rise. Today, technocrats, central bankers, and judges shape economic policy decisions as much as voters, and therefore deserve our attention.

The immobile and weak firm

Much of Iversen and Soskice's argument relies on the assumption that advanced firms are spatially bound, due to the co-specificity of workers' skills. If this holds true, firms cannot challenge the primacy of national politics by threatening to move across borders. Modern firms are, in the words of the authors, 'politically weak' (p. 21). The authors have a point here: naive views on firm mobility deserve correction. The firm as a footloose entity, always prepared to relocate to jurisdictions where states offer better conditions, is a caricature rather than reality. But Iversen and Soskice replace that caricature with yet another: the caricature of fully immobile firms helplessly exposed to the demands of politicians.

The authors should have expressed more explicitly that what they describe is an *extrapolation* of *tendencies* which they observe in *certain sectors*. A more realistic picture would have emerged if the authors had displayed their modern firm as an ideal type that marks the extreme of a spectrum, the fully mobile firm as the other extreme, and real firms, sectors and countries in between. With regard to sectors, the large agglomerations of 'Silicon Valley Capitalism' (Boix, 2019) surely approach the immobile end of the spectrum. The same holds true for certain subsidiaries within old-style industrial capitalism, such as those dedicated to research and development, in addition to management headquarters, and prototype producers. The relocation of such firms is indeed particularly difficult. But they hardly make up the bulk of modern economies. At the other end of the spectrum, arbitrage seeking by the means of relocations or credible relocation threats occurs (remember Nokia). For EU countries, the European Restructuring Monitor (ERM) is a good data provider.

Firms' ability to engage in transnational arbitrage also varies across policy fields. The best example is tax competition. Under conditions of the free movement of capital, transnational firms strategically transfer profits and losses across borders, in order to pay taxes where they are lowest, without having physically to relocate. This especially holds true for the EU, where Member States' attempts to prevent firms from tax arbitrage have often been declared unlawful by the Court of Justice of the European Union (CJEU). Even the global minimum tax rates currently being negotiated will not completely eliminate this kind of tax competition.

The problem is even greater with regard to company law: EU Member States are not allowed to impose their company law on firms anymore, even if the respective firms produce nowhere else

than domestically. Firms are free to choose the company law they prefer among those present in the EU-27. US readers may shrug their shoulders because they know the *Delaware effect* pretty well. But institutional arbitrage by the means of virtual relocations has different implications in the EU, in which quite different industrial relations regimes are present. If the founder of a firm dislikes employees' supervisory board co-determination, he or she can pick a legal form without it. For this reason (among others), co-determination-free zones are on the rise in countries such as Germany (the Hans Böckler Foundation provides data on this). Supervisory board co-determination therefore becomes a voluntary rather than mandatory institution (perhaps even no longer an institution in the narrow sense) – a *weak state, strong firm* constellation, again due to the decisions of European judges who proceed behind the backs of voters.

The co-determination example indicates that firm mobility not only affects state-firm relations, but also labour relations. In order to press workers towards concessions, however, full relocations or respective threats are often not necessary. Most location competition occurs in the course of the national or transnational struggle over the distribution of investments among already existing subsidiaries or over outsourcing, downsizing, and disinvestments, especially in the context of de-industrialisation. In some passages of the book, and surprisingly for political economy readers, Iversen and Soskice deny the existence of the class conflict altogether: 'This contrasts with the widespread assumption in the political economic literature that labor and capital have opposing interests' (p. 102). If that were true, why not abolish collective labour law, given its redundancy if workers apply it against owners and managers who share the very same interests anyway?

Iversen and Soskice should take the weakening of labour and trade unions much more seriously, and think through its societal and economic implications (see Baccaro and Howell, 2017). Capitalism relies not only on the efficient supply of skilled labour and other supply-side policies. It also relies on stable compromises between groups with opposing interests. We have reason to care. At the individual level, the dignity of those who have to sell their manpower is at stake. At the macroeconomic level, at stake is wage-driven demand (Baccaro and Pontusson, 2016): without sufficient wage pressure, capitalism becomes deflationary.

