Much of the academic and nonacademic literature on advanced capitalist democracies over the past two decades has painted a critical and pessimistic picture of advanced capitalism, and—closely linked—of the future of democracy in advanced societies. In this view, the advanced capitalist democratic state has weakened over time because of globalization and the diffusion of neoliberal ideas. With advanced business seen as major driver and exponent, this has led to liberalization, privatization, deregulation, and intensified global competition. In Esping-Andersen’s (1985) striking metaphor, it is “markets against politics” with markets winning out. This explains, inter alia, why there has been a rise in inequality (labor is weakened) and why this rise has not been countered by increased redistribution. If governments attempted such redistribution, the argument goes, it would cause footloose capital to flee. In Piketty’s (2014) hugely influential account, the power of capital to accumulate wealth is governed by fundamental economic laws which democratically elected governments can no longer effectively counter. If they try, capital just moves somewhere else. Democratic politics is then reduced to symbolic politics; the real driver of economic outcomes is capitalism (Streeck 2011a, 2016).
In this book we argue that the opposite is true. Over time the advanced capitalist democratic state has paradoxically become strengthened through globalization, and we explain why at length. The spread of neoliberal ideas, we argue, reflects the demand of decisive voters from the middle and upper middle classes to fuel economic growth, wealth, and opportunity in the emerging knowledge economy. The “laws” of capitalism driving wealth accumulation are in fact politically and, largely, democratically manufactured. This was true to a large extent at the formation of advanced economies in the late nineteenth and early twentieth centuries, but it is especially true in today’s supposedly borderless economy.

Drawing on a wide literature in economic geography, in innovation studies, and in management, we explain how knowledge-based advanced companies, often multinational enterprises (MNEs) or subsidiaries of MNEs, are increasingly immobile because they are tied to skill clusters in successful cities, with their value-added embedded in largely immobile, highly educated workforces. A central aspect of our book is the extent to which advanced capitalist companies are tied geographically into national systems. In our perspective, which reflects a large research program of recent decades, knowledge is geographically embedded—in advanced nations, in regions, cities, and towns—typically in clusters of skilled workers, engineers, professionals, and researchers. Also geographically embedded are institutions, public and private. One way of reading our book is therefore to see it as tying together economic geography, national and regional systems of innovation, and political economy.

As is increasingly understood in contemporary economic geography, the topographical distribution of knowledge competences is of hills and peaks rather than of a flat earth. This reflects the combination of the importance of tacit knowledge (even if partly codifiable), and of the need for colocation in the generation of tacit knowledge. Educated workers collocate in skill-clustered networks (which for them is valuable social capital) and therefore cannot be transported abroad, and companies cannot typically find alternative specialized knowledge competences elsewhere; thus, in business school jargon, “Capital chases skills.” In the modern literature on
knowledge-based MNEs, MNEs are seen as networks of increasingly autonomous companies, which get their value from the colocation with geographically differentiated skill clusters; and the payoff to the MNE derives from the complementarities which may be generated across the network from access to these differentiated knowledge competences.

In turn, skilled employees benefit both from this increased demand from foreign direct investment (FDI) from abroad and also as a result of the knowledge complementarities from the FDI abroad of domestic knowledge-based MNEs. An even more profound benefit from globalization comes from specialization in advanced goods and services in the knowledge economy: the ICT revolution both decentralizes the level and multiplies up the number of groups capable of autonomous projects. This is the basis of specialization manifested in the great expansion of varieties traded across the advanced world. Rising inequality and increased poverty is a consequence of the government-sponsored shift toward the new economy and it is not effectively countered, because the new middle classes are relatively secure and because the old middle classes are opposed to redistribution to the poor. The Meltzer-Richard model fails to predict such opposition since median/decisive voters see themselves as contributors, not recipients. We have put some of the key references and researchers into a long footnote to avoid cluttering the text.¹

The book can at least partially be read as an attempt to integrate economic geography with political economy. As noted, the national embeddedness of advanced capitalism is not new. We will argue that it goes back a long way and is fundamentally rooted in skilled workforces and a broad range of public and private institutions that promote investment in human capital and in new technology, together resulting in economic growth and prosperity. Central to the creation and continuation of this beneficial interaction between policies, institutions, and investment is democracy itself. When the middle classes are educated and tied into the advanced economy, or have strong expectations that their children will be, they start to favor policies that promote growth, and vote for parties and
political leaders with a reputation for doing so. Those with low or obsolete skills may not go along if they cannot see themselves or their children benefiting from advanced capitalism, and here we find a large audience for populist appeals—in the twentieth as well as the twenty-first century. Our goal in this book is to present a new picture of the relationship between advanced capitalism and the democratic nation-state that runs counter to the standard markets-against-politics perspective and explains the remarkable resilience of advanced capitalist democracies, from their beginnings in the early twentieth century and through the arguably most turbulent century of human history.

1.2. The Argument Summarized

This book starts from what appears to us a major puzzle in political economy, though paradoxically one that the literature pays little attention to. This is the exceptional resilience of advanced capitalist democracies (in comparison to any other type of nation state in the last century or so). All the economies which industrialized in the nineteenth and early twentieth centuries were democracies shortly after the end of the First World War; and apart from temporary German and Italian lapses they have remained advanced capitalist democracies ever since.\(^2\) (Czechoslovakia, tenth most industrialized democracy in the early 1920s, is the exception—as a result of external forces.) This resilience is also true of the small number of newly advanced capitalist economies since the end of the Second World War (Japan, Israel, Hong Kong, Singapore, Taiwan, South Korea, Ireland): once they became advanced capitalist democracies they have remained so (with the arguable exception of Hong Kong, again the result of external forces).\(^3\) While the correlation between per-capita income and democracy is well-known (Lipset 1959), and while the near-zero probability of rich democracies reverting to authoritarianism is well documented (Przeworski and Limongi 1997; Svolik 2008), why this is so remains a black box.

