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Is capitalism compatible with democracy?

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Abstract Capitalism and democracy follow different logics: unequally distributed property rights on the one hand, equal civic and political rights on the other; profit-oriented trade within capitalism in contrast to the search for the common good within democracy; debate, compromise and majority decision-making within democratic politics versus hierarchical decision-making by managers and capital owners. Capitalism is not democratic, democracy not capitalist.

During the first postwar decades, tensions between the two were moderated through the socio-political embedding of capitalism by an interventionist tax and welfare state. Yet, the financialization of capitalism since the 1980s has broken the precarious capitalist-democratic compromise. Socioeconomic inequality has risen continuously and has transformed directly into political inequality. The lower third of developed societies has retreated silently from political participation; thus its preferences are less represented in parliament and government. Deregulated and globalized markets have seriously inhibited the ability of democratic governments to govern. If these challenges are not met with democratic and economic reforms, democracy may slowly transform into an oligarchy, formally legitimized by general elections. It is not the crisis of capitalism that challenges democracy, but its neoliberal triumph.

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Sind Kapitalismus und Demokratie miteinander vereinbar?

Zusammenfassung Kapitalismus und Demokratie folgen unterschiedlichen Logiken. Ersterer basiert auf Eigentumsrechten, individueller Gewinnmaximierung, hierarchischen Entscheidungsstrukturen und ungleichen Besitzverhältnissen, Letztere gründet auf der Suche nach Allgemeinwohl, Diskurs, politischer Gleichheit und den Verfahren konsensueller oder majoritärer Entscheidungsfindung. Kapitalismus ist nicht demokratisch und Demokratie nicht kapitalistisch.

Während der ersten Nachkriegsjahrzehnte wurden die Spannungen zwischen Kapitalismus und Demokratie durch einen interventionistischen Steuer- und Wohlfahrtsstaat in Grenzen gehalten. Die Finanzialisierung des Kapitalismus seit den späten 1980er Jahren hat den prekären Kompromiss zerbrochen. Die kontinuierlich zunehmende sozioökonomische Ungleichheit übersetzt sich direkt in politische Ungleichheit. Das untere Drittel der Gesellschaft steigt schweigend aus der politischen Partizipation aus. Gleichzeitig haben Deregulierung und Globalisierung die Handlungsmöglichkeiten demokratischer Regierungen erheblich eingeschränkt. Dies sind gravierende Herausforderungen der Demokratie. Werden sie nicht ernst genommen und wird ihnen nicht mit wirtschaftlichen und politischen Reformen begegnet, werden sich die oligarchischen Tendenzen in Wirtschaft und Demokratie tiefer eingraben. Es ist nicht die Krise, sondern der Triumph des Kapitalismus, der die Demokratie in Bedrängnis gebracht hat.

Schlüsselwörter Kapitalismus · Neoliberalismus · Demokratie · Wachsende Ungleichheit · Entbettung des Kapitalismus · Finanzialisierung · Oligarchisierung · Marginalisierung der unteren Schichten

1 Introduction

Throughout the past two centuries, capitalism and democracy have proven themselves the most successful systems of economic and political order.[1] Following the demise of Soviet-style socialism after 1989 and the transformations of China's economy, capitalism has become the predominant system around the world. Only a few isolated countries such as North Korea have been able to resist the success of capitalism through the use of brutal force. The market has become the main mechanism for economic coordination and the maximization of profits. The global competition

[1] The article is a modified version of a co-authored text by Jürgen Kocka and Wolfgang Merkel: "Kapitalismus und Demokratie" forthcoming in: Merkel, Wolfgang (ed.) "Ist die Krise der Demokratie eine Erfindung?" (Merkel 2014). I am very grateful to J. Kocka, however, all remaining weaknesses or shortcomings of this text are my own.

of economic systems has been clearly won. Yet capitalism, used in singular form, conceals the differences in the "varieties of capitalism" (Hall and Soskice 2001).[2] China's state capitalism, the Anglo-Saxon neoliberal strand of capitalism or the Scandinavian welfare state economies differ substantially from one another. They function or malfunction rather differently in conjunction with democratic regimes.

The success of democracy in the last quarter of the twentieth century was impressive. However, democracy's success pales in comparison to the spread of capitalism throughout the world. If we take the minimal standards of democracy as a measurement, there were 123 countries (out of around 200) that could be called an "electoral democracy" in 2010 (Freedom House 2010). If the much more stringent concept of a liberal democracy is applied, only 60 countries can be classified as liberal rule of law-based democracies (Merkel 2010). Yet, both electoral and liberal democracies coexist with capitalist economies. Historical evidence also confirms that no developed democracy could exist without capitalism. Vice versa this is not the case. National Socialist Germany, the People's Republic of China, Singapore and the capitalist dictatorships of Latin America or Asia in the twentieth century all exemplify that capitalism can coexist or even flourish in the context of different forms of political government, such as democracy and dictatorship.

The impressive advancement of democracy around the world coincides with the often-cited malaise of the established democracies. Since the turn of the millennium, an ever increasing number of theories and analyses define mature democracies along the lines of "diminished subtypes of democracy" (Offe 2003), "post-democracies" (Crouch 2004), "defective democracies" (Merkel 2004) or mere "façades" (Streeck 2013a, p. 241). Capitalism is primarily blamed for this development. Financial capitalism in particular raises inequalities in income and political participation, curbs the powers of parliaments and seriously constrains the capacity to govern from national executives. The latest financial crisis of 2008 and the subsequent Euro crisis have changed the thinking about the complementary nature of capitalism and democracy. Theoretical as well as empirical analyses are showing an increasing number of contradictions—even incompatibilities—between capitalism and democracy. Albeit with new arguments and insights, the debate contains some theoretical links to the leftist debate in the early 1970s about the legitimacy crisis of the "late capitalist state" (Offe 1972; Habermas 1973; O'Connor 1973).

