

# Critical Dialogue

## **Democracy and Prosperity: Reinventing Capitalism through a Turbulent Century.** By Torben Iversen and David Soskice. Princeton: Princeton University Press, 2019. 360p. \$29.95 cloth.

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Contrary to the predictions of a long and distinguished literature, spanning from Marx on the Left through Polanyi and Schumpeter to Mill and Hayek on the Right, that saw democracy and capitalism as partially if not fully incompatible, democratic capitalism reigned unchallenged in the advanced world throughout most of the twentieth century. It did so, according to *Democracy and Prosperity*, Torben Iversen and David Soskice's new, bold, and, overall, optimistic book, because democracy and capitalism are indeed "generally mutually supportive" (p. 5). Democracy "makes" (rather than replaces) markets (p. 258). In turn, a well-functioning capitalism, by delivering growth to an expanding middle class, makes democracy possible.

According to Iversen and Soskice, that "symbiotic relationship" (p. xii) derives, in a nutshell, from the internal logic of both capitalism and democracy. On the one hand, advanced capitalism relies on the use of an educated labor force whose skills are "cospecific with other skilled workers, and ... with other relevant technology" (p. 14). To operate efficiently, firms and skilled individuals "colocate" together in regional clusters. "Cospecificity" and "colocation" then have two crucial consequences. First, both capital and skilled labor benefit from, and therefore demand, public goods—ranging from well-run bureaucracies to infrastructures and education—that generate those skills and reinforce the complementarity of factors. Second, capital is not footloose: firms, embedded in production clusters, are relatively immobile and hence deprived of Lindblom's structural power to exit. On the other hand, skilled labor, which includes educated workers proper and "a wide aspirational community of families concerned that their children can access these advanced sectors" (p. 31), constitutes the majority of the electorate or at least the decisive voting bloc in advanced democracies and, because it benefits from well-functioning markets, supports growth-enhancing policies and public goods that

reinforce advanced capitalism. Moreover, the immobility of capital allows policy makers to establish a generous welfare state, which, in addition to having a redistributive dimension, operates as a provider of public goods (such as universal insurance policies that minimize the costs of job searches, maximize the health of the workforce, or lessen social conflict).

There is much to learn and admire from the theoretical edifice of *Democracy and Prosperity*. It offers a plausible explanation for "the exceptional resilience of advanced capitalist democracies (in comparison to any other type of nation state in the last century or so)" (p. 4). At the same time, however, a deeper examination of the theory's three main assumptions—the nature of complementary labor, the role and stability of cospecificity and colocation, and the majoritarian position of skilled individuals—leads one to question the claim that democracy reinforces rather than follows from capitalism and, more generally, the overall optimistic conclusion that capitalism and democracy are intrinsically compatible.

First, Iversen and Soskice's emphasis on capital-labor complementarity, which contradicts the conventional view that the interests of capital and labor clash with each other, is correct. Still, the type of labor that has been complementary to capital has evolved over time. Broadly speaking, it changed from artisans in preindustrial economies to unskilled workers in the first industrial revolution and then from semiskilled individuals during most of the twentieth century to highly skilled employees in the current knowledge economy. That evolution modified, in turn, employment patterns, wages, the distribution of income, capital's incentives to invest in public goods, and, arguably, the political arena. By focusing its attention on the "virtuous" outcomes of the twentieth century (and, more tentatively at the end of the book, on today's labor market), *Democracy and Prosperity* downplays important historical tensions between capitalism and democracy. For example, nineteenth-century capitalists opposed full suffrage, because of their concern about the condition and demands of labor. Likewise, today's growing inequality and stagnant median incomes (Anthony Atkinson, *Inequality*, 2015; OECD, "Under Pressure: The Squeezed Middle Class," 2019), which challenge the book's thesis that society's middle strata continue to be the winners of democratic capitalism, are feeding the rise of populism.

