



Capitalism, Socialism *or* Democracy: Lessons from Schumpeter for the 21st Century

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1. Introduction

In 1942, when Joseph Schumpeter published his book *Capitalism, Socialism, and Democracy*, both liberal democracy (capitalism) and state socialism (communism) were on the defensive, with fascism engulfing most of Europe and large parts of Asia. Even across the Atlantic, Axis misinformation actively worked (with willing local collaborators) to keep the U.S. out of the war as well as plan for a fascist insurrection there (Maddow 2023).

If this sounds familiar today in 2024, it is not a coincidence. The 2022 Democracy Index report by the Economist Intelligence Unit was titled *Democracy in the doldrums* and recorded democratic stagnation or decline in more than half the countries measured, including in Eastern Europe and the U.S. These trends are in sharp contrast to the euphoria that ensued when the Soviet Union collapsed in 1991. At that time, the failure of totalitarian socialism was thought to be a harbinger of the inevitability of democracy and capitalism worldwide.

And yet here we are, with a return of fascist sentiments and the lure of authoritarianism, including an actual anti-democratic coup attempt in the United States in 2021. Political scientists have some theories as to why this may be happening, but economists are less clear about it, beyond general mentions of rising inequality and the impact of globalization on the middle-class in developed countries.

Indeed, throughout the history of the dismal science, very few economists have taken on the big questions connecting economic and political systems. And while the classical political economists

discussed the concept of class – which straddles these two realms – after Marx, the economics profession moved away from any mention of class, power, or politics, preferring to focus on a hypothetical individual 'economic man'.

A key exception to this trend was Schumpeter, who directly addressed the relationship between economic systems – capitalism vs. socialism – and political systems – democracy vs. autocracy. This meant that Schumpeter inevitably had to take on the concept of class, which he did in a new way, seeing the entrepreneurial class as both economic innovators and the champions of democracy.

While the eight decades since Schumpeter's book was published did not bear out all his predictions, our generation can learn a great deal from his interdisciplinary vision, his understanding of the centrality of power and class, and the ubiquitous geopolitical leitmotif which runs through his thinking.

Armed with these essential tools, we can arrive at an understanding of democracy that is more consistent, and therefore hopefully more resilient, than the one that is under attack now.

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2. An Evolutionary Theory of Class and Power

Homo Sapiens - a previously obscure mammal – became the supreme species on earth due to its ability for imagining and communicating abstract ideas (Harari 2014). This ability was *endosomatic*, that is, within the body. In turn, it allowed humans to develop two powerful *exosomatic* capabilities (Lotka 1945), external to their own bodies:

- Organization - thanks to their ability to imagine and communicate abstract concepts such as state, God, and empire, humans were able to operate in large groups (>150 individuals)
- Production - using the abstractions of language, writing and mathematics, humans created advanced tools and preserved knowledge of such technological changes from generation to generation and place to place

However, the tools and technologies developed by humans served two very different purposes. Some were used for productive uses such as agriculture, home building etc., while others were used for war and pillaging.

We can think of these as productive (T_{π}) and destructive (T_{δ}) technologies, respectively. For most of human history before the industrial revolution, the latter were more powerful than the former, with the result that the class with monopoly of the means of destruction such as weapons and military strategies was superior to the class of economic producers.

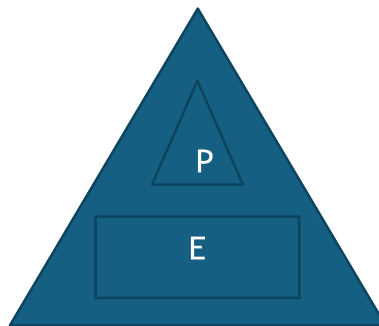
This can be shown in the following equation:

$$T_{\delta} > T_{\pi}$$

The feudal society is an example of this class balance, with warriors ruling over serfs. While the serfs used the land and other tools of production, they did not own them. The warrior had political power by direct control of the means of destruction, and an indirect economic power by controlling the means of production – land and workers - through their superior military power.

This class balance can be shown in the following diagram:

Figure 1: Class Balance in Traditional Societies



This shows both the inter-class balance, where the political (warrior) class is superior to the economic (working) class, as well as the within-class balance. P is shown as a triangle since the political class itself was organized as a hierarchy, with power increasing from the lower vassals to the upper ranks of the nobility, in some cases to the monarch.

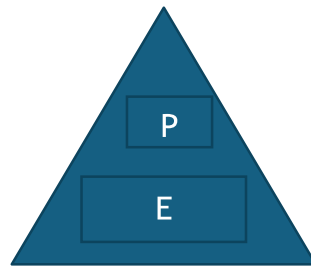
The economic class is shown as a rectangle since there were generally no specific hierarchies among the workers. Merchants and craftsmen existed somewhere in between these two classes but were still not part of the ruling elite.