How deeply seated are the incompatibilities of "varieties of capitalism" with different varieties of democracy? To what extent has capitalism, in its different varieties, become a challenge for democracy and its normative standards? In our approach capitalism is the challenger, the independent variable, while democracy functions as the dependent variable. Yet, this independent variable is in a constant process of change, conditioned by political, social and economic influences. Our argument is structured as follows:

[2] Hall and Soskice, however, only describe two varieties of capitalism that they see represented in the context of the OECD: *liberal market economies* und *coordinated market economies*. New hybrid types of Manchester-like state capitalism in China, gangster capitalism in Russia and Ukraine during the 1990s, and crony capitalism in South East Asia are not taken into consideration here, since they have emerged outside the context of the OECD.

- Presenting the main features of capitalism and democracy;
- Discussing the basic different logics of the two regimes;
- Showing the (in-)compatibility of specific varieties of the two regimes;
- Presenting the specifics of current financial capitalism;
- Analyzing the challenges posed by financial capitalism to “embedded democracies.”

2 Three types of capitalism

The main difference in various types of capitalism is the relationship between the market and the state. Three types of capitalism can be identified as having prevailed during different periods of time over the last two centuries. They are historical types but can also be read as ideal types since the number of defining elements is reduced to the most important ones and the concrete properties of those single characteristics are described in a stylized manner.

Market-liberal capitalism: Coined by the prevailing market principles in the relationship between different companies, this type was dominant in Europe and North America throughout much of the nineteenth century. State institutions in this context largely refrained from interfering in markets (including labor markets), and economic and social policy (Berend and Schubert 2007). Taxes and expenditures were low; the welfare state had emerged only in an embryonic state.

Organized and embedded capitalism: Within the context of technological and organizational innovations, capitalism developed internal needs for coordination and regulation. Moreover, a barely regulated form of capitalism resulted in increasing social tensions. Together, these two factors were the driving force behind a more organized form of capitalism. This became visible on several fronts: Large businesses began to find ways of cooperating that limited competition (such as cartels, mergers and associations), and ways to identify and represent common interest. Furthermore, the state began to interfere increasingly in the economy and society by implementing labor laws, selective subsidies, nationalization and increasing regulation, but also by creating the welfare state and expanding its social policy—in Germany already in place since the 1880s (Winkler 1974; Lash and Urry 1987). The ensuing *organized capitalism* that developed in the twentieth century took different shapes: In the USA it appeared as the New Deal of the 1930s and 1940s, in the Federal Republic of Germany and other European countries as the social market economy, and in France and Scandinavia as distinctly Keynesian welfare state capitalism. It did and does, however, also coexist in a dictatorial variety: in National Socialist Germany and—again in a different shape—in the state capitalism of East Asia during the most recent decades.[3]

[3] The labels for this type of capitalism vary: “organized capitalism”, “coordinated capitalism”, “Keynesian welfare state” (KWS) or “Fordism”. We use the first two terms interchangeably and take KWS as a variety of “coordinated capitalism” that is particularly compatible with democracy.

Neoliberal capitalism: Since the late 1970s, "neoliberal" critique has gained traction, sometimes in sharp contrast to Keynesian welfare state capitalism. It stressed market mechanisms, the principle of capitalist self-regulation and the limits of state regulation (Harvey 2007). John Maynard Keynes's concept of managing capitalism through the demand side and Karl Polanyi's idea of a socially *embedded capitalism* were replaced by that of Friedrich August von Hayek and his understanding of the market as a *spontaneous order*, and by Milton Friedman's pledge for a minimal state where state interference into the economy is restricted only to a modest variation in the supply of money. A new phase of capitalism began, shaped by deregulation, privatization and partial deconstruction of the welfare state. Globalization was advancing quickly, international financial capitalism became exceedingly important and socioeconomic inequalities within different societies began to increase.

3 Three types of democracy

The definition of democracy is highly contested: liberal, social, pluralistic, elitist, decisionist, communitarian, cosmopolitan, republican, deliberative, participatory, feminist, critical, post-modern and multicultural concepts of democracy all compete with each other (Lembcke et al. 2012). From a more simplified perspective, however, three groups of democracy theories can be identified: the minimalist, middle-ground and maximizing theories. Depending on which concept of democracy is applied, a "crisis of democracy" can be identified seldom, often or almost always. In our analysis we will use the middle-ground model of democracy, more precisely, the concept of an embedded democracy as a point of reference.[4]

Embedded democracy consists of five partial regimes: the regime of democratic elections (A), the regime of political participation (B), the partial regime of civic rights (C), the institutional protection of the separation of powers *(horizontal accountability)* (D) and the guarantee that the effective use of power by democratically elected representatives is assured *de jure* and *de facto* (E). In the democratic system these five partial regimes all fulfill specific functions. Every single one of them faces particular internal and external challenges. Each of the individual partial regimes has its own "crisis capacity" and specific inter- and independence within embedded democracy. Whether or not a partial regime is infected by crisis and how far a crisis can expand beyond a certain partial regime depends on these factors. In the following we will concentrate only on those challenges to democracy that are caused by capitalism and its different varieties.