Democratic capitalism and inequality

It is remarkable how Iversen and Soskice shift the blame for rising inequality back and forth between the two spheres of democratic capitalism: democracy and capitalism. Empirically, the authors make clear that the knowledge economy comes with rising inequality of primary income (p. 192); that low and semi-skilled workers and highly skilled workers, complementarily stuck together in Fordism (Ch. 3), now drift apart; and that these developments translate into inter-regional social and cultural divisions between internationalised cities and rural areas (Ch. 5, see below). But given that democratic nation states are free to redistribute primary income, democratic choices rather than 'the dark forces of capitalism' (p. 253) are to blame, they say (p. 140). This move (with which one could in principle affirm even the most asymmetrical distribution of primary income) enables them to differentiate themselves from critics of capitalism.

So, the reader redirects his or her hopes to democracy – only to learn that democracy is for the middle classes, not for the left-behinds. 'The essence of democracy is not equality or redistribution' (p. 158), they argue. 'It is instead that the decisive voters [...] want to secure a more or less constant share of the productive capacity of the economy for themselves [...] Concern for the poor is limited to the extent of the middle classes [...] being concerned about becoming poor themselves' (p. 158). Well, the essence of the *median voter model* is not equality. What the essence

of *democracy* is depends on the democracy theory applied. Neo-republican theory treats inclusion as the decisive promise of democracy and takes the social equality prerequisites of well-functioning democracy seriously (Schäfer, 2015). If social inequalities translate into asymmetrical political participation chances, neo-republicans question the functioning of democracy. In this perspective, the essence of democracy *is*, in fact, equality.

One may surely question the normative impetus of neo-republicanism and of theories about ‘social democracy’. However, *Democracy and Prosperity* makes the reader wonder whether the median voter model, by contrast, is really as free of normative content as it claims. Is it really a heuristic research tool only – or does it in fact deliver normative approval of unacceptable outcomes, as long as the median voter profits? Anyway: if we combine what Iversen and Soskice say about rising inequality under conditions of the emerging knowledge economy, on the one hand, and about the essence of democracy which makes correction in favour of the poor unlikely, on the other hand, an alarming picture emerges, a picture that calls for an up-to-date crisis theory of democratic capitalism rather than affirmation of it.

The new cleavage

After these critical remarks, I now turn to the parts of the book which I perceive as the best: those that concern the new cleavage, in the narrow sense of Lipset and Rokkan (1967), between the winners and the losers of the ongoing economic transformations. The cleavage has famously been theorised as one between ‘cosmopolitans’ or ‘anywheres’, on the one side of the divide, and ‘communitarians’ or ‘somewheres’ on the other side (Zürn and de Wilde, 2016; Goodhart, 2017). *Democracy and Prosperity* helps to think through the nature of the cleavage.

The so-called cosmopolitans are by no means globetrotters, as Iversen and Soskice clarify. The point is rather that they are parts of ethnically and culturally diverse networks and live in large, internationalised cities. In such work environments, cultural flexibility and openness sell economically, while conformism and intolerance do not (p. 217). One does not have to assume full economic determination of cultural dispositions in order to accept that there is an affinity between left-liberal openness and the working and living conditions in the centres of the knowledge economy. Iversen and Soskice use Granovetter’s (1973) terminology to characterise the mindsets of the highly skilled members of the advanced sectors: they have trained and internalised the willingness and ability to invest in the ‘strength of weak ties’ (p. 205).

Similarly, we can think of the opposite dispositions, empirically positioned in the left-behind rural areas and therefore far away from the highly productive skill clusters in the global cities, as valuing strong, long-lasting ties. For the left-behinds, the promise of at least status maintenance in exchange for hard work has lost credibility. In the course of the transition to the knowledge economy, they see their skills, social statuses, and lifestyles rejected and act as the basis of the populist countermovement.