At this point it is worthwhile to consider how liberty and equality (two of the three mottos of the French Revolution, with fraternity being more an emotion than an observable quality) featured in this structure. The warrior class, P, was free but unequal. The working class, E, was unfree (serfs or slaves) but mostly equal among itself.

It is against this context that the ancient democracies of Greek city-states can be evaluated. Ancient Greek democracy was an agreement of the ruling class of warrior citizens to choose their own government. It therefore made the people who were free also equal but kept the unfree economic class of slaves in its place, without citizenship or the right to vote.

Greek societies of this kind were therefore still hierarchical overall (outside triangle), but with democracy added as *within-class* equality, while inter-class inequality continued:

Figure 2: Class Balance in Limited Democracies



The Peace of Westphalia (1648) marked the emergence of the nation-state as the prime political form of organization in a world previously dominated by empires and city-states. The joint-stock corporation, a new form of economic organization, also emerged around this time, but was a creature of the state and subject to its whims and needs. Indeed, many leading politicians, including Queen Elizabeth I, owned parts of these corporations (Stern 2023).

The declaration of independence from Great Britain by the 13 American colonies created a similar society, albeit with a larger political (citizen) class. This new constitution empowered some of the working class, but another part (slaves) was still excluded. Thus, the diagram above applies to the early U.S. as well as ancient Greece. Instead of equality and freedom for all, these systems gave *equality (only) for the free*.

It was only with the French Revolution in 1789 that the entire working class rebelled against the political elite, and seized power, at least temporarily. In this situation, citizens were both free and equal, and the government was the servant of the public will.

3. Industrialization and the Metamorphosis of Power

The dominance of the political class, democratic or otherwise, was challenged by the rise of a new class. First this class consisted of merchants, craftsmen and members of guilds, but its power was not sufficient to challenge the warrior aristocracy.

The industrial revolution changed all that. For the first time, humans could control and mold energy itself (first steam and coal, later electricity and nuclear energy), thus not just utilizing nature's powers (as in the agricultural revolution) but surpassing them. This had enormous consequences for technological change and productivity, accelerating their previously tepid rates of growth, as is well documented (e.g. Maddison 2003).

This has changed the balance of power between the two types of technologies:

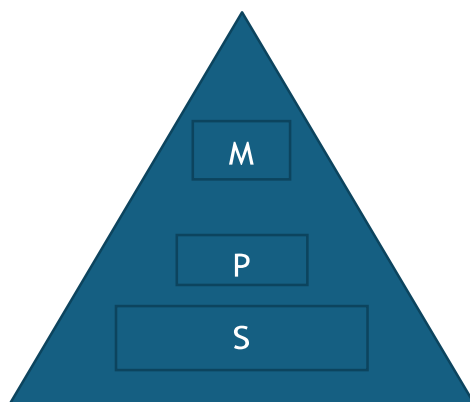
$$T_{\pi} > T_{\delta}$$

However, this exponential increase in one exosomatic capability – production - had proceeded far ahead of the other- organization - leading, for the first time in history, to new economic elites gaining the upper hand over the older political elites.

Streeck (2014) distinguishes between *Marktvolk* – capitalists, owners of corporations and the wealthy - from ordinary citizens, the *Staatsvolk*. One can extend Streeck's logic to the new role for politicians, *Parteiolk* who are civil servants representing the will of other classes.

Marx expressed this change in the relative power of economic and political institutions wryly in the Communist Manifesto, noting that “[t]he executive of the modern state is nothing but a committee for managing the common affairs of the whole bourgeoisie” (Engels and Marx 1848). Thus, Marx saw the new capitalist class – which has excluded the working class from economic power through enclosures and ‘primitive accumulation’ - as hollowing out any potential democracy, by controlling the state through their economic power.

Figure 3: Class Balance in Capitalist Societies



This new class balance can be illustrated as above, with the *Marktvolk* (M) controlling the government (P), even though the citizens (S) may be able to vote for it. So, while the *Staatsvolk* were now free, unlike serfs and slaves, they were not equal. It is a matter for another inquiry whether it the extension of the vote to most (male) adults just as the power of the political class was overtaken by the capitalist class a coincidence or not.

that capitalism is compatible with democracy – fared even worse than the first. Championed first by Friedman (1982) and then, at the end of the Cold War by Fukuyama (1989), the notion that ‘economic freedom’ somehow naturally led to ‘political freedom’ was never vindicated. Two logical problems explain this conceptual error.