4 Compatibilities and incompatibilities

The basic logics of capitalism and democracy are fundamentally different and lead to considerable tension between the two. Both have different claims to legitimacy: unequally distributed property rights on the one side, equal civic rights on the other.

[4] Cp. more extensively: Merkel (2004).

Within these claims to legitimacy, different procedures prevail: profit-oriented trade within capitalism, debate and majority decision-making within democratic politics. Capitalist activities clearly aim to facilitate the selfish seeking behavior of particularistic advantages, even though, according to Adam Smith, it can be claimed that such selfish actions serve the common good. The realization of the common good is the aim of democratic politics, however in this context it is clear that the outcome of competition and cooperation of pluralist interests is only coming to light *a posteriori* (Fraenkel 1974 [1964], p. 189). Under capitalism, decisions and their implementation lead to a degree of economic and social inequality (of income, wealth, power and life chances) that is hardly acceptable in a democracy built on principles based on equal rights, opportunities and duties. Vice versa, full application of democratic decision-making—general and equal participation as well as majority decisions and minority protection—is unconceivable according to the rules of capitalism. Thus, capitalism is not democratic, democracy not capitalist.

As this is only one aspect, two further aspects must be considered. *On the one hand* it is a fundamental rule of liberal democracy that the reach of political decisions has to be limited: by securing basic rights (among them the right to private property since the time of John Locke and the Enlightenment), through constitutions and the rule of law, and not least through the recognition of the principle that democratic decision-making is a key element of the political system. However, other partial systems must have the freedom to work according to different logics (Luhmann: "communication codes") within the framework given by a politically set and only democratically alterable constitution (Walzer 1983; Luhmann 1984).

Capitalism and democracy can easily conflict in two situations: If the distribution and use of property rights lead to an accumulation of wealth large enough to hinder politics through capitalist pressure, and if democratic decisions are taken to massively limit the use of property rights. Weighing the two against each other, it is generally the case that rights to property and use of capital should be limited and regulated by democratic governments if they threaten to overshadow or transform democratic decisions in the political sphere. Within the hierarchy of legitimacy, democratic rights can claim a normative superiority as long as they do not violate human rights and abolish property rights.

On the other hand, it is also important to highlight certain affinities and congruencies between capitalism and democracy. Competition and electoral decisions play key roles in both contexts. In theory, capitalism and democracy share common enemies: the uncontrollable agglomeration of state or economic power, disorder, unpredictability and corruption. But there is a decisive difference: whereas certain forms of capitalism produce and function with an extreme concentration of wealth and capital, democracies cannot coexist with a similar constellation and concentration of power. Finally, capitalism and democracy can support each other. Capitalism struggles without a generally predictable state order, something most likely to be achieved in the long run through democratic means. It is similarly true that socially embedded capitalism is most likely to achieve sustainable growth, which in turn legitimizes and strengthens democratic institutions.

5 Social welfare capitalism: the golden age of coexistence?

In the second half and especially in the third quarter of the twentieth century, an increasingly organized form of capitalism proved particularly compatible with democratic politics in Western Europe, North America and Japan. This was the result of an increasingly expansive, interventionist welfare state that interfered with the capitalist economy by regulating, stabilizing and equalizing it. The "Keynesian welfare state" (Offe 1984) emerged in certain Northern and Continental European countries as one form of social and coordinated capitalism. A specific system of strong interdependence developed between the state and the market, between democratic and economic institutions and the capitalist economy. Economic actors were multiply embedded, regulated and socially obligated. The state's decision-making opened increasingly towards economic and social influence under the label of "tripartite neocorporatism" (Schmitter 1974, 1982). Even elements of democracy were introduced into the economic system, such as codetermination and workers' councils. Several important historical factors facilitated the development towards this system of a rather cooperative, but nevertheless often precarious coexistence: rapid economic growth in the years following World War One, the shocking experience of the Great Recession in 1929, and political catastrophes during World War Two and the interwar years. The ongoing critique of capitalism in the name of democracy, and social justice in intellectual and political debates also contributed to the social and political embedding of capitalism. A major driving force behind that development was, however, the challenge to the Western model of capitalism by a non-capitalist alternative in the form of Soviet-style *actually existing socialism*. This period proved to be the zenith of coexistence between social capitalism and social democracy in Northern and Western Europe. Yet, it remained incomplete, precarious and different from country to country (Esping-Andersen 1990; Hall and Soskice 2001).

6 Financial capitalism:[5] the breakup of peaceful coexistence

Since the 1970s, capitalism has changed in a way that has challenged its compatibility with democracy considerably. The turn towards neoliberalism, deregulation and globalization, and the rise of financialization has contributed to these changes significantly (Heires and Nölke 2013). The global financial crisis since 2008 has manifested and intensified the critical elements of this new divergence: It has once more changed the relationship between the economy and the state, capitalism and democracy. The crisis of capitalism threatens to turn into a crisis of democracy.