What is particularly puzzling about this resilience is that it took place over arguably the most perturbed century in European
recorded history (apart perhaps from the fifth century). In any case, a dominant theme in the book is how advanced capitalist democracies have responded to and shaped interactively two great technological regimes. The second industrial revolution (or the scientific regime) started in the last third of the nineteenth century and morphed into an organizational revolution of giant Chandlerian conglomerates, often described as the Fordist regime. And then the Information and Communication Technology (ICT) revolution that followed ushered in so-called “knowledge economies.” A fine analysis of changing technological regimes is by Freeman and Louca (2001). In addition to encompassing technological change, the advanced world has seen major wars, the end of empires, the rise and fall of communism, the rise of Asian manufacturing, and exceptional social, occupational, and locational change, including a massive entry of women into the labor market. Most dramatically, two deep financial crises led to prolonged depression and deep recession and slow growth.

The reader will be likely to read this book in the light of the financial crisis. That is partially intentional. But from our perspective it is written in the light of the performance of the advanced capitalist democratic nation-states, both as resilient and as responsible for the huge rise in living standards, decline in poverty, and, relative to other countries, fall in inequality over more than a century, as will be seen in the next section.

Our initial motivation is to understand this striking resilience of advanced capitalist democracies. So one concern of this project has been to develop a broad model of advanced capitalist democracies to explain the resilience. We sketch key elements of this model here. We also see how this may help to solve several other puzzles about advanced capitalist democracies, such as the continued differences in institutions and public policies despite the globalization of production.

In contrast to almost all other approaches, apart partially from Lindblom (1977), we argue that there are powerful *symbiotic* forces explaining why democracy, the advanced nation-state, and advanced capitalism are generally mutually supportive and have been so over this perturbed last century. In common with Hayek (1944, 1966),
Lindblom (1977), Schumpeter (1942), and Poulantzas (1973), we see a strong state as necessary to promote successful innovation-oriented advanced capitalism, notably by enforcing competition on advanced capitalist companies (who would prefer protection and stable profits) and labor market rules to ensure workplace cooperation (against predatory unions). For both Hayek and Schumpeter, and also Poulantzas, capitalism and social democracy are both enemies of such enforcement—capitalism because it eliminates monopoly profits and social democracy because it undermines monopoly wages. But in our model a central component is that the large skilled workforces of the advanced sectors of the economy, and the aspirational voters who seek to join these workforces, have interests aligned with the promotion and success of advanced capitalist sectors, and are generally decisive voters. This contrasts with the general assumption in almost all this literature that democratic capitalism is a clash of interests between labor and capital.5

Our approach, building on the alignment of decisive voters with the success of advanced capitalism, assigns a very different role to democratically elected governments, in which they play a central and activist role in an uncertain technological environment promoting change in their advanced capitalist sectors. Democratic governments construct and reconstruct their economies, conditioned by past choices, in response to voter demands for effective economic management and internationally competitive economies and a better life for themselves and their children. This draws heavily on our academic background in the rich comparative political economy of advanced capitalism.6 A dominating concern in this literature is how democratic governments guarantee the effective organization and reorganization of their advanced capitalist sectors. This literature has also been concerned with understanding heterogeneous socio-economic institutions across different advanced economies which underpin specialization of economic activities: a specialization we also seek to understand in this book. Given the scope for variety, advanced capitalist democracies evolve over time in response to technology and other shocks, but in turn also reshape them; and
they are themselves embedded in different electoral and legislative rules. Common for all are the incentives for governments to promote the advanced sectors of the economy and construct and reconstruct institutions in order to further this goal. We see new technologies as political opportunities, and their adoption is politically determined.

The most distinctive element of advanced capitalism in our approach has already been mentioned—the large skilled and educated workforces of the advanced capitalist sectors. Some of our understanding about skills has developed from comparative political economy, and much has developed from the literature on innovation (Dosi 2000), Malerba (2004), Lundvall (1992, 2016), Freeman (2008), Nelson (1993), Casper (2007), Whitley (1999, 2007). The skills of these workforces are tacit and cospecific both with each other and with company technologies; technologies are themselves partially codifiable and perhaps patented, but, as Teece (1986) underlined, protected by the cospecific skills of the workforce even in the absence of patents. Moreover, their tacit skills are generally learned from each other, in an overlapping generation (OLG) logic. This implies colocation in work environments and/or skill clusters over time. This is widely recognized in the economics of agglomeration (Glaeser 2010), despite the role of the internet and global trade and finance; it is also true of the different environment of giant Chandlerian corporations, in an earlier technological regime with Fordist and earlier technologies (Chandler 1967, 1977). Quite generally it has pinned down advanced companies or their subsidiaries to the national environment where education and training takes place; the high value-added activities of an advanced company are thus generally embedded in the national or regional or local environment—advanced capitalism is geographically specific and not footloose (irrespective of where the shares or patents are held). Knowledge-based multinationals (typically but not necessarily with core technologies in a particular national environment) may have many geographically embedded skill-intensive subsidiaries (Cantwell 1989). It is only across the low-skill subsidiaries that multinational companies (MNCs) can easily move between locations at low cost, leaving little rent to the countries they are in.
A second implication of the colocation and cospecificity of skills and capital is geographical specialization. Specialization is deeply embedded in innovation-oriented activities. Again, this follows both from the literatures on comparative and international political economy, and also from the innovation literature including that on national systems of innovation (Lundvall 1992, 2016; Nelson 1993; Cooke 2001). Geographically embedded skills and specialization in turn lead to another symbiosis, namely that each advanced nation in general derives complementarities from trading and capital mobility with other advanced economies. Thus advanced nations gain from globalization with other advanced nations, at least in the advanced sectors. This then is a game of strategic complementarities. In our broad model the greater the specialization, the greater the value the community of advanced governments gain from each individual advanced economy: hence the symbiosis between the advanced nation-state and the extent of advanced globalization. A hegemon may be important in protecting an advanced economy from military threats by nonadvanced economies; but it is not relevant within the community of advanced economies.