First, ‘economic freedom’ has usually meant freedom of corporations from state intervention, rather than individual economic freedoms (e.g. from hunger, scarcity, or exploitation). In other words, economic freedom only for big market players, or as Streeck (2014) calls them, *Marktvolk*, as opposed to economic freedom for all citizens, the *Staatsvolk*. Thus, political and economic freedoms belonged to two different (and only partly intersecting) groups².

By contrast, Schumpeter (1942) saw democracy as an “outgrowth of the structure and the issues of the bourgeois world”. Capitalists, in his view, used democracy as an instrument in their struggle for supremacy against the older landed aristocracy (Elliott 1994). Schumpeter argued that no other society before capitalism was willing to “bear with and even finance the mortal enemies of the leading class” (Schumpeter 1942).

However, Schumpeter also recognized that in a complex industrial society, there was “no uniquely determined common good that all people could agree on or be made to agree on by the force of rational argument”, which led to democracy reaching “deadlock or interminable struggle” (ibid).

The notion that capitalism is compatible with democracy was also championed by Friedman (1982) and then, at the end of the Cold War by Fukuyama (1989), arguing that ‘economic freedom’ somehow naturally led to ‘political freedom’ was never vindicated.

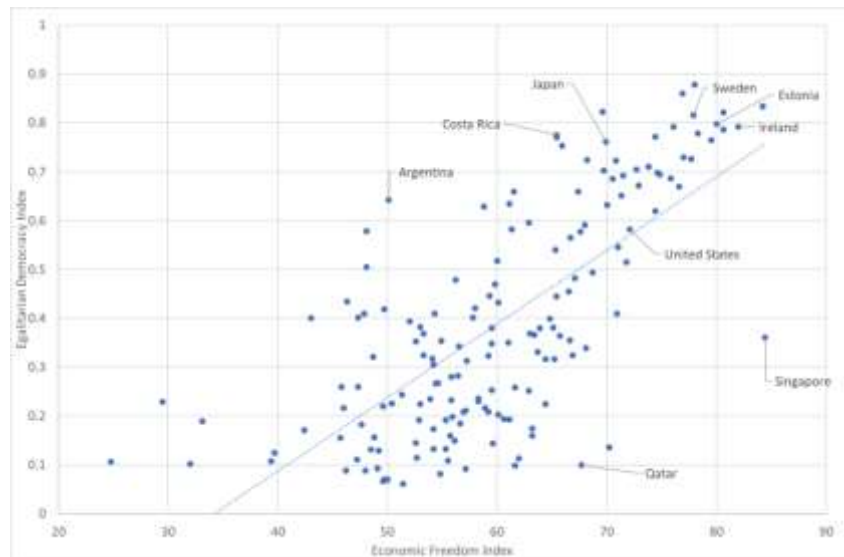
However, ‘economic freedom’ has usually meant freedom of corporations from state intervention, rather than individual economic freedoms (e.g. from hunger, scarcity, or exploitation). In other words, economic freedom only for the *Marktvolk*, as opposed to economic freedom for all citizens, the *Staatsvolk*. Thus, political and economic freedoms belonged to two different (and only partly intersecting) groups.

In this context a *Gedankenexperiment* would help to illustrate the point. The Economic Freedom Index published by the Heritage Foundation is a good proxy for the economic freedoms of corporations and investors, while the egalitarian democracy index published by V-dem Institute at the University of Gothenburg is based on the idea “that material and immaterial inequalities inhibit the exercise of formal rights and liberties and diminish the ability of citizens from all social groups to participate. Egalitarian democracy is achieved when 1) rights and freedoms of individuals are protected equally across all social groups; and 2) resources are distributed equally across all social groups; 3) groups and individuals enjoy equal access to power”.

So, while the Economic Freedom Index is a proxy for the power of *Marktvolk*, the Egalitarian Democracy Index can be thought of as a proxy for the power of the *Staatsvolk*.

How do the two proxies of class power align across countries?

Figure 4: Egalitarian Democracy Index vs. Economic Freedom Index across 164 Countries



Source: V-Dem Database v13, Series code: v2x_egaldem and Heritage Foundation. Both accessed March 2023.

Some countries have very high economic freedom for corporations (Singapore or Qatar) but are not very democratic, while others have high democracy scores but lower economic freedom (Costa Rica, Japan and Argentina). Some countries manage to achieve both (e.g. Sweden, Ireland and Estonia).

Taking the ratio of the EFI to the EDI yields an index of *Marktvolk* power. Of 164 countries with data for both indices, 143 (87%) score over 100, meaning the *Marktvolk* dominate politics, and only 20 countries score under 100, implying that the *Staatsvolk* are in control².