I have not read this in such clarity so far and it has fully convinced me. It is an enlightening way to think about the nature of the new divide, not only because the authors avoid the over-emphasis on globalisation by replacing it with structural change and correct misguiding characterisations of ‘cosmopolitans’ as globetrotters. Much more important, the authors helpfully arbitrate between the proponents of purely cultural and of purely economic views on the cleavage. The divide has cultural content, but nevertheless strong material sources.

However, it does also not remain unnoticed that the authors’ theorisation of populism is to a large extent drawn from the US experience, in which the populists (the Trump supporters) have a free-market social policy stance (p. 222). This not only leaves left-wing populism aside (which

later comes in rather surprisingly, p. 248), but also ignores variance within the right-wing populist camp: consider the Rassemblement National which has basically copied the economic and social programme of the 1980s French Communists. Similar political positioning, far away from economic liberalism, can be found in the Eastern parts of the German Alternative für Deutschland.

The future challenges

The productive symbiosis of democracy and capitalism, Iversen and Soskice argue, is nevertheless not in danger: populism is unlikely to attract political majorities. The point is not that the members of the highly productive skill clusters are numerous enough to outvote the non-members. The point is rather that aspirational supporters complement the actual winners (pp. 102, 146, 219, 272). Everyone who perceives the promises of knowledge capitalism as plausible enough to be attractive for her or him, or her and his children, will support politicians who add rather than take away dynamism to the cycle (see also Beckert, 2016: 164–167).

The populist threat may become more serious once we go beyond the strictly rational-economic heuristic. Cultural disruptions (or extraordinary threats to inner security, for example) may add to the readiness to support anti-elite parties and may culminate in ‘extreme’ election outcomes from time to time, such as the Trump election or perhaps the Brexit decision. Nevertheless, with regard to the decisive institutions of democratic capitalism, the authors have a point. Neither Trump nor Brexit have put an end to democracy, capitalism, or both of them. In this sense, democratic capitalism is resilient indeed – but this does not imply that things are good. The prospects for a fair balancing of interests of the winners and losers of the rapid transformation are unclear, to say the least. Social cohesion is at stake even if the populist countermovement does not succeed. The populist threat is only the *symptom* of a deeper problem.

Will states, under the conditions described above, be able to rebalance among winners and losers? In principle, the authors’ analysis paves the way for pessimism. But the book also offers gleams of hope. First, Iversen and Soskice express optimism with regard to the states’ ability and willingness to build more open and mobility-enhancing educational systems (pp. 243, 250–251). If this works out, more people could join those with reasonable aspirational hopes for them and their children. Every reader will agree that this would be good, but every reader will also doubt that it would be enough.

Second, for reasons explained above, the authors insist on the political steering capacity of the state, which also includes redistributive capacity. Redistribution works well in terms of the transfer of welfare from the top to the middle classes. In the US, Iversen and Soskice point out (p. 25), about 70 per cent of federal income tax revenues come from the top 10 per cent of earners. What looks like good news at first glance is however not very telling with regard to the resulting degree of equality. It is much more telling with regard to the extraordinary extent to which US primary income is concentrated at the top of the income distribution (Piketty, 2013: Ch. 9). More importantly, it does not inform us about the willingness of the middle classes to redistribute towards the poor, a matter on which Iversen and Soskice are pessimistic in most parts of the book.

In the concluding chapter of the book, and in contradiction to the aforementioned pessimism, Iversen and Soskice see solidaristic dispositions on the rise in the centres of the knowledge economy. ‘The major urban corridors’, they say, ‘have become hubs for new technology, higher education, and progress, and in contrast to the declining periphery they tie together people in ways *that reach beyond class and ethnicity*’ (p. 277; my emphasis). The nature of solidarity that emerges under conditions of increasingly weak and flexible ties is an important object for future research:

one wonders whether the solidarity-enhancing effect of openness works for class as much as it works for ethnicity.