The colocation and cospecificity of skilled workers, enabling and enabled by specialization, are in turn what endow the nation-state with power, and in democracies this power is used to improve the lives of a majority by creating the institutional conditions for innovation, skill formation, and growth, and by responding to demands for social insurance and sometimes redistribution. This then suggests a third implication: there exists a strategic complementarity, or symbiosis, between democracy, the advanced nation-state, and advanced capitalism. Democratic parties and politicians that successfully promote the prosperity and welfare of a majority will be rewarded by winning elections, and the majority will be skilled workers who are keen to see the advanced sectors of the economy thrive.

Spelled out in greater detail below, we thus see our broad approach going some way in explaining the resilience puzzle. It also explains, we believe, five related puzzles which we elaborate below: first, the middle-income trap, and why so few countries have developed into advanced capitalist democracies after the Second World
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War. Second, it shows why a thoroughly integrated world economy has not undermined the existence of different forms of advanced capitalist democracies, since their institutional differences cause and are caused by distinct patterns of specialization. Third, it illuminates how democracy reinforces advanced capitalism when it is widely thought to cause “decommodification” by majoritarian demands for policies that undermine markets in the name of equality. Fourth, and related, it goes a long way in understanding the distinct paths to democracy of the different advanced economies, and the limitations of generic arguments such as that of Acemoglu and Robinson (2005). Finally, it helps us understand why advanced democracies, despite generating prosperity and greater income equality than most non-advanced countries, have not responded to rising inequality since the late 1970s. Closely related is the question why advanced capitalist democracies have given rise to populist political movements that oppose the very elites that grow out of the knowledge economy as well as open borders and the prosperous cities and the live-and-let-live values that they give rise to. But first we highlight some key conceptual distinctions, causal claims, and empirical hypotheses that make up our basic argument.

1.3. Our ACD Framework Approach

Our broad thesis is that a relatively simple framework model of advanced capitalist democracies (ACD) evolved over a long period of time, at least over the last century—from roughly the end of the First World War, by which point all the early industrialisers had become democracies. In summarizing this framework more closely than above, we attach central importance to the symbiotic relationship between five core elements: We follow many analysts before us (for example, Poulantzas (1973), Hayek (1944, 1966), and Schumpeter (1942), among the major theorists of advanced capitalism from quite different political

1.3.1. THE ROLE OF THE STRONG NATION STATE

We follow many analysts before us (for example, Poulantzas (1973), Hayek (1944, 1966), and Schumpeter (1942), among the major theorists of advanced capitalism from quite different political
perspectives) in paying close attention to the central role of the state in putting and maintaining in place key necessary conditions for the operation of advanced innovation-oriented capitalism. The state, to be successful, can be thought of having four sets of tasks:

(i) Imposing on business the requirement that product markets are competitive; this is a key requirement, for there is considerable evidence that competition (so long as not too intense) is a precondition for innovation. It requires a strong state to impose competition because businesses prefer protected markets with low-risk and high-profits which they can share with politicians. The first country to emerge as a modern capitalist economy, Britain, did not take off until the rampant rent-seeking and corruption that characterized the political system up until the end of the eighteenth century was eliminated (Popa 2015).

(ii) Imposing on labor the requirement that businesses are allowed the right to manage and to cooperate with management. If labor is too powerful, it may prefer to control production and to limit innovation and skill replacement, or with cospecific skills in a technology to “hold up” management once the technology is installed. Thus a strong enough state is needed to organize labor market rules to prevent this.

(iii) In addition to these rules of the game, the third role of the state is to invest in a range of public goods, especially in the areas of education, training, and research. Here the problem for the nation-state is that if advanced capitalist companies are mobile, they will take the benefits of these investments and locate elsewhere. Thus the benefits of knowledge generated in the nation-state need very broadly to remain there.

(iv) Finally the state needs to negotiate out through the political system and interest groups how advanced capitalism and the state can reset rules and reinvest in response to shocks. Fioretos 2011 shows this with insight
over the whole postwar period in relation to France, Germany, and the UK). More generally, in periods of deep uncertainty—as in the early 1980s—it needs to debate the direction to be taken to promote advanced capitalism. In an important recent book, *Marketcraft: How Governments Make Markets Work*, Vogel discusses this process at length, in particular in relation to the United States and Japan since the 1980s.

### 1.3.2. Aligned Interests of Decisive Voters with Advanced Capitalism

Why should a strong enough state behave in these market-enhancing ways? If capitalism is politically strong it will be tempted to demand protection from the state, and politicians will be tempted to make bargains with it. Advanced capitalists will exchange profits with the state for protection and the quiet life. Poulantzas (1973) saw this as a fundamental problem facing capitalism. Arguably one of the most brilliant Marxist theorists from the 1960s to the 1980s, his “regional” theory simply posited that the state had the “function” of maintaining a competitive environment; this both geared business to innovation and prevented businesses from collective action such as investment strikes because of the collective action problem they faced when competing against each other. This approach may appear slightly mystical, but it showed how Poulantzas was aware of the problem.8 Hayek (1944, 1966) was equally aware of the need to impose competition requirements on businesses if they were to innovate. His concern was with democracy: he believed that voters as workers would vote for protection to guarantee their jobs. And Schumpeter (1942) was equally aware of the problem and thought that advanced capitalism would lead to corporatism and an end to a competitive environment, or that voters would choose socialism.

We take a quite different position. Along with Lindblom (1977), but without his emphasis on the structural power of capital, we argue that governments pursue policies supporting advanced capitalism in the nation-state because the electorate, or at least decisive voters,
punish governments which don’t.⁹ We argue that they do so because a large number of voters see themselves as benefiting from advanced capitalism, whether directly as employees or as aspirational voters: thus we take the opposite position to the standard view of political economy, that the interests of workers are opposed to those of capitalists.