4. The Polity Stikes Back

Polanyi (1944), writing in Vienna around the same time as Schumpeter, reached another conclusion on the relationship between capitalism and democracy. He saw the *Great Transformation* of the rise of capitalism as a process in which the economy, long embedded in the polity, finally broke free from, and in some dimensions even overtook the rules of society. Labor, land and money became commodified, and the ensuing social unrest led to the rise of fascism, which attempted to bring back the superiority of politics over economics.

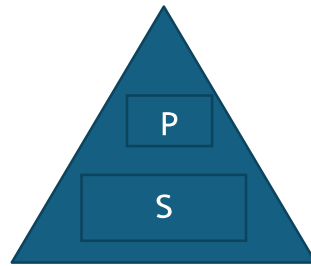
²These 20 countries are Slovakia, Luxembourg, Portugal, Germany, Czechia, Seychelles, Sweden, Lesotho, Spain, Greece, Trinidad and Tobago, Japan, Denmark, Norway, France, Belgium, Costa Rica, Italy, Suriname, and Argentina.

Along with fascism, state-socialism was another reaction as part of the double-movement of capitalism. But while Marx foresaw communist revolutions in industrial, capitalist states, these only occurred in agricultural, feudal societies (Russia in 1917, China in 1949, Cuba in 1959).

Socialism in these three cases did away with the *Marktvolk*, taking over their functions and re-imposing state control over the citizenship, with elections either outlawed or merely symbolic. However, it did ensure a level of *within-class* equality among the *Staatsvolk*, by providing free education, healthcare, nutrition and housing. As Sen (1979) noted, mere equality of access to resources is not the same as equality of capabilities, where people have not only the same resources but also the *freedom* to choose which resources they value most. Communist regimes did not allow such freedom, as the *Parteivolk* made all the political as well as economic decisions.

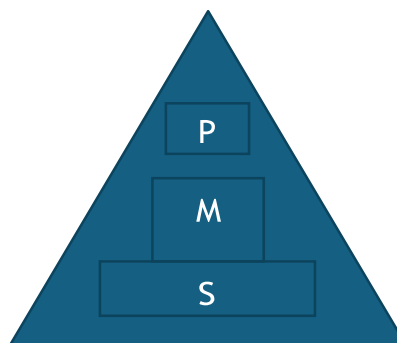
Thus, the *Staatsvolk* were partly equal but not at all free. It was a variation, in a sense, of the feudal system, except citizen-workers took the place of serfs, and indeed communism has been sometimes referred to as industrial feudalism.

Figure 5: Class Balance in Communist Societies



Fascism was a reaction to socialism, although its proponents embraced some socialist rhetoric (as in National Socialism). It actively defended capitalist interests while weakening labor unions and other egalitarian institutions. Thus, fascist regimes maintained the economic power of the *Marktvolk* while depriving the *Staatsvolk* of its freedoms. The result is a system with neither liberty *nor* equality. It is the reverse image of the capitalist diagram shown above in Figure 6:

Figure 6: Class Balance in Fascist Societies



In 1942, when Joseph Schumpeter published his book *Capitalism, Socialism, and Democracy*, both liberal democracy (capitalism) and state socialism (communism) were on the defensive, with fascism engulfing most of Europe and large parts of Asia. Even across the Atlantic, Axis misinformation

actively worked (with willing local collaborators) to keep the U.S. out of the war as well as plan for a fascist insurrection there (Maddow 2023).

At this historical point, Schumpeter was hoping for the defeat of fascism, but also predicted that the rise of monopoly capital and modern corporations would inevitably lead to socialism by concentrating the means of production. This prediction did not materialize, and instead, corporate capitalism became the norm in the post-war era, first in the regime of managerial capitalism, and later as financialized capitalism.

Schumpeter also saw socialism as incompatible with democracy given its centralization of political power. By contrast, he saw democracy as an “outgrowth of the structure and the issues of the bourgeois world”. Capitalists, in his view, used democracy as an instrument in their struggle for supremacy against the older landed aristocracy (Elliott 1994). Schumpeter argued that no other society before capitalism was willing to “bear with and even finance the mortal enemies of the leading class” (Schumpeter 1942).

However, Schumpeter also recognized that in a complex industrial society, there was “no uniquely determined common good that all people could agree on or be made to agree on by the force of rational argument”, which led to democracy reaching “deadlock or interminable struggle” (ibid).

The view that socialism and democracy were incompatible since the former centralizes power while the latter decentralizes it – had more mixed results. It has certainly been the case in the former Soviet Union, China, Cuba, and North Korea. But a democratic form of socialism also emerged, in what is now known as *les Trente Glorieuses* in Europe and the *New Deal* in the U.S.