Beginning with Margaret Thatcher and Ronald Reagan in the early 1980s, there have been concerted efforts among most capitalist economies for more deregulation

[5] The term financial capitalism resembles Rudolf Hilferding's "Finance Capital" (Das Finanzkapital, Wien 1910) terminologically. Hilferding described the transformation of competitive liberal capitalism into monopolistic finance capital. However, whereas Hilferding's "organized capitalism" must be understood as a fusion of industrial, mercantile and banking interest, today's financial capitalism or "financialization" of capitalism emphasizes the dominance of finance capital over all other forms of capital.

and privatization, as well as (in some countries) significant cuts in welfare benefits.[6] The process was initiated and driven by Anglo-Saxon capitalism, particularly from the UK and US. Following Friedrich von Hayek (neo-classical fiscal conservatism) and Milton Friedman (monetarism and minimal state), neoliberal theories became popular in science and journalism. They valued the self-regulating forces of the market and scorned the possibility of state intervention. The atmosphere changed: it turned away from organization, equality and solidarity as guiding principles toward favoring free markets, productive inequality and individualism. The decades of "organized capitalism" came to an end; the Anglo-American model of deregulated financial capitalism threatened to sideline other varieties of a more regulated, continental capitalism. The reasons for this turn were undoubtedly the weaknesses of the Keynesian welfare state, such as the "stagflation" and sticky unemployment of the 1970s, but also the technical-organizational innovations and the beginning of the IT age. The main impetus, however, came from cross-border competition and the worldwide interconnectedness that had developed alongside globalization. Globalization put the model of organized capitalism under enormous pressure, as it had been developed within the context of the nation state. The regulating capabilities of strong nation states now faced the opposition of cross-border competition. Globalization and neoliberalism went hand in hand. The globalization of capitalism did not and should not bring with it effective global governance structures beyond the G-7 or G-20. The balance between the market and the state shifted to the disadvantage of the regulatory state and hence to the disadvantage of democracy. Legitimate democratic political regulations were dismantled into many different economic spheres, such as labor and financial markets. The supposedly more efficient market forces restructured formerly regulated markets. The already precarious "power balance" during the era of organized capitalism and the Keynesian welfare state (Korpi 1983) between capital and labor shifted in favor of capital. Globalization and deregulation were mainly the result of conscious political decisions by the US, UK and major capitalist international organizations such as the World Bank, International Monetary Fund (IMF) and European Union (EU).

Financial capitalism is the epitome of the kind of business that is not done through the production and exchange of goods but rather with money, conducted by brokers, banks, stock markets, investors and capital markets. It is not a new phenomenon. Following globalization, financial and monetary deregulation, and partial deindustrialization in some Western countries, the financial sector experienced a massive expansion, particularly within England and the US. Its share of total GDP in the US rose from 10% (industrial sector 40%) in 1950 to more than 50% (industrial sector 10%) in 2000 (Heires and Nölke 2013, p. 251). The assets of banks and the profits of bankers rose exponentially. Investment banks, investment funds and newly formed equity companies were created in large numbers. Global capital flows increased massively. A large portion of this did not serve as investment in production but funded speculation instead. Large profits were created that were not matched by any added value. The expectation of high profits—as well as the willingness to accept high

[6] Such cuts were only moderate in Scandinavia, Germany, Austria and France, but drastic within the context of Anglo-Saxon economies (USA, UK, NZ).

risks—increased. This part of the capitalist economy was particularly deregulated and left to itself. It was equipped with new, faster technology and increasingly complex instruments. It became driven by strong competition in and amongst itself. As such it was unable to develop sustainable, widely accepted business rules. Yet, at the same time, its overall importance for the economy increased. *Shareholder value* became the almost universal yardstick for success and business strategies became increasingly short-term oriented. Central elements of non-market coordination (e.g. regulatory state and neo-corporatism) that had stabilized organized capitalism were undermined. In many segments of the economy, speculative investment capitalism replaced the previously dominant manager's capitalism. As investor George Soros already recognized in 1998, this transformation put "financial capitalism in the driver's seat" (Windolf 2005; Streeck 2009, pp. 77–89, 230–272; Kocka 2013, pp. 96–99; Soros 1998, pp. XII, XX).

Profit seeking and investment are integral parts of both owner's and manager's capitalism. They are embedded in different functions of business leadership: the development of long-term strategies, human resource management and defining social relations. The new type of financial and investment capitalism leaves most of this behind. From the outside, investment fund directors and bankers decide on the future of businesses to which they have little personal relationship. They know little more about these enterprises beyond their score on standardized indices and profit relevant market information. A radical form of differentiation or, rather, a specialization of the investment function takes place. It is expressed in the absolute focus on profit as the almost only remaining criterion for evaluating business success and financial remuneration (e.g. salary, bonuses and shares) of equity fund managers. The internal dynamics of capitalism are increasing, but so is its instability. The gap between selfish equity fund success and the public good is becoming enormous. Despite being so inherently unstable and prone to crises, the changing capitalism has increased its ability to shape society. It is the driving force behind the increasing inequality of wealth and income, exemplified by the tremendously high income of today's business leaders. The ever more radical, market-oriented and fast-paced capitalism is also the motor of labor market deregulation, bringing about an increasing number of short-term, limited and part-time contracts.

How did this transformation from coordinated and socially embedded capitalism into deregulated financial capitalism affect democracy?

7 Challenges for democracy

From the 1950s to the 1970s, capitalism was characterized by a strict regulatory framework and the expansion of interventionist Keynesian welfare states.[7] In this way it was directly and indirectly constrained in its independence and modes of capital accumulation both *a priori* (e.g. regulations) and *ex post* (e.g. high taxes and social obligations). If a golden age of capitalist-democratic coexistence could be identified

[7] The welfare state and Keynesianism were, of course, developed to different degrees within the OECD countries (Esping-Andersen 1990; Hall and Soskice 2001).

during this period, it would be that of the "social market economy"—an embedded form of capitalism—rather than capitalism itself (Polanyi 1944; Offe 1984; Hall and Soskice 2001). The postwar decades experienced decreasing socioeconomic inequality, the expansion of the welfare state, and financial and labor market regulation. Labor unions were at the height of their socioeconomic and political power. Walter Korpi (1983) and Esping-Andersen (1990) have written about a "balance of class power". At no other point in time did capitalism and democracy coexist as complimentarily as during this short period.