Within advanced capitalist democracies, political parties and their leaders need to build up reputations among decisive voters as effective economic managers to be electable: that is to say, they need to build up a reputation for maintaining and, where necessary, changing the product and labor market rules (mainly, product market competition and labor market cooperation) and the public infrastructural investments (education, skills, research, universities) necessary for innovation-oriented capitalism. We can think of these as electable parties. An important question is what ensures a majority, or decisive vote, for these policies and parties. Who are these voters?

First, there is a large vote from employees in advanced capitalist companies. Advanced capitalism has required since the second (or scientific) industrial revolution from the last third of the nineteenth century, a large skilled and educated labor force, cospecific and collocated with the technology of the company in question (Thelen 2004; Goldin and Katz 1998). It is often wrongly thought that the knowledge of the company is a technology which can be codified and patented; but technology is almost always cospecific with the tacit skills of the workforce (Teece, 1986). The level of skills and education is relative to the prevailing technology, but management in the advanced sectors has always had to secure the cooperation or motivation of the labor force, because of the significant costs of hiring and firing. This is as true of semiskilled workers under Fordism as of contemporary software engineers: they could easily stop the line, and replacing them involved both strikes and significant retraining costs, especially if training new workers required the tacit cooperation of existing semiskilled workers. Thus we can think of this skilled workforce as gaining rent from advanced capitalism above the competitive market value of their skills. In one form or another this aligns
the interests of the skilled worker with advanced capitalism. Because advanced capitalism is skill-intensive, this electorate is very large.

Second, the aspirational vote has a particular relevance in relation to advanced capitalism. By contrast to status-ordered societies, growth in the demand for skilled and educated labor is core to the idea of advanced capitalism as a result of technological change (Goldin and Katz 2009). Hence, while aspirational individuals, parents, and families have always existed to some extent, it is particularly associated with advanced capitalism. Even if parents may not themselves be skilled they can aspire to their children becoming skilled, which is equivalent to upward intergenerational mobility. Thus the aspirational voter has interests aligned with the success of advanced capitalism. Our analytic approach thus explains why advanced capitalism must grow, since growth is needed to provide the new jobs for aspirational voters and/or their children.

By this token, when some families are blocked from experiencing upward mobility they tend to react politically against the system, which we see as the root cause of populism. For reasons we will spell out below (and in detail in chapters 3–5), the transition to the knowledge economy has produced blockages, and this raises the question of whether populism is a threat to advanced democracy.10 We think not. The reasons are discussed in detail in chapter 5, but the most fundamental in our view is that those benefiting from the knowledge economy have an obvious incentive to make sure that a solid majority will continue to feel included in, and benefit from, the knowledge economy in the future. That said, we do not want to minimize the challenges of potentially creating a large left-behind minority who feel alienated from society and democratic institutions. Even if populist parties will never attain majority status, populist appeals could prove a destabilizing force in democracy (as they arguably have in the United States and in Britain), and we do not want to underestimate the social costs of large minorities losing hope in the future and turning to drugs or crime as a consequence. This is a serious problem for democracy, even if it is not a serious threat to democracy (or advanced capitalism, or the nation-state). As we spell in out in chapters 3 and 5, this problem has been addressed much
more effectively in some democracies than in others (in particular through the training and educational system).

1.3.3. SPECIALIZATION AND LOCATION COSPECIALIZATION

This is perhaps the most novel element of the argument, and it underpins the symbiosis discussed above, between decisive voters and governments promoting the framework rules and infrastructural investments needed for advanced innovation-oriented to function effectively.

A critical and major empirical assumption we make about advanced capitalism is that (at least since the scientific revolution) it has been skill-intensive. That is an empirical assumption, and Braverman (1998) argued to the contrary that the microprocessor would result in a fall in skill-intensity. That has not happened so far in the advanced sectors; it has, arguably, as in Asian manufacturing, turned what had been advanced sectors in the Fordist era into less skilled sectors today. We will discuss in the conclusion different future scenarios depending on the nature and trajectory of technological developments. In the contemporary world, however, advanced capitalism is built on a large skilled labor force. More than forty-two percent of twenty-five-to-thirty-five-year-olds today have tertiary degree in the OECD (compared to twenty-six percent among fifty-five-to-sixty-four-year-olds), and more than half of the current university-age cohort will acquire a tertiary education, with the great majority of those who do not acquiring a higher secondary degree. Many of the latter will expect their own children to go to university. Almost eighty percent of the working-age population in contemporary OECD countries have at least a higher secondary degree (OECD 2016, 41). In a middle-income country like Turkey, the number is thirty-seven percent.

Not only is labor skill-intensive in the advanced sectors, those skills are tacit (i.e., difficult to codify) and cospecific with other skilled workers, and they are also cospecific with the relevant technology, even in cases where the technology is itself is codifiable and thus (generally) patentable. This in turn implies that the skilled
workforces of advanced companies are collocated and have to work physically together. The great Chandlerian companies of the Fordist era typically had huge plants or connected sets of plants—the advanced sector of their era—which housed the skilled workforce, often from sophisticated manufacturing through to research and development. Many find it surprising that colocation has increased in the knowledge economy, despite the internet. This is often today in the form of skill clusters, so that knowledge is geographically confined, and both workers with the relevant skills and knowledge-based companies wanting to tap into the relevant knowledge cluster have strong incentives to locate there.

This is then a picture of the value-added of companies being constituted by their skilled workforces. Because whole workforces are extraordinarily difficult to relocate (especially to another country), and because of the costs of training relevantly skilled workforces abroad, advanced companies (or their subsidiaries) are relatively immobile.

