

Onwards, but not via Beijing: for a democratic re-embedding of capitalism

A decade into an age of crisis, the end of history is over. The Great Financial Crisis shook Fukuyama's settlement. Trump, Brexit, climate change and COVID buried it. From this unsteady present, what can we discern about the relationship between democracy and capitalism, today and in the future?

The last decade shows: their current relationship is dysfunctional, the legitimacy of their current accommodation near exhaustion. And yet, the two most common takes sharing this broad outlook are at best incomplete. First, against a backdrop of rising inequality and falling tax compliance, weakening trade unions and powerful digital conglomerates, many feel that capitalism has gotten the better of democracy.¹ There is truth in this, but not the whole truth: who is "capitalism", and how precisely does it rule?

Others claim that both competitive markets and competitive politics have been captured and corrupted by small elites, be they plutocrats in London and Shanghai, mandarins in Brussels and D.C., or some swamp-like mixture of the two. This view, too, captures important elements of the truth. But in its simplicity, it ignores the structural constraints that even powerful players are subject to: Hillary Clinton did not win the 2016 presidential election; the UK electorate voted for Brexit; and the Great Financial Crisis caused great embarrassment for major financial players. To be convincing, critiques of elite capture would have to offer better accounts of the structural dependencies between the elites they focus on, and the rival elites, state administration, markets, and the demos they contend with.

No, in this essay we argue that our current predicament is at once more disturbing and more hopeful: in the liberal democracies of the West—though not in China—neither capitalism nor a small elite is in control. Instead, nobody is: power has been fragmented, turned into a "floating Arcanum,"² and nowhere more so than in the Eurozone. Here, the post-2008 interaction of states and markets caused failure and near-failure for both states and markets. The European Central Bank and national central banks were the last players capable of averting catastrophe, revealing their quasi-sovereign position;³ but while central banks did and do exercise "governance over governments", due to limits arising from their tools and mandates these actors of last resort are veto players rather than true sovereigns, compliance officers rather than CEOs. The result is a

¹ Wolfgang Streeck, *Gekaufte Zeit. Die vertagte Krise des demokratischen Kapitalismus*. Berlin: Suhrkamp 2013; *How Will Capitalism End? Essays on a Failing System*. London: Verso 2016

² Joseph Vogl, *The Sovereignty Effect: Markets and Power in the Economic Regime*. In: *Qui Parle*, Vol. 23, Nr. 1, Special Dossier: Rethinking Sovereignty and Capitalism (2014), p. 153.

³ Joseph Vogl, *Der Souveränitätseffekt*. Berlin: diaphanes, 2015.

configuration of power in which nobody is truly in charge.

How did we get here?

This regime of independent central banks and market-deferential states was born in reaction to a world-historical novelty: Nixon's 1971 closure of the Gold Window. For the first time in history, money became fully unmoored, tied neither to gold, nor silver, nor any other commodity. Overnight, money became what (and how much) states said it was.

In conventional telling, this unmooring proved fatal for the then-existing accommodation between democracy and capitalism: embedded liberalism.⁴ The temptation to print money and buy off the electorate was now irresistible, and the result was stagflation.⁵ Since money could not be re-anchored—the Gold Standard's inglorious end was too recent, memories too fresh—it had to be de-politicized. Some heroic Ulysses had to stuff the printing press staff's ears with wax, set them on a clear course, and then chain himself to the mast; central bank independence, inflation targeting, and a deliberate abdication of control, in other words.

Leaving aside the historical accuracy of this narrative, which we challenge below, over time monetary authorities suffered from mission creep. As in Hemingway's description of bankruptcy, this happened gradually and then suddenly. At first, two paradigmatic growth models emerged after the fall of Bretton Woods: the German regime of export-led growth, enforced by the Bundesbank through competitive disinflation after 1974; and the Anglo-American regime of consumption-led growth, pioneered by the Reagan administration and premised on private sector credit creation (enabled through financial deregulation) to keep demand growth stable despite stagnating incomes.

These two models destabilised each other: because German exports depend on US demand (both directly, via exports to the US, and indirectly, via exports to China which only flourish if Chinese exports to the US also flourish), the German model is vulnerable to financial crashes in the US. Conversely, in a context of free trade the US could not generate sufficient domestic demand through higher wages, as this would have undermined US competitiveness and sucked in even more German exports. The result: continued US reliance on credit to fuel growth and a series of bubbles and crashes, notably in 1987, 2001, 2008, and March 2020.

This mutual destabilisation necessitated what one might call *monetary-financial cooperation*:

⁴ The classic description of "embedded liberalism" is John Ruggie, *International regimes, transactions, and change: embedded liberalism in the postwar economic order*. In: *International Organization*, Vol. 36, Nr. 2, 1982.

⁵ James Buchanan und Richard Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*. New York: Academic Press, 1977

as each speculative bubble burst, treasuries and central banks bailed out private financial institutions, both to preserve the basic functioning of the economy and to sustain the credit driven growth model. Since only central banks have unlimited firepower, a larger and larger share of these bail-outs fell to central banks. In this manner, the de facto mandate of central banks expanded to include financial stability (or more prosaically, stable or rising asset prices): gradually and imperceptibly before 2008, suddenly and overtly ever since. At the same time, to bridge recurring gaps between real economy recessions and central-bank-supported asset prices, wage shares fell, profit shares increased, and inequality rose across the West.