However, the actual triumph of capitalism in the twentieth century was not its power-balanced coexistence with democracy but its astonishing ability to successfully detach itself from social and regulatory frameworks. With the political support of democratic governments, capitalism managed to disengage itself from major social and political responsibilities. But since the financial crisis in 2008, it has become obvious that with this triumph comes the danger of self-destruction.

"Unleashed" financial capitalism implies more problems for the functioning of embedded democracy than the capitalism that was regulated by the welfare state or Keynesianism in the first decades after World War Two. The increased "denationalization" (Zürn 1998) of the economy and political decision-making went hand in hand with increasing socioeconomic inequalities. Together they undermined two fundamental principles of democracy: (1) the democratic core principle that authoritative political decisions can only be taken by those who are legitimized by constitutional-democratic procedures and (2) the principle of political equality, which is diluted by the asymmetric distribution of socioeconomic resources among citizens, largely to the disadvantage of the lower societal classes. All OECD democracies are affected by these two developments, even if to different degrees. The more denationalization progresses, and the more capitalism loses its social ties and turns into (neo-)liberal financial capitalism, the more its negative effects on the quality of democracy can be observed, all other things being equal. We will elaborate on this central concept in four theses.

Thesis 1: Increasing socioeconomic inequality and poverty lead to asymmetric political participation.

In 2010, economic inequality reached levels that characterized capitalism—at least Anglo-Saxon capitalism—before World War One (Piketty 2014). Economic inequality translates into social and then rapidly into political inequality. Much has been written about the connection between the availability of socioeconomic goods and their transformation into cognitive resources and political participation.[8] It already becomes apparent in the context of the least demanding form of political participation, namely general elections. Election turnout is declining in Western Europe and to an even greater degree in Eastern Europe. The average turnout in Western Europe in

[8] It is thus even more surprising that neo-classical economics and neo-liberal political forces question this relationship. They see political equality fulfilled by the equal availability of political rights (cp. von Hayek 2003; the Free Democratic Party of Germany (FDP) and the liberal political parties in the Netherlands and Scandinavia respectively).

1975 stood at 85 %; by 2012 it had declined to an average of 75 %. In Eastern Europe the decline is even more dramatic: While an average of 72 % of voters cast their vote in 1991, this figure had declined to 57 % in 2012. Yet in the context of the US even those numbers would represent a positive development. The average turnout in US congressional elections over the last three decades (1980–2012) was a mere 45.4 % (WZB 2014).

General elections in which only 50 % (or even less) of the electorate participate are problematic. The explicit consent for and therefore also legitimization of the elected is lower than for those representatives who were chosen in elections with a turnout of 70 or 80 %. Yet, there is still no democratic theory that can determine the ideal electoral turnout in democracies. The absence of half the citizens during the most important act of legitimization in a representative democracy is evidence of how (un-)important political participation in the *res publica* has become for the majority of citizens in the US and most of Eastern Europe. Empirical studies show that the vast majority of those who refrain from voting also do not engage in other forms of political participation (Przeworski 2010). Bernard Manin (1997, pp. 222 f.) called this a "democracy of spectators". Joseph Schumpeter, however, understood this state of democracy as the ideal type of a(n) (elitist) democracy.

The crucial problem democratic theory faces is not the turnout figures themselves but the social selectivity they imply. The empirically proven rule of thumb is that the lower the electoral turnout, the higher the social exclusion within the context of elections. Undeniable evidence confirms that the lower social classes are the ones taking the political exit option, while the middle and upper classes are the ones that stay.[9] Among US citizens, 80 % of those with a disposable annual household income exceeding USD 100,000 state that they vote, compared with only 33 % of those with a household income of USD 15,000 or less who state that they vote[10] (Bonica et al. 2013, p. 111).

Increasing evidence shows that the American symptoms of lower class exclusion are ever more pertinent within the context of European societies (Weßels 2014). The electoral *demos* is unbalanced: The dominance of the middle classes is increasing, participation of the lower classes constantly decreasing. With regards to turnout, most OECD countries have become "*Two-Third-Democracies*", where the lower class is largely excluded from political participation. The political principle of equality is undermined: Voting tilts the policy scales in favor of top incomes (ibid.).

The process of declining turnout and increasing social selectivity of the electorate has become ever more prevalent in Western Europe over the last three decades. There it is slow but steady; in Eastern Europe it is rapid, in the US chronic. The primary reason can be found in the rise of socioeconomic inequality (Hacker and Pierson 2010, p. 194; Schäfer 2010; Merkel and Petring 2012; Bonica et al. 2013, p. 111; Weßels

[9] When asked whether their vote or political participation influence political decision-making, more than two-thirds of lower class citizens in Germany answer with the negative. When confronted with the same question, more than two-thirds of middle class citizens resoundingly respond with the affirmative, stating that their voice has an impact (Merkel and Petring 2012).

[10] The exclusive character of US democracy becomes even more apparent if the 10–15 % of the lower class without citizenship are taken into account. A considerably smaller part (5 %) at the upper end of the income scale does not have citizenship (Bonica et al. 2013, p. 110).

2014). Declining turnout and increasing social selectivity of the electorate also stem from increasingly precarious conditions faced by the lower classes on the labor market as well as the decline of catch-all parties, labor unions and other large collective organizations that played a crucial role in the politicization and representation of the lower classes throughout the twentieth century.