This is consequential for how we understand modern capitalism. First, the common view of footloose capitalism makes little sense in relation to advanced companies, or at least their knowledge-based part. This is different from the behavior of MNEs in nonadvanced countries. It is different to financial assets, including the ownership of companies. And it is different to the ownership of patents. But even if the technology or discovery is codifiable, it is typically cospecific with skilled workforces. (Not always, as in the case of patents for therapeutic drugs.) In the substantive sense of the value-added of their knowledge, advanced companies are relatively immobile. Equity capital is liquid and can be owned in many different national markets, but its value is still tied to firms that are nationally embedded, hence also to the skilled workforces on which they depend. Short-term financial assets, such as foreign currency holdings or short-term bonds, impose constraints on macro-economic policies—notably, the capacity of governments to build up large debts or to use currency devaluations—but these are self-imposed constraints, as we will see in chapter 4. Besides, they have no effects on the capacity of governments to use balanced budgets to
redistribute, or to use countercyclical fiscal or monetary policies in times of high unemployment.

Second, collocated and relatively immobile workforces are generated both by economies of scale and scope. In the scientific revolution and, increasingly, under Fordism, this required colocation in vast plants covering multiple interlinked activities gaining great economies of scale and also frequently of scope. It also took the form of smaller skilled companies carrying out interrelated activities. And it typically included many high value-added service sector activities, as skill clusters do now. Both in the past and now it has required differences, major and minor, across advanced nation states in knowledge competences.

Our argument about the immobility of capital in ACDs runs counter to common claims to the contrary. Among the more prominent examples in the academic literature are Streeck (2010), Piketty (2014), and Rodrik (1997, 2017), who all argue that capital mobility undermines the capacity of governments to tax and finance the welfare state. For Piketty this is the basis for his prediction that \( r > g \), which will produce ever-greater concentration of wealth. Yet Piketty’s own data show that after taking account of destruction of capital and capital taxation, in fact \( r < g \) for the entire period from 1913 to 2012—that is, basically during the period of democracy (see figures 10.10 and 10.11). The dire prediction for the future relies on the key assumption “that fiscal competition will gradually lead to total disappearance of taxes on capital in the twenty-first century” (2014, 355), coupled with a sharp drop in growth rates.¹¹

A look at actual capital taxation rates instead reveals remarkable stability. While top statutory capital tax rates have come down in most countries since the 1980s, Swank and Steinmo (2002) show that such cuts were accompanied by a broadening of the tax base that left effective tax rates virtually unchanged from 1981 to 1995. The most ambitious attempt to estimate capital tax revenues as a share of the capital base (called the implicit tax rate) by Eurostat shows no tendency for decline in European ACDs between 1995 and 2015 (see table 1.1). If anything, the opposite is true. The United States is an exception because corporate tax rates were cut in the Republic tax
reform, but only to about the average rate of other OECD countries, which is twenty-one percent (the United States had exceptionally high rates before the reform). Of course, there is no reason that governments should rely on capital taxation to fund the welfare state, and such taxation rarely exceeds twenty-five percent of revenues (with income and consumption taxes making up the bulk of the rest). The composition of taxation is a political choice, not a matter of the structural power of capital to exit.

### 1.3.4. STRATEGIC COMPLEMENTARITIES AND INSTITUTIONAL HETEROGENEITY

Because of nationally rooted specialization in an integrated world economy, the advanced capitalist democracies are engaged in a game of strategic complementarities. Globalization between them increases the payoffs from the game, as opposed to constraining domestic political choice or suborning democracy of the advanced economies.

In Chandlerian companies in a Fordist regime, free trade and freedom of foreign direct investment movement are both important,
as they are in knowledge economies. In knowledge economies, as knowledge competences become more decentralized, so knowledge-based MNEs become more like networks of autonomous subsidiaries with complementary knowledge competences. In both cases there is a political incentive to promote globalization across the advanced economies; but it is arguably more important in the contemporary world. There are several implications of this insight:

A. *The political power of advanced capitalism is unlikely to be strong.* Advanced capitalist companies need to operate in an international competitive environment in the advanced democracies. That makes it difficult to solve the collective action problems (such as mutual punishment) needed for carrying out, for example, an investment strike, as well as sharply reducing the temptation to doing so. Even in coordinated systems, business action against a government is both costly and limited to areas like training, technology transfer, and wage restraint, where advanced companies are unlikely to want to follow disruptive activities.

Equally, as we have seen, since companies are relatively immobile geographically, it limits both actual exit and the credibility of exit threats. The critics of capitalism are right that footloose capital constrains what states can do; it is just that advanced capitalism is not footloose. Thus we find the idea thoroughly unpersuasive that advanced capitalism has suborned the autonomy of democracy through globalization, and is responsible for austerity, poverty, and cutbacks in redistribution and the welfare state. One can of course find examples of governments giving tax concessions to companies that promise to retain jobs instead of moving them to low-wage countries. Such pressures and temptations arise naturally as part of Vernon’s (1966) product life-cycle as production becomes more routinized and can be performed by robots or low-skilled workers abroad. But we think it is far more remarkable that governments in ACDs routinely shun such temptations. At the height of deindustrialization in the 1980s governments across ACDs engaged in policies that accelerated the decline of sunset industries by cutting back subsidies, privatizing unproductive public enterprises, and removing barriers to competition from low-wage countries while betting on
new high value-added industries moving in to take advantage of an abundance of high-skilled labor (and the associated institutional supports). Nor are such “tough” industrial policies catering to the collective interests of “capital”—even in the broadest Poulantzas (1973) or Lindblom (1977) interpretation. The Rehn-Meidner model informing the economic strategy of the Swedish LO, the major union confederation, and of the Social Democratic Party was deliberately designed to force low-productivity firms to die or to innovate. A right-wing version of this modernization strategy was pursued in the UK and it was vehemently opposed by business. Sometimes the siren song of jobs from declining companies are too hard to resist, but more often than not these companies are shown the door.