This dynamic has exhausted the legitimation of the central bank independence regime. At birth, it had been justified with the conventional narrative mentioned above: markets are in principle self-equilibrating, but alas the unmooring of money created an irresistible inflationist temptation, namely printing money to win elections. Since nobody wins from instability and inflation, central bank independence is not just compatible with democracy, this argument went, but actively supports it via removing this threat of instability. Moreover, the argument continued, nothing important is lost, for inflation targeting brings an economy to full employment and fiscal and regulatory policy can make whatever structural changes majorities desire.

This justification failed the test of time. Deregulated financial markets proved to be self-destabilising.⁶ In the process of stabilising them, central banks have made more and more consequential distributive decisions.⁷ Moreover, the loss of control caused by the separation of finance ministries and central banks has proven destructive, not benign: central banks, fenced in by their mandate and tools, proved capable of slowing economies down, as with the Volcker shock or the 2011 interest rate increases of the ECB, but have proven incapable of countering demand side secular stagnation or advancing the urgently needed sustainability transition.⁸ Treasury departments, deprived of the market-shielding that central banks previously offered, were forced to become paladins of market-conforming democracy. The result: inequality, insecurity, environmental crisis, and ever-mounting unrest.

⁶ Hyman Minsky, *Can "it" happen again? Essays on instability and finance*. Armonk, NY: Sharpe, 1982. *Stabilizing an Unstable Economy*. New Haven, CT: Yale University Press, 1986

⁷ Jens van 't Klooster und Clément Fontan, *The Myth of Market Neutrality: A Comparative Study of the European Central Bank's and the Swiss National Bank's Corporate Security Purchases*. In: *New Political Economy*, August 2019.

⁸ Lawrence Summers, *Demand Side Secular Stagnation*. In: *American Economic Review*, Vol. 105, Nr. 5, Mai 2015

What is to be done?

Full democratic control, so the conventional history goes, has disproven itself in the stagflationary 1970s. Does this imply that only the Chinese answer—political, but technocratic-authoritarian rather than democratic, control over capitalism—is the wave of the future?

Not so. A closer reading of our origin story reveals an alternative option. In a criminally under recognised essay, Stefan Eich and Adam Tooze show that it is simply not true that Margaret Thatcher, Ronald Reagan, and the Bundesbank were lone heroes, struggling against the “unwashed masses” in a fight to conquer inflation.⁹ Instead, a desire to bring down inflation was widespread, both within politics and among the demos, throughout the 1970s. The real bone of contention was: *how* is this best done?

This recognition is liberating. It means that permanently integrating central banks into the democratic political process is a promising way of re-embedding markets within liberal democracy. Majority support for inflation fighting means that an altogether more ambitious politics is possible. We may dare to attempt a fundamental restructuring of our economies, so to render them environmentally sustainable; an education, labour market, and aggregate demand regime that ensures all who want to work have a job; a healthcare, old-age care, and pension system that leaves nobody behind. We may dare to attempt these and other projects, even if—at the risk of overly crude simplification—they involve printing money, and even if they scare investors. For democratised central banks can create the financial space for elected governments to go against bond market vigilantes; and if inflation does get serious, then popular majorities will demand to bring it back under control, providing cover and pressure for central bank governors, finance ministers, and parliaments to negotiate the best ways of doing so.

But what does democratised central banking look like in practice? While this is virgin soil, and while we can offer no more than preliminary remarks here, we believe that a sunset clause for central bank mandates, coupled with removing restrictions on their toolkit, would be a major step in the right direction. Permitting *monetary-fiscal coordination* would re-establish sovereign control and re-embed the market economy; parliamentary re-authorisation and, if desired, a reform of the mandate every ten years or so would ensure that this control is not exercised arbitrarily. Continued operational independence would preserve technical expertise.

In a first revision, a new ECB mandate, for example, could take seriously the biggest fears of

⁹ Stefan Eich und Adam Tooze, *The Great Inflation*. In: *Vorgeschichte der Gegenwart. Dimensionen des Strukturbruchs nach dem Boom*, Hgg. Anselm Doering-Manteuffel, Lutz Raphael, and Thomas Schlemmer. Göttingen: Vandenhoeck & Ruprecht, 2016.

our times: environmental crisis and social anxiety. Fiscal-monetary cooperation could create macro conditions conducive to truly full employment, thereby empowering workers, raising wages, increasing demand and hence growth, and thus reducing economic anxiety. The likely result would be increased social stability and a return of economic confidence to the West. This climate of confidence, in turn, would enable—politically and economically—the necessary transformation of our material economy, away from unsustainable resource use and emissions, towards a model that we can confidently pass on to the generations to come.

Re-embedding liberalism

When the Brexit campaign adopted the slogan “take back control”, it was on to something. Western liberal democracies convinced themselves, in the late 1970s and early 1980s, that they were not capable of handling their own money. This self-delusion did lead to the conquest of inflation, but at the price of a surrender of control, in the form of central bank independence. At the time, this may have looked like a good bet, since the demand to find some way, any way to control inflation was widespread. But this surrender has turned out harmful to people and the planet, corrosive to the trust and legitimacy that underpin successful democracies and buoyant economies.

The time has come to recognise this self-delusion for what it is and channel the spirit of Disney: let us re-awaken the power that was within liberal democracies all along and let us return central banking—the final and fundamental control over our money—to democratic politics. This does not mean an overthrow of our economic system, a replacement of markets by GOSPLAN. It does mean, however, that central banking, and with it the financial system, be returned under political control, to be used for democratically chosen ends. It means, in other words, re-embedding the economy within politics. Such a new settlement between democracy and capitalism will no doubt generate other pathologies down the road. But for now, it promises a path to regain control, restore legitimacy, and rebuild confidence—a path that does not lead via Beijing.