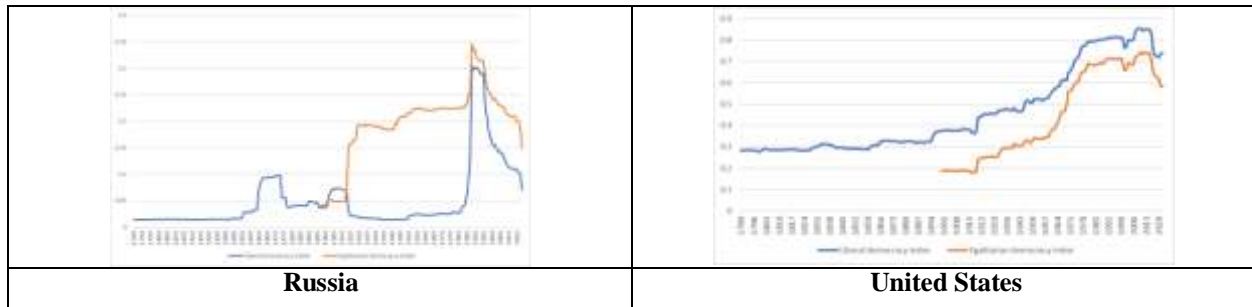
Even in these hybrid cases, however, the economy was fundamentally capitalist. The democratic polity imposed certain restrictions on capital, creating a social welfare state and nationalizing some industries, but wage labor and the private ownership of the means of production were not eliminated.

Thus, for the duration of the Cold War, a spurious contrast existed. A free (capitalist and democratic) but unequal West, vs. an equal (socialist and non-democratic) East. Naturally, this was a simplification, convenient for ideological and geopolitical purposes. Using two different V-dem indicators, we can see the more complex reality in these two countries:

- The *liberal democracy index* “takes a “negative” view of political power insofar as it judges the quality of democracy by the limits placed on government. This is achieved by constitutionally protected civil liberties, strong rule of law, an independent judiciary, and effective checks and balances that, together, limit the exercise of executive power.”
- By contrast, the *egalitarian democracy index* is based on the idea “that material and immaterial inequalities inhibit the exercise of formal rights and liberties and diminish the ability of citizens from all social groups to participate. Egalitarian democracy is achieved when 1) rights and freedoms of individuals are protected equally across all social groups; and 2) resources are distributed equally across all social groups; 3) groups and individuals enjoy equal access to power”.

The differences between these two measures of democracy can be dramatically contrasted by charting their trends for Russia (left panel) and the United States (right panel) over time:

Figure 7: Liberal vs. egalitarian democracy index for Russia and the United States



Source: V-Dem Database v13, Series codes v2x_libdem and v2x_egaldem. March 2023.

While Russia has never even approached a median score on the liberal democracy index, it has become much more egalitarian in the 20th century, though that trend declined since 1991. However, the fall of the Soviet Union did not replace non-democratic communism with capitalist democracy, since the resulting oligarchy disposed with *both* equality and democracy. In the United States, egalitarian democracy has always been lower than liberal democracy, and both have declined since the global financial crisis.

Overall, while the liberal democracy index represents the state of *nominal* democracy (formal political rights) in each country, it is the egalitarian democracy index that more accurately represents the *real* ability of people to exercise these rights, accounting for how this ability is deflated by inequalities (much like nominal GDP is deflated using a price index to arrive at real GDP).

Given these limitations of common-wisdom links between economic and political systems, what can we learn from the combined insights of Schumpeter and Polanyi?

An immediate lesson is that neither a commitment to capitalism nor to socialism - both economic systems at their core - can tell us anything *ex ante* about the political system that would be compatible with them. Deciding on the economic system first and then attempting to see if it is compatible with democracy is bound to fail, as demonstrated by both communist and fascist reactions to these economic ideals in the 20th century.

Another complication is that while political science gives a key role to the concept of power, in economics, especially the modern variety, power has a very narrow and marginal meaning (market power). This asymmetry gives the illusion of the polity being highly contested while the economy being merely competitive in a benign, 'free' way.

We propose two theorems based on these observations:

Theorem 1: *Power is fungible.*

Where economic power is centralized – whether in private corporate hands or in the state – even an initially decentralized political system (democracy) would become centralized through the channels described above (as in the decline of social-democratic capitalism). Likewise, when political power is centralized (various kinds of autocracy), even the most decentralized economic system would tend towards centralization (as in the rise of oligarchy instead of free markets in the former USSR).

Theorem 2: Individual liberty is absolute, while social liberty is relative.