B. Redistribution and the welfare state is democratically decided, for better and (often) for worse. In understanding inequality before and after redistribution and the policies toward the welfare state in advanced societies, there is consequently little mileage to be gained from focusing on the political power of advanced capitalism; in ACDs (though not elsewhere) capital is politically weak. Instead, for understanding “bad” outcomes, the focus should be on three aspects of advanced democratic systems: first, that the winners from advanced economies are typically the decisive voters—they choose policies to re- and in some measure also predistribute; they may or may not make those choices to compensate the losers; and in particular they may choose not to compensate the poor. (Moreover, if we think of populists as losers of advanced capitalism, they are if anything more hostile to compensating the poor.) Second, that “rules of the democratic game” differ as one moves from consensus PR-based systems to majoritarian “winner-takes-all” Westminster systems (Iversen and Soskice 2006); and further still to the porous American system in which primary elections and semidisciplined parties enable money to influence outcomes (Hacker and Pierson 2010). Third, the level of political information among the electorate exacerbates bad outcomes (Iversen and Soskice 2015). In understanding the problematic of inequality and poverty in the advanced world, it is at these aspects of democracy that we will look, and it is on these aspects that critics of contemporary politics in advanced democracies should focus. We
are, needless to say, strong proponents of democracy, but the failure of adequate redistribution in advanced economies lies in the workings of democratic systems rather than in the political power of capital.

C. A key underlying condition for a democratic system to support heavy investments in education and research infrastructure is their geographical immobility. Geographic immobility relates to the rents of skilled workers and the alignment of their interests with advanced capitalism. Critically it also explains the logic behind the heavy infrastructural investments needed to support advanced capitalism in the first place. For if it could be taken abroad (as companies could do in the absence of the tacit skills of the domestic workforce and their cospecificity with company technology), then incentives for governments and voters to invest would collapse.

1.3.5. THE FUNDAMENTAL EQUALITY OF DEMOCRACY

We have established above that advanced capital in ACDs is immobile and that the state for that reason is powerful. We have also argued that democracy and capitalism are in a symbiotic relationship in the sense that decisive voters—skilled or aspirational or both—vote for parties and policies that promote the advanced sectors, which raise the demand for skills, and so on. In this section we suggest that the essence of democracy is not redistribution or equality, as so commonly assumed, but the advancement of middle class interests, and we capture this idea as the “fundamental equality of democracy” (to distinguish it clearly from Piketty’s (2014) “fundamental inequality of capitalism”).

The interests of the middle classes are aligned with advanced capitalism via two key mechanisms. The first is direct inclusion into the wealth stream created by the continuous progression of the advanced sectors. By far the most important path to such inclusion is education, since the advanced sectors are skill intensive. Even when the skills of middle-aged workers fall behind the needs of the advanced sectors, these workers can benefit indirectly if their
children acquire the skills needed to move up in the economy. Such intergenerational mobility creates aspirational voters who will also support policies that push forward the advanced sectors—notably through investment in education and research and development (R&D), coupled with strong competition rules.

The second mechanism is the welfare state, broadly construed to include cash transfers, social insurance, and public services. Accounting for more than one-third of GDP on average, wide-ranging tax-financed middle-class programs ensure that those with high and rising incomes share some of their wealth with the rest of society. This is especially important in the transition to the knowledge economy because gains of new technology have been concentrated at the upper tail of the income distribution. The tax-and-transfer system ensures that these gains are shared with the middle classes.

Exactly who benefits and how much from the knowledge economy is a matter of democratic politics, which varies with the institutional framework of each country. In this book we pay particular attention to electoral and party systems, but for now we can capture the role of electoral politics with the simplified notion of a “decisive voter.” Given that democratic governments ordinarily depend on support from a majority and given that politics is broadly organized around class and economic interests, this decisive voter will be someone from the middle of the income distribution (although not necessarily the median). With a right-skewed distribution of income, a majority has income below the mean and the decisive voter will therefore also typically be someone with income below the mean.

Contrary to standard notions, the overriding concern of the decisive voter is neither equality nor redistribution, but rather his or her own income and welfare, with due attention to efficiency costs of taxation. Although the literature tends to equate political equality with economic equality, there is no reason that the decisive voter should care about those at the bottom of the distribution, except insofar as he or she fears falling into the ranks of the poor (or fears that his or her offspring will)—an insurance motive we discuss in subsequent chapters. Nor is there any reason for decisive voters to oppose
rising incomes for those above them, as long as such windfalls are shared. There are clearly efficiency limits to taxing the rich but whatever the optimal level of taxation from the perspective of the decisive voter, we should expect democracy to ensure that the net income of the decisive voter keeps up with the capacity of the economy to generate income. This capacity is reflected in per-capita income, or average income, and we can therefore represent the political logic of ACDs as a simple identity: $Y_D/\bar{Y} = k$, where $Y_D$ is the disposable income of the decisive voter, $\bar{Y}$ is average disposable income, and $k$ is a nationally specific constant (defined over some suitable length of time to smooth out short-term fluctuations).\textsuperscript{14} Needless to say, this assumes that the decisive voter does not change over time because of, say, declining voter turnout or reforms in the electoral system.

Much of the contemporary literature on advanced capitalism implies, however, that any such equality of democracy has ended—if it ever existed. Globalization critics like Rodrik imply that footloose capital has undermined the capacity of labor—which presumably includes our decisive voter—to maintain its share of national income. In Piketty, what he calls the “fundamental inequality of capitalism” ($r > g$) guarantees that national wealth and income will increasingly accrue to those at the top of the distribution. In the more political interpretations of Streeck (2016), Bartels (2008), Gilens (2012), and Hacker and Pierson (2011), the will of the majority is subverted by the outsized political resources of business and the rich, again causing a concentration of income at the top while the middle and lower classes lose out.