The participation-representation gap has increased in almost all OECD countries over the past decade. Citizens from lower classes are participating less in politics than other social classes, resulting in considerable consequences for the representation of their interests. Parliamentary studies show that the interests of the "lower third" are less represented in parliament than those of the "upper third" of society (Lehmann et al. 2014).

Thesis 2: In open, embedded democracies elections are increasingly unable to halt growing socioeconomic inequalities.

Considering the idea of class-oriented *economic voting*, it could be argued that all voters—or at least a considerable majority—with an income below the median would vote for political parties that fight for redistribution. This would give democracy an instrument to counterbalance severe socioeconomic inequalities. But why has this mechanism failed in the past decades? One of the reasons was already mentioned: The lower classes are, much more so than the middle and upper classes, increasingly staying home on Election Day. Moreover, vote-maximizing parties are tempted to abandon the lower classes as potential voters to be won over. Social democratic and other left-wing catch-all parties still sometimes claim to represent the interests of those classes in their party programs. However, this is often only lip service paid to preserve the party's "social justice" image rather than a genuine attempt to mobilize the politically apathetic and indifferent lower classes.[11] Furthermore, party manifestos and actual policies have to be considered separately. For both ideological and electoral reasons, conservative, liberal and right-wing parties do not write normative or electoral interests into active policies of top-bottom redistribution. Left-wing parties that, when in office, wish to pass policies aimed at improving the situation of the lower classes—more education, minimum wages, maintenance of the welfare state, taxation of higher incomes to raise public revenues—are confronted with threats from capital owners and wealthier classes, both in discourse and in reality. The main threat from these classes is to move capital and investment abroad. The financialization of capitalism and the now easier option to move financial capital across national borders has made the democratic state vulnerable. For left-wing parties this quickly results in a conflict of interest. If investors begin to shift investments abroad, this costs jobs and results in lower economic growth, less public revenue, less social investment and ultimately less votes. Fritz Scharpf fittingly defined this dilemma: "In capitalist democracies, governments depend on the confidence of their voters. But to

[11] The financial crisis and the bottom-to-top redistributive effects that have become visible within its context seem to have reached social democratic parties nonetheless. The minimum wage and the effects of deregulation on the financial and labor markets have, after two decades, slowly made their way back onto the front bench of programmatic party demands.

maintain this confidence they also depend on the performance of their real economies and, increasingly, on the confidence of financial markets" (Scharpf 2011, p. 1). Not least with this in mind, the policies of the "third way", implemented by most social democratic parties and governments, can be understood as a premature and obedient adjustment to a globalized economy. Within the context of economic and labor market policies, many social democratic parties have succumbed to the neoliberal globalization discourse of the past two decades. Issues of redistribution have thus lost their main advocate in the political arena (Merkel et al. 2006).

Economic voting or class voting is not the only explanation for electoral behavior. Socioeconomic conflicts are also divided along the lines of cultural conflicts. The latter can be religious or ethnic in nature, but is also apparent in attitudes on a scale of libertarianism to authoritarianism (Kitschelt 2001). Particularly the lower (middle) classes (mainly men) are receptive to authoritarian and ethnocentric policies. Examples can be found in the right-wing populist parties of Scandinavia, France, Austria and Switzerland. In these countries the lower class electorate partially voted for authoritarian and xenophobic parties that sometimes pursue neo-liberal economic policies (e.g. SVP in Switzerland and FPÖ in Austria).

During the first three quarters of the twentieth century, the right to vote and democratic elections became "paper stones" (Przeworski 1986). The post-revolutionary working class used them to tame and socially entrench capitalism by electing left-wing (mostly reformist social democratic) parties, and to successfully establish workers' rights, a progressive tax system and the expansion of the welfare state. This long period of social expansion witnessed a moderate redistribution of the economic growth gains in most industrially advanced countries, especially after 1945. However, this trend halted and even reversed in the 1970s.[12] Regarding top-down redistribution, the *paper stones* have lost their effectiveness and have instead turned into *paper tigers*. Since the 1970s, democratic elections have no longer stopped newly increasing inequality where the rich become richer and the poor and lower classes remain stuck in social immobility.

Thesis 3: During times of financialization the state becomes more vulnerable.

The financialization of capitalism increased the vulnerability of the state to banks, hedge funds and large investors, making it more visible. Financialization describes a process that began in the US and UK as its core countries. In the last two to three decades it has changed capitalism as well as the relationship between capital and the state in all OECD countries. Heires and Nölke (2013, p. 248) define financialization as a process that demands the deregulation of financial markets, eliminates national borders and facilitates the introduction of new "financial products" such as derivatives and debt obligations. It brought forth the rise of hedge and pension funds as well as other "institutional investors". Financialization made the ideology of *shareholder value* the primary, if not only, criterion for investment decisions.

[12] In non-Anglo-Saxon countries this shift did not happen by cutting back the welfare state, but was pushed through by a tax and income policy in favor of business and the better off.