At the individual level, liberty – both positive and negative – is absolute. Person A can have the freedom to do Y or not, and be free from Z or not, regardless of person B's freedoms. At a social level, however, *inequality* means that if A is more powerful than B (economically, politically, or both), A can impinge on B's freedoms.

This dialectic between liberty and equality can be summarized in the following table:

		Equality	
		Yes	No
Liberty	Yes	Democracy	Capitalism
	No	Socialism	Autocracy

The two systems on the off-diagonal – capitalism and socialism – are unstable, given the fungibility of power (*Theorem 1*). Both degrade to some form of autocracy (communism or fascism).

This implies that both socialism and capitalism (which concentrate economic power) can be compatible with autocracy (centralized political power), but neither is compatible with democracy (decentralized political power) *in the long run*. Also, given the relativity of social liberty (*Theorem 2*), true democracy implies both equality *and* freedom.

Looking at this logic in the context of the class balance discussed above, we can develop the following taxonomy:

	Economic Power	Political Power	Balance of Power	Long-term Equilibrium	Liberty and/or Equality
Capitalism	Marktvolk	Staatsvolk	M>S	Economic Oligarchy	Neither
Socialism	Staatsvolk*	Parteivolk	P>S	Political Oligarchy	Neither
Democracy	Staatsvolk	Staatsvolk	Democratic polity > Economy	Democracy	Both
Fascism	Marktvolk	Parteivolk	P>M	Autocracy	Neither

* As discussed above, the citizens in state-socialist countries only have economic *rights*, but not economic freedoms a la Sen.

An interesting conclusion from the table above is that while capitalism and socialism start with one feature of democracy – liberty in the former and equality in the latter – they end up with neither (due to the principle of the fungibility of power). Thus, these economic systems can be thought of as unstable, intermediary stages, while democracy and autocracy are stable, in that they start with either both liberty and equality (in the case of democracy) or neither (in the case of fascism) and end up with the same.

5. Liquid Feudalism: The Other Road to Serfdom

Even the limited economic protections and social freedoms offered by the hybrid capitalism of the immediate post-war era were dismantled quickly starting in the 1980s and accelerating in the 1990s. Now that state-socialism was no longer a threat, capital went on the offense and drove the 'social' out of the social-democratic compromise. Not surprisingly for students of history, these events led to the return of far right and even fascist and neo-Nazi parties in many capitalist countries (including both western and eastern Europe as well as the US).

This double movement is also visible in the return of fascism since 2000. Various democracy indices show decline in both Europe and North America, as people lose trust in the institutions of democracy and in voting itself.

But how were the *Marktvolk* able to pull off this coup?

The answer lies in a subset of the class, the financial elites. This was not a new class, and in fact, a lesser-known contribution of Schumpeter was the distinction between a first wave of finance which was necessary for undertaking production, and a second wave which involved speculation on the yet unearned income from production or on assets appreciating in value (Bezemer 2014).

During the gold standard era and up to 1973, both the Bretton-Woods system of fixed-exchange rates and the existence of capital controls in most developed countries meant that financial capital was caged within national borders and subject to their jurisdiction.

With the collapse of Bretton-Woods, national currencies began to float in the global market, and most capital controls were removed, finance was able to move unhindered across the world in search of higher yields.

Part of this phenomenon is covered in the literature on financialization, which looks at the rise of the financial sector in most capitalist economies. Research in this vein focuses on three main trends: the change in accumulation from industrial to financial capital, the rise of the shareholder-value philosophy with corporations focusing more on short-term dividends and less on market share, and the financialization of everyday life, such as the rise in consumer and mortgage credit (Van der Zwan 2014).

However, financialization also involved a more fundamental shift in power between classes. Previously, only states could issue hard currency and earn the benefits of seigniorage from it. Banks were able to create 'inside' money through loans, and benefit from interest payments, but such money was destroyed when the loans were repaid. Furthermore, bank loans were limited by the extent of reserves commercial banks had to keep at the central bank, and the state's issuance of the currency itself was limited by its link to gold.

With the collapse of Bretton-Woods and the link between the US dollar and gold, the financial industry found itself operating in a world of fiat money. Currency issuance by governments was no longer limited by the availability of gold, and the lifting of capital controls enhanced the market for banks' lending power.

At the same time, national politics (backed by monetarist economist) sought to limit the money-creation power of governments, partly in response to the inflation of the 1970s and 1980s but also due to ideological biases. This worldview led to several developments, including currency unions (such as the Euro), central bank independence, and self-imposed spending limits (such as in the U.S.).