At first blush these pessimistic conjectures seem to be borne out by the data. No matter what measure is used, inequality has risen significantly since the 1980s across all ACDs. For example, Piketty shows that the top decile share of US national income rose from about thirty-five percent in 1980 to about forty-seven percent in 2010 (Piketty 2014, 24). Goldin and Katz (2007) show a similar rise in US wage inequality. Across twenty-two ACDs the Gini coefficient of market household income has risen an average of eleven percent from 1985 to 2014, according to data from Solt (2016), and the disposable income Gini (after taxes and transfers) increased a
more modest seven percent. (The pattern is illustrated in figure 1.1, panel a.)

Yet there has been no corresponding decline in the $Y_D/\bar{Y}$ ratio if we proxy $Y_D$ by median disposable income and $\bar{Y}$ by mean disposable income. This is shown in figure 1.1 (panel b) for a sample of ACDs for which we have comparable data starting in 1985 and ending in 2010. The $Y_D/\bar{Y}$ ratio in 2010 is more or less the same as it was in 1985 for most countries (the observations lie close to the 45-degree line), and the average difference in the ratio between the two years, $\Delta r$, is indistinguishable from zero: $\Delta r = [-0.043; 0.047]$. So it appears that the median income group has been exceptionally successful in keeping up with the overall growth of income. We think this is also bound to be true for more accurate measures of decisive voter income since decisive voters tend to be closer to the means as voter nonturnout is concentrated among the poor.

New Zealand is something of an outlier with a drop in the $Y_D/\bar{Y}$ ratio from .92 to .87 between 1985 and 2010, or about six percent. Even in this case, however, it is notable that average real incomes rose by thirty-five percent in the same period, so the middle class was much better off in 2010 than in 1985. The Gini of disposable household income in this period rose by twenty percent, according to data from Solt (2016). This highlights the general fact that while income inequality has been rising fast, the relative position of the median has been fairly stable, even in an “outlier” like New Zealand. This is also true in the case of the other negative “outlier”: Germany. Here the relative income of the median declined from .93 to .90, or about four percent from 1985 to 2010 (undoubtedly in large part because of unification); yet the mean income rose by more than fifty percent. Even in cases where relative income of the median has slightly slipped, the middle group of income earners is thus clearly enjoying rising incomes despite increasing inequality.

The stability of $Y_D/\bar{Y}$ is particularly remarkable considering that the data cover a period with the most dramatic increase in inequality since the emergence of democracy. The middle class is a critical constituency for democratic governments, yet it has no interest
**Figure 1.1.** Measures of distribution of income, 2010 vs. 1985. (a) Gini coefficients of market (circles) and disposable (squares) household income; (b) Disposable income of median relative to disposable income of mean (working-age population). Labeled observations are the countries for which data are available in panel (a). The first observation for the United States refers to 1995, not 1985. Sources: (a) OECD Income Distribution Database (IDD): Gini, poverty, income. Data extracted on December 31, 2017, 13:11 UTC (GMT) from OECD.Stat. (b) Solt, Frederick. 2016. “The Standardized World Income Inequality Database.” Social Science Quarterly 97. SWIID Version 6.2, March 2018.

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in inequality per se; only in seeing its own fortunes rise with the economy as a whole. Even when the gains are concentrated at the top, the middle benefits. As we discuss below, in the United States about seventy percent of federal tax revenues comes from the top ten percent of earners, and about forty percent from the top one percent. Indeed, we argue in this book that the reforms that enabled the knowledge economy to take off created huge inequalities, yet were supported by a majority of voters. Those left out of the new economy are generally also weak in the political system. Indeed, a recurrent theme of this book is that democracy, not capitalism, is to blame for the rise of low-end inequality. Phrased positively, greater equality is a democratic choice, which is little constrained by capital.

Our argument may seem to run counter to the evidence in Gilens (2005, 2012), Bartels (2008), Peters and Ensink (2015), and others that the rich are much more politically influential than the middle class. But as we will discuss in detail in chapter 4, this evidence does not in fact say much about whether the economic interests of the middle class are attended to in government policies. The reason is that these analyses compares preferences for policy change with actual policy change, and many policy changes are at the margin and do not much affect how well the broader interests of different classes are represented. If it was truly the case that the rich almost monopolized political power, it would be very hard to understand the emergence and persistence of large-scale middle-class programs such as Medicare and Social Security, let alone why the top one percent of earners pay almost half of the bill for these programs. Moving outside the United States, the notion that middle-class interests are ignored in public policies is even less plausible. Those with high education and income may simply understand the constraints on government policies better than others—the obvious example here is the need for countercyclical fiscal policies—and this will show up as congruence between preferences for change and actual change (see Elkjær and Iversen 2018 for evidence). But this is not synonymous with deciding whose class interests are favored by government policies; the fundamental equality of democracy is an expression of middle-class power.

In the following we develop our argument further by applying it to the five puzzles we identified above in addition to the resilience
of ACDs: the middle-income trap; the strengthening of advanced capitalism by democracy; the rise of democracy; persistent varieties of capitalism in an age of globalization; and the lack of response to rising inequality.

1.4. The Middle-Income Trap Puzzle

A remarkable fact is that the group of advanced democracies has only been slightly expanded since their rise in the nineteenth and early twentieth centuries. The distribution of world income has become marginally more equal since the 1980s, but this is virtually all due to the rise of a few populous poor countries to the ranks of middle-income economies, notably China and India, and not the rise of middle-income countries into the high-income group. For more than a century, entry into the advanced group has only occurred in the instances of Singapore, South Korea, Taiwan, Israel, Ireland, and Hong Kong.