Second, there is no doubt that cospecificity and colocation have contributed to the clustering of production and the “immobility” of capital. Nevertheless, two key transformations are weakening those forces and, as a result, destabilizing democratic capitalism. In the first place, regional production clusters and nation-states arguably overlapped under Fordism. But their coincidence has declined in the last few decades, giving way to a well-known divergence between urban clusters and peripheral regions, at least in medium-sized and large countries (cf. David H. Autor, “Work of the Past, Work of the Future,” *AEA Papers and Proceedings*, 109, 2019; Christophe Guilluy, *Twilight of the Elites: Prosperity, the Periphery, and the Future of France*, 2019). Their overlap was also weaker during the nineteenth century, mostly because of the spatially uneven rise of manufacturing, and this resulted in strong tensions within nation-states. In the second place, cospecificity has not prevented the rise of factoryless manufacturing, triggered by declining costs of transportation and of coordination brought about by new information and communication technologies. Even though these new production chains have developed within “continental triads” or regions (North America, Europe, and East Asia), they are not contained within national borders, hence jeopardizing the symbiotic relationship between democracy and capitalism.

The unraveling of the economic conditions that propped up twentieth-century democratic capitalism leads us to the third key assumption of the book: the political mechanisms that drive democracy to sustain capitalism. In the wake of a growing split between winners (capital and complementary labor) and losers (the rest of labor), it is unclear whether the former will continue to be a majority or at least decisive enough to set policy. If they are not, then, democratic capitalism may unravel: either noncomplementary workers (together with a growing mass of retirees, who are much forgotten in the political economy literature) may vote against capitalism-enhancing policies, or winners may choose to redesign the political system to avoid being outvoted. Alternatively, if the latter continue to be the majority, as defended in the book, it is still unclear whether they will have any interest in investing in and redistributing to losers and their children. The hollowing out of middle-class jobs combined with strong immigration flows, which might strain the social contract on which the universal public provision of insurance rests, could push the majority toward welfare chauvinism.

*Democracy and Prosperity* explores the symbiotic relationship of democracy and capitalism mainly through the examination of the political and economic equilibrium that crystalized in the world’s “North” in the central decades of the twentieth century. Unfortunately, the single-case nature of the study makes it particularly hard to establish that democracy and capitalism were mutually

supportive in equal fashion—that is, that each one contributed to the outcome “independently” of the other, as Iversen and Soskice argue. In fact, the history of contemporary capitalism challenges the idea that democracy and capitalism necessitate each other. Nineteenth-century capitalists abhorred mass democracy. Contemporary capitalism developed and thrived in earnest in a substantial number of nondemocratic countries: in Germany until 1948 (with the brief interlude of the Weimar period), in southern Europe until the 1980s, and among the East Asian “Tigers” until the 1990s. Today, an important literature has already uncovered the inordinate power of wealthy sectors in policy making, at least in the United States (Larry M. Bartels, *Unequal Democracy: The Political Economy of the New Gilded Age*, 2008; Martin Gilens, *Affluence and Influence: Economic Inequality and Political Power in America*, 2012). Thus, it seems more plausible to conclude that twentieth-century democratic capitalism was the result of a particular configuration of production technologies and economic institutions that enabled the emergence of an enlightened middle class, making democracy possible.

With its emphasis on the overall relationship between democracy and advanced capitalism, *Democracy and Prosperity* attenuates the causal relevance of the differences among several capitalist regimes suggested by the literature on “varieties of capitalism,” to which the authors have contributed decisively. Still, the book insists that the distinction between coordinated and liberal market economies matters in at least two regards. On the one hand, the two types of market economies differ in their (capacity to develop a) response to the distributional conflicts that have followed from the diffusion of information and communication technologies. There is little to disagree with here. Those regimes correlate with social spending and the nature of the welfare state, even though they may not have caused them.

On the other hand, both types of market economies informed (or perhaps embodied) their distinct evolution toward democratic capitalism through the rules governing the selection of political representatives, the provision of human capital, and the extent of enforced redistribution. More specifically, *Democracy and Prosperity* identifies two paths to democracy. In liberal (or protoliberal) economies that lacked good training systems, industrial elites, in need of a skilled labor force, introduced democracy to overcome the resistance of landed elites to mass education. In protocorporatist countries, endowed with a skill-generating system supported by unions, business, and the state, political and economic elites could do without democracy. Trade unions, however, were unified and strong enough to force a full democratic transition.