Are the winners still perceiving the losers as part of ‘us’ as the economic and social transformation goes on? I am not sure. Even within the large and internationalised cities, the winners and losers meet less and less, due to gentrification. The rich and the poor use different means of transportation, buy their food in different shops, go to different doctors, and send their children to different schools. Even rarer are the contact points, the only source of solidarity, between the members of the highly productive skill clusters and the left-behinds in the small cities. These are alarming crisis symptoms.

Enormous financial resources will have to be mobilised in order to address these problems, on top of those required for ecological transition. I do not want to suggest that this is impossible. But I very much doubt that the solution lies in the further perpetuation of what Iversen and Soskice describe as the virtuous cycle of democratic knowledge capitalism. The necessary political reorientation towards the left-behind regions will in all likelihood have to be enforced *against* and to the *disfavour* of the most advanced sectors of modern capitalism. Furthermore, new policy tools will most probably have to be invented, such as direct monetary financing of the state (Overt Monetary Financing, OMF), as the proponents of Modern Monetary Theory suggest (Mitchell et al., 2019). The reasons why it will be extremely difficult to push through such reform programmes are all to be found in Iversen and Soskice’s book. In the light of *Democracy and Prosperity*, our hopes may have to rely, and I hesitate to say this out loud, upon the intensity and credibility of the populist threat.

Acknowledgements

This review essay has very much profited from discussions with Lea Elsässer, Timur Ergen, Paul Marx, Fritz W. Scharpf and Armin Schäfer. Special thanks go to Armin Schäfer for his critical reading of a former version of this essay. All remaining misreadings and mistakes are mine.

Funding

This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

References

- Baccaro L and Howell C (2017) *Trajectories of Neoliberal Transformation: European Industrial Relations since the 1970s*. Cambridge: Cambridge University Press.
- Baccaro L and Pontusson J (2016) Rethinking comparative political economy: the growth model perspective. *Politics & Society* 44(2): 175–207.
- Beckert J (2016) *Imagined Futures. Fictional Expectations and Capitalist Dynamics*. Cambridge, MA: Harvard University Press.
- Boix C (2019) *Democratic Capitalism at the Crossroads: Technological Change and the Future of Politics*. Princeton, NJ: Princeton University Press.
- Goodhart D (2017) *The Road to Somewhere: The Populist Revolt and the Future of Politics*. London: Hurst.
- Granovetter MS (1973) The strength of weak ties. *American Journal of Sociology* 78(6): 1360–1380.
- Hayek FA (1944) *The Road to Serfdom*. Chicago, IL: Chicago University Press.
- Lipset SM and Rokkan S (1967) *Party Systems and Voter Alignments. Cross-National Perspectives*. New York, NY: Free Press.
- Mitchell W, Wray LR and Watts M (2019) *Macroeconomics*. London: Springer Nature.
- Piketty T (2013) *Capital in The Twenty-First Century*. Harvard: Harvard University Press.

- Pontusson J (2005) Varieties and commonalities of capitalism. In: Coates D (ed.) *Varieties of Capitalism, Varieties of Approaches*. Houndmills: Palgrave, pp. 163–188.
- Rodrik D (2012) *The Globalization Paradox. Why Global Markets, States, and Democracy Can't Coexist*. Oxford: Oxford University Press.
- Schäfer A (2015) *Der Verlust politischer Gleichheit. Warum die sinkende Wahlbeteiligung der Demokratie schadet*. Frankfurt: Campus.
- Streeck W (2011) E Pluribus unum? Varieties and commonalities of capitalism. In: Granovetter M and Swedberg R (eds) *The Sociology of Economic Life*. Boulder, CO: Westview, pp. 419–455.
- Streeck W (2014) *Buying Time. The Delayed Crisis of Democratic Capitalism*. Translated by Patrick Camiller. New York, NY: Verso.
- Zürn M and de Wilde P (2016) Debating globalization: cosmopolitanism and communitarianism as political ideologies. *Journal of Political Ideologies* 21(3): 280–301.