The financial sector began to occupy a dominant key position in the economy. Its profits far outgrew those of the industrial sector. Industrial producers like Porsche earned more through speculation on financial products than in its core sector, the production of cars. Financialization, however, not only increased the dependence of industrial production on the financial industry; it also increased the dependence of the state and of society. Whether intentional or unintentional, the state emasculated itself by deregulating financial markets. Governments and parties dependent on economic prosperity because of the threat of being voted out of power became reliant on the decisions of big investors and foreign creditors. The financial and Euro crisis that began in 2008 made this visible. Many governments felt obliged to follow the self-help cry of banks that claimed to be “too big to fail” (at least in Europe[13]). Being “system-relevant” became the characterization of an extra-constitutional state of emergency, which in doubt would justify sacrificing freedoms of parliamentary-democratic decision-making. The fact that taxpayers were the ones to foot the bill is yet further proof of how financial capitalism has become empowered to enforce policies on state and society that lead to bottom-to-top redistribution, both in times of success and crisis.

Following the logic of financial capitalism, some states gave up their authoritative role as the rule maker and regressed to being nothing more than a policy taker, constantly assessed by rating agencies. Every autonomous action or even discourse contradicting the new rules could lead to a lower credit rating or an increase in interest rates at which the state would be able to loan money on deregulated financial markets (Simmerl 2012). The combination of an international run on investments, national party competition and neoliberal economic dogma among those governing lead to a “liberation of the market from mass democracy” (Streeck 2013a, p. 77). In the long run this could lead to a “Hayekian dictatorship of the market”, which would be autonomous from democratic impositions. Should this process not be stopped, capitalism and democracy would have to separate eventually (Streeck 2013a, p. 235). Even if one does not share the apocalyptic perspective of Streeck’s analysis, the core argument is amazingly precise: Deregulating markets has put a strain on the compatibility of capitalism and democracy, and has made their incompatibilities more visible. The gap between capitalism and democracy has become larger than during any of the democratic periods in the twentieth century. The state did not become a more proactive regulating force despite the fact that the financial sector caused the financial crisis. Neoliberalism survived the self-inflicted crisis, which Colin Crouch has aptly termed “the strange non-death of neoliberalism” (Crouch 2011). This shows the objective state of helplessness and subjective lack of willingness of democratic governments to act in times of financialization. Current Chancellor of Germany Angela Merkel highlighted this rather openly (and likely unintentionally) when she stated that a “market conformist democracy” is what we should aim for. Had she spoken from a democratic point of view, the argument would be clear: We should not aim for “market conformist democracy” but rather for “democracy conformist capitalism”. The direction of Merkel’s political course is clear: It is not the market that must

[13] The US government followed the capitalist rules of a free market more closely when it allowed many more banks to go bankrupt then did European governments.

submit to democracy, but rather democracy that must submit to the market. The most recent Euro crisis and the maneuver of the European Central Bank is further proof: Democracy is subordinate to the market, democracy must adjust to the market.

Thesis 4: Economic and political globalization increasingly move political decision-making away from parliament to the executive.

The hallmarks of financial capitalism in an age of globalization are the speed, volume, complexity and scope of financial transactions. By contrast, parliaments are always limited by their territorial scope and the need for time to prepare, deliberate and pass laws. In an age of digitalized computer-based financial flows, large-scale financial transactions take only a fraction of a second. American political scientist William Scheuermann (2004) speaks in general terms of an "empire of speed". German sociologist Harmut Rosa calls this the "desynchronization" (Rosa 2012; Rosa and Scheuermann 2009) of politics and economics, of democratic state decisions and private economic transactions. The increased speed of economy and society works in favor of political institutions that do not act deliberatively like the legislature, deliberative citizen councils or the judiciary, but rather act decisively like the executive. It would be naïve to assume that any political decision could keep pace with the speed of financial transactions. Yet, both the *demos* and the global elites implicitly and explicitly demand faster political decision-making. This is valid especially in times of crises that call for a strong executive (Schmitt 1996 [1931]). The most recent example of this has been evident in the political discourse and actions of European governments since 2008. The demand for faster political decision-making illustrates a particular democratic paradox in times of crisis: Far-reaching crisis decisions often have considerable welfare and redistributive consequences. Thus, especially those decisions require reliable, democratic input legitimacy (Enderlein 2013, p. 720, 733). The objective or assumed time constraints typically result in technocratic-executive decision-making with thin input legitimacy. Within the context of democratic regimes, the circumvention of important central democratic procedures cannot be justified with better outcomes. This is what differentiates Denmark from Singapore, for example.

8 Conclusion

Our theoretical and empirical analysis detects clear and distinct tension between capitalism and democracy. It is apparent that capitalism can prosper under both democratic and authoritarian regimes but that so far, democracy has existed only with capitalism. Nevertheless, capitalism and democracy are guided by different principles that create tensions between the two. This is expressed primarily in the different relations to equality and inequality. The level of inequality that defines specific variants of capitalism and supposedly secures productivity and profits is hardly compatible with the democratic principle of equal rights and opportunities for political participation. Socioeconomic inequality challenges the core democratic principle of equality in participation, representation and governance.

However, “the” capitalism does not exist; instead we see different “varieties of capitalism”. This is equally true today as in the past. Different forms of capitalism show different degrees of compatibility with democracy. In (Western) Europe full democracy only truly took root after 1945, when universal suffrage was introduced in most countries.[14] As democracy was fully established in Western Europe, Australia, Canada and New Zealand,[15] a certain type of capitalism developed not uncoincidentally: a socially, embedded, and economically (often in a Keynesian form) stabilized and nationally regulated capitalism. However, the general tensions of socioeconomic inequality and the political principle of equality remained unresolved. Nevertheless, their effects were mitigated considerably by regulated labor markets, increased economic welfare, the welfare state, strong labor unions and the activism of class-conscious social democratic or communist (e.g. Italy and France) workers’ or center-left parties. Coexistence between (social) capitalism and (social) democracy never functioned better than during this period.