The existing empirical evidence makes these claims unconvincing. As shown by Christian Morrisson and Fabrice Murtin in their comprehensive study of

education around the world, Britain, France, and Germany had the same average years of schooling in 1870, just before the expansion of democratic institutions identified in the book. Their levels of educational attainment also evolved at a similar pace throughout the twentieth century (“The Century of Education,” *Journal of Human Capital*, 3 [1], 2009). The electoral reform of 1867, hailed as a political breakthrough that allowed liberal elites to democratize Britain and expand public education, only enfranchised one-third of male adults, a threshold that the standard literature does not define as democratization. In fact, Westminster extended the franchise to all men (and most women) in February 1918, only a few months ahead of the full democratization of Germany, which the book posits as an example of change achieved through working-class pressure. Indeed, a robust literature challenging the coevolutionary thesis of *Democracy and Prosperity* has shown democratic transitions (or, at least, democratic consolidations) to be endogenous to the process of economic development spurred by capitalism (Daniel Treisman, “Is Democracy in Danger?: A Quick Look at the Data,” manuscript on file, UCLA, 2018).

Iversen and Soskice also extend the double-path thesis on democratization to the adoption of electoral rules. Again, a long debate in the literature has provided no evidence showing that elites designed electoral systems to meet the functional needs of each variety of capitalism. The level of economic coordination did not matter when choosing proportional representation (PR); it was rather the vulnerability of old parties that shaped their preferences, with the constitutional structures and majorities in place determining the final selection of an electoral system (Carles Boix, “Electoral Markets, Party Strategies and Proportional Representation,” *American Political Science Review* 104, 2010). In turn, the nature of the welfare state derived from the interaction of electoral rules and the geographical distribution of left-wing voters, rather than from the coalition incentives generated by the electoral system per se (Jonathan Rodden, *Why Cities Lose*, 2019).

### **Response to Carles Boix’s Review of *Democracy and Prosperity: Reinventing Capitalism through a Turbulent Century***

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— Torben Iversen  
— David Soskice

We have benefited a lot from this exchange, as well as from Boix’s splendid book. Without qualifying that judgment, we should probably correct a few potential misinterpretations he makes.

Our primary concern is to explain the extraordinary resilience of the advanced capitalist democratic state

model through the deeply unstable century from 1920 to 2019. *Ceteris paribus*, governments have a strong incentive (as in Latin America) to engage in crony capitalism—to protect the markets and profits of domestic capitalists in exchange in one form or another for a share of those profits; such anticompetitive policies stand in the way of advanced technological innovation. Alternatively, the working class might have overturned advanced capitalism democratically. Both Schumpeter and Hayek saw democracy as dangerous for these reasons.

We argue instead that after democracy was established in the early 1920s in then-advanced capitalist economies, it played a central role in the subsequent century in ensuring that governments promoted advanced capitalism (with exceptions between 1935 and 1945). The result has been rapid technological change and unprecedented prosperity. The middle class benefited greatly, partly by acquiring valuable skills and partly through state social programs. And although it is the better educated who benefit in today’s knowledge era, we maintain that democracy continues to play this role. Add in the very large constituency of aspirational families (often concerned about economic opportunities for their children), and the electoral concern with economic competence is understandable (see Mads Andrea Elkjær and Torben Iversen, *World Politics*, 2020; also contra Bartels and Gilens cited earlier by Boix).

Boix misreads us as arguing that democracy caused or was a precondition for advanced capitalism: evidently it did neither in the “new industrializers.” And as we underscored in the book, nineteenth-century capitalists in the coordinated economies were hostile to political democracy. Our argument in those countries is, if anything, that the necessity of cooperation with skilled workers led to the eventual development of democracy. When democracy did emerge, it took the form of PR. Since it is not essential to the broader argument, we refrain from a detailed response here (one can be found in Cusack et al., *APSR* 103, May 2010, 393–403).