We can illustrate this using patent data because the number of patents per capita is a measure of the size of the advanced sector (as opposed to GDP per capita, which is affected by oil and other natural wealth). If we focus on OECD and major middle-income countries with at least five million citizens, figure 2.1 shows the number of patents per one million working-age adults in 1976 compared to 2015. The data are from the US Patent and Trademark Office, where nearly every major patent is taken out by individuals, labs, and firms from around the globe.15

It is apparent that the ACDs are clustered in the top right corner and that only South Korea, Taiwan, and Singapore have made the transition into this group from 1976 to 2015. This ties into our argument, since in each of these cases powerful governments were deeply committed to becoming advanced capitalist countries. Taiwan, South Korea, and Singapore were semi-authoritarian and in each case, governments were powerful enough to impose competition (in different ways, but always involving trade) and shift massive resources into the educational system. Taiwan and South Korea have since become democracies with powerful electoral
lobbies for advanced capitalism. Singapore has only slowly moved in a fully democratic direction, but its commitment to education and open trade has been unwavering; it is in fact the only advanced country that is (still) not fully democratic.

The difficulty of breaking into the rich ACD club is known in the economic literature as the “middle-income trap” (e.g., Kharas and Kohli 2011). Eichengreen et al. (2012) have persuasively argued that the key barrier is the creation of large knowledge-intensive sectors sustained by internally driven innovation. It is precisely the existence of such dynamic, skill-intensive sectors that define advanced capitalism as we use it in this book. This is as true today as it was at the turn of the previous century.

In fact, if one considers the distribution of the world population, the share who lives in rich democratic countries has declined since the Second World War, and the total number of people living in these countries has barely risen. Paradoxically, in the face of this evidence most of the recent work on globalisation has focused on the concern
that rich countries might fail in global competition with “low-wage”
countries and decline into the middle income group. But no country
has suffered this fate, and the gap to middle-income countries is
stable. Simply put, there is no convergence, whether viewed from
above or from below.

Our framework explains the middle-income trap at least in part:

1. The advanced capitalist democracy requires (ab initio) a
strongly organized government with both the ability and the
incentive to impose the relevant labor and product market
rules as well as to build the requisite education and research
infrastructure. The incentives for nonadvanced governments
to do so are not likely to be fulfilled since they will have
strong incentives to do protectionist deals with companies;
or a wish to control the companies in the first place; or
with natural resources to exploit. Post–1945 exceptions
were initially strongly organized states with effective
bureaucracies, an absence of natural resources, and a need
for the revenues to maintain a powerful military—Singapore,
South Korea, and Taiwan. Israel is a related case in point,
where the electorate understood the military need. But
absent that special case, and absent initially large skilled and
educated workforces supportive of advanced sectors, there
is no democratic incentive for governments to behave in this
way (Doner and Schneider 2016).

2. The professional social networks and skill clusters do
not generally exist to create the capacities and requisite
knowledge to build innovative companies with the necessary
marketing and financial linkages with other companies and
the relevant markets (themselves nearly always in advanced
capitalist democracies). Israel and Taiwan were able to
benefit from social networks and skill clusters composed of
returnees and also between networks strung between them
and Silicon Valley (Saxenian 2007); Singapore and South
Korea from MNEs; and in all cases from rapid build-up
of skills and research. These now constitute skilled and
educated electorates supportive of government promotion
of advanced capitalism. But it is only the rare cases where
governments had the relevant incentives, connections, and
capacities (Breznitz 2007).

3. The democratic institutions necessary to support advanced
capitalism are mostly absent. First, there has to be
government support for broad-based public investment in education (and a range of supporting institutions that we discuss later), and this in turn requires disciplined political parties that are preeminently concerned about their reputation in a political system where governments must continually appeal to electoral majorities. Reputation-based political parties are also necessary for the government to be sufficiently independent of local strongmen and business interests to ensure that they will not allocate resources or restrict competition for short-term political support. Such reputation-based democratic institutions failed to emerge in most countries. Instead, the middle-income countries tend to be characterized by an economic system where firms seek rents from the political system by offering bribes in exchange for protection against market competition, while politicians accept bribes for personal gain and in order to wage personalized electoral campaigns or party-internal contests. Consistent with this logic, Svolik (2013) shows that voters in such a setting will rationally conclude that all politicians are bad, giving even honest politicians reasons to act like them. While Latin America has many candidates for moving out of the middle-income trap, this logic captures the Latin American dynamic of weak product market competition legislation ensuring the market dominance of large, typically family-owned conglomerates, Grupos, with close links to the political systems (Schneider 2009).

From this we can begin to understand why it is so difficult for middle-income countries to join the rich camp. Unlike the neo-classical notion that technology is available to every country, it is in fact embedded in immovable national workforces. Advanced technologies therefore have to be built from within, and for middle
income countries to acquire this capacity requires two simultaneous revolutions: one economic and another political. The economic revolution is that firms have to abandon their current product market strategies and make major investments in new technology, at the same time as the supply of highly skilled workers expands dramatically. The latter requires a political revolution, since politicians have to free themselves from both educated elites who have no interest in such a major supply shock, and from clientilistic networks of existing producers and their dependent workers who want to remain protected. Competition is a requisite for technological progress, but it can be the death knell for many middle-range producers that have to confront global competition. Moreover, because mid-range technologies rely on easily replaceable skills, any attempt by governments to impose costs or demands on business can be met by exit. So, unlike advanced capitalism, the nation-state in middle-income countries is generally weak and short-sighted, while capital is strong.

1.5. The Puzzle of Democratic Politics

Strengthening Capitalism

It is natural to think that democracy and capitalism are on a collision course. One is based on a principle of equality (“one person, one vote”) while the other is based on a principle of market power (“one dollar, one vote”). Esping-Andersen captured this tension succinctly in the title of his 1985 book *Politics Against Markets*, and it underpins the entire power resources approach to capitalist democracies. Streeck (2013) interprets every major institutional change, economic crisis, and distributive outcome in the post-WWII period in terms of the struggle between (egalitarian) democracy and (inegalitarian) capital, with capital gradually winning out as its mobility rises. Piketty (2014) concurs but does not even perceive a need to analyze democratic politics because mobile capital inevitably undermines the capacity of democratic governments to either arrest the growth of capital or accelerate the growth of the economy. So how can we claim that democracy prevents markets being undermined, leading to divestment and capital flight?

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