This coexistence has become gradually more difficult since the late 1970s. The OECD countries have moved closer to the Anglo-Saxon variant of capitalism: They were challenged by the neoliberal policies of deregulation and privatization pushed by Ronald Reagan and Margaret Thatcher. The IMF and the neoliberal concept of the European Single Market (ESM) forced their implementation (Scharpf 2012; Streeck 2013a, b): tax reforms in favor of companies, capital income, and the rich; labor markets and financial markets deregulated. Even the strongest welfare states of Northern and Western Europe were not able to shield themselves from the neoliberal winds of change. The financialization of capitalist accumulation advanced even in this context and today dominates the world of finance, labor and trade (Heires and Nölke 2013, p. 252, 2014). Table 1 below summarizes and highlights the democratic drift that resulted from the transition from Keynesian welfare capitalism (KWC) to deregulated financial capitalism (DFC).

Considering this (very concise) depiction of the development of democracy during the two stages of capitalism since 1945, a deteriorating quality of democracy can be witnessed in four out of five partial regimes of embedded democracy. They are not only and not always directly caused by financial capitalism, but financial capitalism plays a relevant role. A closer look, however, suggests two causal explanations:

1. Deregulated financial capitalism led to increasing socioeconomic inequalities. This had a negative effect on elections and political participation, two of the partial regimes of democracy (A, B). Socioeconomic exclusion and inequality largely transformed into political exclusion and inequality. Exclusion and inequality affected mainly the bottom third of the social classes.
2. The globalizing transformation of capitalism led to a transnationalization of markets and the partial supranationalization of important decisions on monetary and

[14] US democracy is, of course, older than that. But even there universal suffrage for women was only introduced in 1920 (in Great Britain in 1928, in France in 1945). Until the mid-1960s six southern US states banned African Americans from voting for racist reasons. Only since that period can the “mother country” of democracy be seen as having fully implemented democratic values.

[15] If one takes full suffrage of men and women as the crucial indicator for a complete democracy, then New Zealand (1900) was the first and Australia one of the first democracies, not the US or UK.

Table 1 Democratic drift from KWC to DFC

Partial regime of democracy	Regulated capitalism/Keynesian welfare regime (KWC) (1950s–1970s)	Neoliberal financial capitalism (DFC) (1979–today)
Elections	Higher turnout, lower social exclusion	Lower turnout, higher social exclusion
Participation/association/representation	Strong labor unions and left-wing parties represented labor and reduced socioeconomic inequalities	Dominance of liberal-conservative parties and doctrines plus weak labor unions support inequalities
Civil rights	Inequalities of gender and lack of minority rights	Movement towards gender equality and more civil rights for minorities; strong political NGOs
Horizontal accountability	Powerful parliaments, few decisions by supranational executives	Weaker parliaments, executives face less parliamentary control
Effective power to govern	Strong executive vis-à-vis markets; political decision-making takes place mainly in democratically legitimate national institutions	Loss of regulating power vis-à-vis markets; shift of political decision-making towards thinly legitimized and controlled supranational governance structures

economic policy. These changes led to a significant loss of parliamentary powers in favor of the executive (partial regime D: horizontal checks on powers), central banks and the IMF. At the same time, the transnationalization of markets also diminished the effective power of national governments to govern (partial regime E: effective power to govern). This became visible especially during the financial crisis. The losses of the financial sector, forced by "systemic relevance", and the fear of a negative domino effect, were "socialized" despite decades of previously reckless and politically supported (through deregulation) profitmaking.

Financial capitalism is harmful for democracy, as it has cracked its social and political "embeddedness". This does not mean that capitalism *per se* is incompatible with democracy. A sustainable coexistence of capitalism and democracy is achieved best through mutual embedding. The existence of the right to private property and functioning markets are vital restrictions on the centralization of political power in democratic regimes. Particularly in conjunction with industrialization, capitalism unleashes demands, protests and emancipatory movements that can, under favorable conditions, lead to democratization despite diverging capitalist intentions. The history of capitalism and democracy demonstrated this over large periods of the past century.

Since the late 1970s, protest movements have focused more on cultural than economic issues. These new movements were crucial. However, as social and political protest no longer paid much attention to socioeconomic inequalities, these problems grew in the shadows. The brief, more virtual than real protest of the "Occupy Wall Street" movement cannot be compared with the negotiating power of strong trade unions or labor parties in the 1960s and 1970s. The disembedding of capitalism is challenging democracy's crucial principal of political equality. Representative democracy has not found effective antidotes against the disease of socioeconomic and political inequality. All countermeasures discussed in democratic theory—from referenda to deliberative assemblies, monitoring (Keane 2011), or counter-democracy (Rosanvallon 2008)—may save whales, help control government and improve certain spheres of local democracy, but have little relevance for reregulating markets, restoring social welfare and halting progressing inequality. The cultural turn of progressive democratic politics has forgotten the problem of economic redistribution and now stands empty-handed, without a cure for democracy's most obvious disease: inequality. Is capitalism compatible with democracy? It depends. It depends on the type of capitalism and on the type of democracy. If one insists that democracy is more than the minimalist concept proposed by Joseph Schumpeter and takes the imperative of political equality and Hans Kelsen's dogma of "autonomous norms" seriously, the present form of financialized "disembedded capitalism" poses considerable challenges to democracy. If these challenges are not met with democratic and economic reforms, democracy may slowly transform into an oligarchy, formally legitimized by general elections. It is not the crisis of capitalism that challenges democracy, but its neoliberal triumph.

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