In the United Kingdom the story is more complex: advanced capitalism developed in the eighteenth and early nineteenth centuries, and governments through the nineteenth century wanted modernization and centralization (Gary W. Cox, *The Efficient Secret*, 1987), both to help foster industrialization and to keep the empire running. The complex 1867 Reform Act probably did reflect the need for liberals and modernizers to get support from the “safe” skilled (and not large) working class; yet (very limited) democracy was also about constraining the landed elites who opposed major expansions of education. Forster’s 1870 Education Act was a result. The slightly gratuitous last Boix paragraph misreads Morrisson and Murtin’s 2009 article cited earlier: UK education was on average 20% behind that of other advanced economies (apart from France)—and was far more wanting if

vocational training is added in— and caught up over the subsequent two or three decades (similarly to the French Third Republic experience and the Ferry legislation).

Boix also suggests that we misread the present political situation. He argues that changing geographical patterns since Fordism as a result of the cross-national geography of the global (or triad) value chains vitiates our general argument. We disagree. The value-added of advanced capitalist companies (including the knowledge-based subsidiaries of multinationals in the advanced economies) lies in their embedded skilled workforces: these they cannot relocate. Advanced capitalism is not a key purposive actor (at least in the advanced democracies). “Foot-loose” capitalism, eroding the autonomy of contemporary advanced democracies, which was never plausible, is even less so in the knowledge era. The argument is laid out in detail in chapter 4.

### **Democratic Capitalism at the Crossroads: Technological Change and the Future of Politics.** By Carles Boix.

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In his sophisticated and ambitious book, Carles Boix takes a bird's-eye view of the development of democratic capitalism since the industrial revolution. The central driver of change in Boix's story is technology. He makes a useful distinction between Manchester, Detroit, and Silicon Valley capitalism, with a focus on the transition to the last type. In the terminology of our book, this is the transition from Fordist mass production to the knowledge economy. For Boix, as for us, each technological regime is associated with distinct economic, institutional, and political dynamics. Detroit capitalism, which became fully entrenched after World War II, caused high demand for mid-level skills, a relative equalization of wages, and a political convergence around a generous welfare state. “The roots of that new political order,” writes Boix, “were economic” (p. 8). Silicon Valley capitalism has different economic and institutional imperatives, with a steep drop in demand for low- and semiskilled workers, sharply rising inequality, and a new contentious politics represented by the rise of populist parties. Governments can modify the distributive consequences of new technology, especially through education and redistribution, but they are reactive, not proactive, agents.

Throughout the book, Boix makes use of well-trodden arguments about the skill-biased nature of new technology, as well as the effects of deindustrialization, to explain rising inequality. Like others he also links the dislocations created by the transition from a “Detroit” to a “Silicon

Valley” economy to the rise of populism. The “bite” in the argument lies in the conjecture that each major technological shock drove the entire set of broad economic, political, and institutional changes. But in our view, the advanced democratic states in which knowledge economies are embedded played the central role, with key parts of the electorate in support of state strategies, in contrast to Boix's fundamentally technology-driven approach.

Across advanced capitalist democracies, we argue, governments promoted the advanced sectors of the economy through a series of reforms: financialization, strengthening of competition policies, lifting of capital controls and restrictions on foreign direct investment, central bank independence and inflation targeting, and massive investment in higher education. All of these reforms, in our view, were required to leverage the new information and communications technologies (ICTs) and transform advanced capitalist democracies (ACDs) into much more decentralized, knowledge-based economies, but they were not caused by the availability of these technologies. The economic-institutional transformation in turn caused major social and political upheaval, as well as a complete reconfiguration of the social and economic position of women.

Of course, new technologies are rarely caused directly by government policies (apart from ICTs, in the United States), but whether they are widely adopted and have broad political-economic consequences is very much a matter of deliberate and major political choices. The knowledge economy would not have been feasible without government reforms, and it failed where such reforms were lacking. For example, the Soviet Union had the centralized scientific computing expertise in the 1970s and 1980s to evolve into a knowledge economy, but it was not prepared to pay the necessary political price in terms of a decentralized institutional framework; indeed, it was felt necessary to maintain prohibitions on personal computers until the late 1980s. Without politically initiated reforms, economies stagnate, even when they possess the necessary technologies and know-how.