The combination of increased bank lending and circumscribed sovereign money creation can be thought of as **the privatization of seigniorage**. This has been an important part of sovereignty since the beginning of human society and history. Its privatization has marked the final step in the shift of power from national democratic governments, at the service of the *Staatsvolk*, to supra-national financial institutions, owned by and representing a *global Marktvolk*. In this way, global finance (F_G) has become superior to national citizens (S^N) and overruled their democratically elected governments.

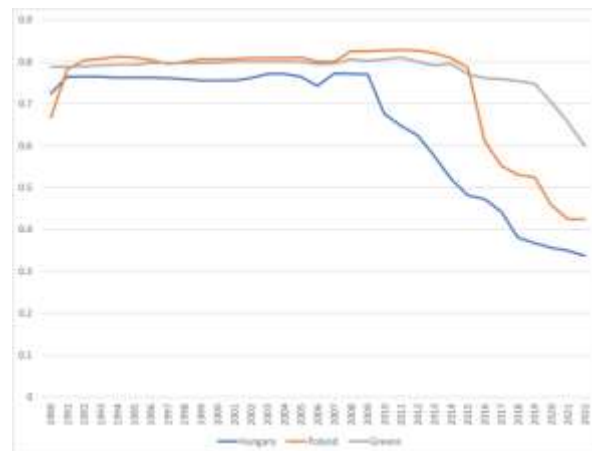
$$F_G > S_N$$

Global and regional finance's role in superseding democracy in such cases was analyzed by Slobodian (2018) and Varoufakis (2017). As more policy-making power moves from national polities, accountable to voters, to supra-national bodies like the European Union or European Central Bank, policies increasingly respond to these unelected bodies, sometimes working along investor-focused institutions like the International Monetary Fund (IMF).

While some of the cases where right-wing parties succeeded involved a backlash against immigration, the global financial crisis also played a role, as the policy-space of nation-states to respond to the crisis and recession was restricted by regional and international economic institutions (Varoufakis 2017).

In 2015, successive democratic governments in Greece were forced by a Troika of intra-national economic institutions to accept the austerity they were elected to reject, resulting in decreasing trust in government and the election of a neo-Nazi party to the Greek parliament. Across the Atlantic, the failure of U.S. politics to hold the *Marktvolk* accountable for unleashing the global financial crisis of 2008 resulted in democratic decline, a rise in right-wing sentiment, and the election of a member of the *rentier* class to the presidency in 2016.

Figure 8: Decline of Liberal Democracy in Three European Countries



Source: V-Dem Database v13, Series code: v2x_libdem. March 2023.

Political scientists have documented how hyper-capitalism has diluted or hollowed out democracy (Gilens and Page 2014, Bartels 2016). Laws and policies no longer reflect the views or positions of the middle-class or even most citizens, but those of corporations and the wealthy elite. This is due to a combination of factors, such as the increasing cost of participating in political campaigns, the resulting amount of money in politics, and the decline of unions.

The concerns about capitalism’s corrosive effects on democracy are far from new, and have in fact been voiced by one of the founding fathers of the United States:

“I hope we shall take warning from the example [of England] and crush in its birth the aristocracy of our monied corporations which dare already to challenge our government to a trial of strength, and to bid defiance to the laws of their country.” (Jefferson, 1816).

The domination of the polity by the economy not only weakens political rights and democracy, but also civil rights, as captured by the V-dem indicator ‘Social class equality in respect for civil liberty’.

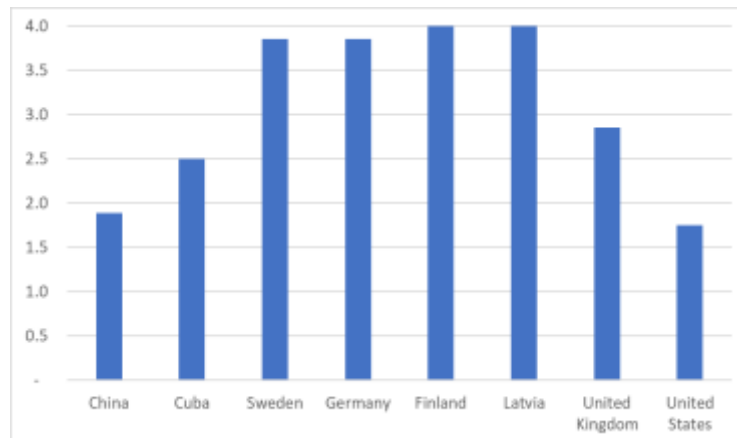
This indicator asks, ‘Do poor people enjoy the same level of civil liberties as rich people do?’ and thus “specifies the extent to which the level of civil liberties is generally the same across socioeconomic groups so that people with a low social status are not treated worse than people with high social status. Here, civil liberties are understood to include access to justice, private property rights, freedom of movement, and freedom from forced labor.”