The core difference between Boix and us is therefore this: Boix takes major new technologies as exogenous drivers of societal change. We instead argue that government strategies in reconfiguring institutional frameworks are preconditions for the new technologies to be successfully and widely adopted. And we further argue that governments reconfigure these frameworks in advanced democracies in response to an electoral concern that the advanced economy is (however painfully) remaining competitive. If these reforms are called (a bit misleadingly) neoliberal, then in our view the move of most advanced democracies to adopting similar reforms is ultimately a democratic one.

Thus our differences relate to the question of the *politics* of major institutional reforms and, more



fundamentally, to how we should understand the relationship between democracy and capitalism. Like Boix, we emphasize the role of political and economic institutions in conditioning distributive outcomes—indeed, this has been a central theme in our work over the past two decades—but there is a prior and more fundamental question about the motivation of democratic governments to initiate major institutional reforms. Boix does not engage much with that question. He briefly considers the neoliberal reforms of Reagan and Thatcher but concludes that they cannot be an important part of the story, because other countries also made the transition to the new economy under very different partisan governments (pp. 137–38). We agree, but the new economy would not have been feasible without major reforms, which democratic governments undertook everywhere, often against the interests of the dominant companies at the time (no longer).

Given that these reforms happened in all varieties of capitalism and under all stripes of governments, what was the common underlying engine of change? Here we come to what we see as one of the most important logics of ACDs, which we refer to as the *symbiotic relationship*. Very broadly, and over long periods of time, democracy and advanced capitalism have been in a symbiotic relationship across advanced nation-states. Democracies positively reinforce advanced capitalism, and advanced capitalism reinforces democratic support. In our framework, advanced capitalism is driven by the democratic nation-state via politicians and political parties keen on building reputations for good governance. Because advanced capitalism is skill intensive, voters with good education, as well as “aspirational voters” with an ambition to enter the advanced sectors (even just on behalf of their children), support parties and policies that push the advanced sectors forward. That logic, in our perspective, underpins the range of reforms listed earlier. Democracy continuously reinvents capitalism.

One way to think of the relationship between government policies and middle-class voting is in the form of an implicit social contract: the government invests in education and in the broader institutional infrastructure of the advanced sectors while individuals delay consumption in order to acquire skills and then work in well-paid occupations. This is an intergenerational contract—in addition to an intragenerational contract—because many will vote for economically transformative policies if they believe that they will help their children gain a foothold in the new economy. Mobility within and across generations is a hallmark of the implicit social contract and indeed of all ACDs. What remains a constant in the social contract is the inclusion of the middle class in the sharing of the gains of economic progress. It is therefore not surprising that in terms of net income the middle class has by and large retained its relative position in the economy, measured as a share of average income.

Yet, democracy only guarantees that a majority benefits, and many have not benefited from the knowledge economy. Here we see a notable overlap with Boix’s explanation for the rise of populism. In the Fordist industrial economy (“Detroit capitalism”), semiskilled workers did well, in large part because the Fordist assembly-line logic made them strong complements in production to skilled workers. Such complementarities extended to peripheral areas, which served as “feeder towns” for the urban industrial machine. In the new knowledge economy (“Silicon Valley capitalism”), these types of complementarities have collapsed. Semiskilled workers are now segregated into low-paid services with few linkages to skilled workers; geographical agglomeration effects are increasingly confined to the urban centers. Boix uses a somewhat different language to discuss these changes, but the logic, we think, is very congruent.

Boix interprets this new cleavage in strictly economic terms and suggests that the “old” middle classes are turning against globalization in all its forms, including trade and immigration. It is this discontent that fuels populism. We agree but favor a somewhat broader interpretation. For people who are shut out of the new economy, and therefore usually also the cities, the negation of the old economy is felt as a rejection of their own skills, values, and lifestyles—indeed, of their very identity. It is perceived as a *broken* social contract, which implies a cultural-political divide in addition to an economic one. It recalls divisions between workers and the bourgeoisie, and between the center and periphery, in nineteenth-century Europe, which gave rise to the party systems of the twentieth century, as famously recounted by Lipset and Rokkan.

Are rising inequality and populism threats to democracy or, for that matter, capitalism? Boix takes a cautious view and argues that the prosperity attained by ACDs and the long-run consolidation of democratic institutions provide insurance against a breakdown. To us, both prosperity and institutional resilience are reflections of the continued symbiotic relationship. Advanced capitalism generates a large constituency for policies that promote the advanced sectors, and this pillar of support is a barrier to any attempt to subvert the system.

Still, the fundamental differences in our understanding of the coevolution of democracy and capitalism are clear in our approach to contemporary politics. Boix concludes, “In exploring . . . the evolution of contemporary capitalism, we have learned that, because they operate according to very different principles, democracy and the market are in tension with each other” (p. 214). On this tension, Boix is in good company: Schumpeter and Hayek agreed. We take the opposite view that advanced capitalism and democracy are symbiotic. In understanding the workings of capitalist markets, including the roots of inequality, we should look to how democracy works.

The huge transformation from a Fordist to a knowledge economy was induced by democratic governments in advanced democracies, even when this reinvention of capitalism created massive economic and political upheaval.

**Response to Torben Iversen and David Soskice's Review of *Democratic Capitalism at the Crossroads: Technological Change and the Future of Politics***

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— Charles Boix

Iversen and Soskice's review emphasizes two crucial questions: the sources of change in capitalism (and, hence, of growth) and the compatibility between democracy and markets.

Their new book *Democracy and Prosperity* attributes the origins of today's capitalism to (democratic) politics. Governments, foreseeing the potential of technological change (with either full foresight—before it happened—or partial foresight, when it was incipient), altered the policy environment accordingly, leading to the current economy. Although theoretically possible, that explanation seems empirically implausible. We have no evidence that any government relied on specific ideational models connecting the reforms introduced in the 1980s with the world of today: Thatcherism was a (coherent) neoclassical response to economic decline and, as such, agnostic about the specific technological consequences of deregulating the economy. Likewise, both the weak performance of southern Europe (including France) and the continuing anxieties of German industrialists and policy makers about their incapacity to fully compete with US companies at the new technological frontier further belie the “policy foresight” explanation.

By looking at the full history of industrial capitalism in *Democratic Capitalism at the Crossroads*, I show, instead, that technological progress (mostly resulting from a learning-by-doing process involving profit-seeking entrepreneurs and engineers) has been the main driver of change, especially by defining what human skills are complementary to the dominant productive

machinery of the era. Nineteenth-century Manchester firms used unskilled labor. Twentieth-century Detroit companies relied on semiskilled labor in factories, resulting in a more equal organization (and distribution of returns). Today's Silicon Valley technologies favor high-skilled labor while making semiskilled labor's performance of routine tasks redundant. Nevertheless, mine is not a story of technological determinism. First, economic change is embedded in a social and institutional matrix, where the crucial problem, which I have discussed analytically in *Political Order and Inequality* (2015), is in fact the protection of growth against those who, not having generated any, want to appropriate it. Second, I describe the relationship between technology and politics as one defined, to employ Toynbee's forgotten but still useful terminology, by a sequence of challenges (generated by technological progress) and responses (of policy makers deciding how to adapt to a constantly changing environment).

To Iversen and Soskice, that relationship (between capitalism and democracy) is “symbiotic.” Yet, as I insisted in my initial review, we cannot conclude from the way in which both related to each other during the middle decades of the twentieth century that they had been compatible before (they had not) or that they will be after (they may not be for a given level of technological disruption). Because the future is essentially unknowable—even though it may be sometimes predictable—I deliberately avoided siding with either techno-optimists or techno-pessimists. Instead, I attempted to dissect the parameters that have determined and will determine the chances of democratic capitalism: the race between technology and education, the nature of capital ownership, the way in which the majority (itself affected by technological change) may respond (given the political institutions in place). I do this both for the North and (a less discussed topic in the literature) the whole South. Overall, I anticipate a lot of turmoil ahead. Still, I also see that our current levels of wealth (and a relatively large democratic stock) ought to allow us to respond to any future challenges successfully.