The indicator ranges from 0 to 4 as follows:

Indicator Value	Social class equality in respect for civil liberty
0	Poor people enjoy much fewer civil liberties than rich people
1	Poor people enjoy substantially fewer civil liberties than rich people
2	Poor people enjoy moderately fewer civil liberties than rich people
3	Poor people enjoy slightly fewer civil liberties than rich people
4	Poor people enjoy the same level of civil liberties as rich people

A fascinating outcome of considering class inequality *directly* is that it shows a symmetry perhaps unexpected given the 'end of history' logic. Both left-leaning, communist countries such as China and Cuba *and* hyper-capitalist, right-leaning countries like the UK and US have high class inequality with respect to civil rights (which are even more unequally distributed in the US - 'land of the free' - than in Cuba). It is only the 'social democracies' in the middle that have high or full class equality.

Figure 9: Social Class Equality in Respect for Civil Liberty, Selected Countries.



Source: V-Dem Database v13, Series code: v2clacjust. March 2023.

Neither capitalism, on the right of the diagram, nor state-socialism on its left, ensure social class equality in respect for civil liberty. This empirical finding is in line with our theory described above, as the two economic systems are unstable, beginning with either equality or liberty but ending up with neither (as they degenerate into economic and political oligarchies, respectively).

6. Conclusion: Staatsvolk über Alles

On the one hand, we are in a similar situation today as that observed by Schumpeter over eight decades ago. Liberal democracy is on the decline throughout the world, while capitalism is doing just fine. And fascism, authoritarian parties and leaders, and anti-democratic sentiment are on the rise globally, including in the two former Cold-War superpowers (largely due to the export of nationalist ideology and techniques of disinformation from East to West, see Snyder 2018).

On the other hand, the conditions that have led to this situation are different than in 1942. State-socialism (communism) is nearly gone, with even China embracing some role for markets and in fact becoming the world's workshop. Decolonization since 1945 has resulted in many more independent nation-states, and many of them embraced some form of democracy in the second half of the 20th century.

However, the encroachment of global finance on national democracy has, predictably, emptied the latter from its contents, and laid bare the fact that national and regional policies follow the desires of economic and financial institutions and investors rather than those of citizens. Austerity policies imposed around the world, from Greece (by the ECB, IMF and EU) to the United States (by its two market dominated parties) has repelled ordinary citizens and destroyed their belief in democracy. As a result, many do not vote, while others vote in the hopes of preserving capitalism without democracy (i.e. fascism).

This is reminiscent of the reactions in the 1920s and 1930s to the first wave of globalization and financialization. However, while in that era national social democracy was a viable way to bring global capital under national control, today this option is no longer possible. While economic and financial power is indeed organized on an intra-national and even global scale, there is no world government (with the UN functioning merely as an inter-governmental forum).

But the diagnosis of the recent threat also points the way to the solution. If the globalization of finance – financialization - has upended the democratic class balance, de-financialization can rebalance it. But this path involves several policy choices which may be anathema to many mainstream political parties.

First, instead of the ‘sound finance’ approach imposed by international organizations (like the IMF and EU) and self-imposed by many governments, functional finance, pioneered by Abba Lerner almost exactly at the same time Schumpeter and Polanyi were writing (Lerner 1943), can free public policy from the tyranny of balancing the budget, ridding democracy of the deficit myth (Kelton 2020), and freeing democratically elected governments from the paper shackles they have accepted.

This would also mean the democratization of central banks. The myth of the ‘independent central bank’ evaporates as soon as we realize that such banks – independent as they may be of public control, i.e. by the *Staatsvolk* - are owned and controlled by private commercial banks, i.e. the *Marktvolk*. Since power, like nature, abhors a vacuum, democratic public control of the central bank is preferable to private corporate control.

These first two policies would reclaim the power of seigniorage for nationally sovereign governments, while also limiting the scope of commercial banks to operate across borders. A third policy could encourage more non-profits banks. The German model is instructive in this case. Around 70% of German banks are locally based and owned. Some are credit unions or cooperative banks, while others are municipal savings banks. Both types are non-profit institutions (Werner 2014), and thus do not have the financial might of large multinational banks and their political lobbying heft.

Protecting democracy in the age of globalization, therefore, would amount to returning to Keynes’ recommendation:

“I sympathize, therefore, with those who would minimize, rather than with those who would maximize, economic entanglement among nations. Ideas, knowledge, science, hospitality, travel – these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, *let finance be primarily national.*” (Keynes 1933, emphasis added).

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