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The market economy and the open society: inseparable or incompatible? A historical analysis

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1. Introduction

On the relationship between the market economy and the open society differing views have been voiced. Some scholars argue that the two are fundamentally incompatible. Many others, however, would hold that the two go hand in hand, or even reinforce each other, and are inseparable.

Only few societies use the market as the dominant system of exchange and allocation not only for output, but also for the production factors: land, labour and capital. These societies – labelled market economies here, or capitalist economies[2] – are quite rare in history and they are found particularly in the modern and contemporary period. The United States, the United Kingdom and several counties in continental Western Europe form the main cases. Open societies, defined here as societies with social (material equity, equal opportunities, meritocracy) and political openness (political equity, broad access to decision making, legal impartiality), are also rare in history, since societies with high material inequality and political inequity are the general rule. Again, the countries mentioned are the main examples where this rule is broken earliest and most profoundly, and which can be labeled open societies. The fact that the two overlap seems to endorse the view that the market economy and the open society are inseparable.

The underlying assumption that the economic freedom to act within free markets on the one hand and political and legal freedom on the other hand will, or should, mutually reinforce each other, is elaborated in all kinds of literature. For instance, Friedrich Hayek, in his influential *The Road to Serfdom* (1944), argues how state planning and government coercion, and the associated reduction of free markets, go hand in hand with tyranny and lack of personal freedom.[3] These

[1] I should like to thank Mark Bovens, Rutger Claassen, Ido de Haan, Paul 't Hart and John Komlos for their comments on earlier versions of this paper.
[2] Note that the terms 'market economy' and 'capitalist economy' are often used in a much more loose sense, and mostly only in relation to the prevalence of output markets, which were ubiquitous in history as they are today.
[3] Hayek, *The road to serfdom*, passim. About the influence of Hayek up to the present: Komlos, 'Another road to serfdom'.

ideas were elaborated by Milton Friedman, who states that "political freedom clearly came along with the free market and the development of capitalist institutions" and that – although it is not a sufficient condition - "capitalism is a necessary condition for political freedom".[4] According to Friedman, the market as a kind of natural, self-regulating phenomenon, is able to offer coordination without coercion, it provides economic freedom, permits a wide diversity and prevents the concentration of power. Although Hayek and Friedman in the immediate post Second World War period may have been at the margins of economic thinking, their influence grew, emanating from centres including the University of Chicago,[5] and it resonated with the emphasis placed by Western governments during the Cold War on the link between political and economic freedom.

Especially in the 1970s, these ideas were received by broad groups in society. This applies to free market adherents and neoliberal thinkers and politicians, of course, but also to many outside this sphere. People placing themselves in the political Centre were easily won for the idea that the market would go along with freedom and prosperity. Some of them held that the market would directly generate social welfare, while others argued that social policy should play a complementary role in order to translate economic growth into social welfare. The latter idea was associated with the concept of the social market economy, germinated in Germany in the late-1940's, in which an open, democratic polity through social security measures would translate the economic gains of the free market economy into social welfare.[6] Even the political Left increasingly accommodated to this latter view. The shifting attention of Left-wing politics from economic structures to towards issues of race, gender and socio-cultural emancipation, and the growing stress generally on cultural and economic individualism, and also the implosion of the communist states in Eastern Europe in the 1980s and 1990s, all contributed to this.[7] Even though there were variants, especially regarding the complementary role of social policy, the notion of the compatibility, or even inseparability, of market economy and open society thus became widely shared. Even more than that: it became engrained in the thinking and discourse of journalists, policy-makers and the general public.

Recent institutionalist research has, in the meantime, brought advances in our conceptualization of the market.[8] The field of economic sociology saw the work by Mark

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[4] Friedman, *Capitalism and freedom*, 9-10 (where these citations are taken from) and 13-15.
[5] Van Horn & Mirowski, 'The rise of the Chicago school', in *The road from Mont Pelerin*.
[6] For the genesis of this concept: Goldschmidt & Wohlgemut, 'Social market economy', and for its ordoliberal roots: Ptak, 'Neoliberalism in Germany'.
[7] Lavelle, 'Explanations for the neo-liberal direction'.
[8] Even though earlier decades also saw important work, sometimes forgotten now, including that by Robert Dahl and Charles Lindblom.

Granovetter, who stresses that there are no "free", abstract markets where rational, atomized actors with perfect information operate, contrary to the assumption of many neoclassical economists. Rather, he argues, any market is embedded in society and there are always social relations, rules and hence power disparities at play.[9] Further, there was the revival of institutionalist thinking in economics, as expressed most clearly in the growing influence of the New Institutional Economics, and the works by Douglass North in particular. The resulting studies have highlighted how markets are a web of formal institutions (e.g., property rights, contracting rules) and informal institutions (norms, customs), that is, they are a complex and varying set of rules of the game of exchange, and not a uniform, almost abstract playing field where supply and demand directly meet.[10] Thus, there is not a single, universal type of market, in contract to the abstract market of Friedman, but many different types of markets, each with their own characteristics and their own positive or negative effects, depending on their institutional make-up.

These approaches have opened up possibilities to link the organization and functioning of markets to the interests of social groups and associated power disparities. This is a way to account for the observation that many societies end up with obviously inefficient institutions, as with privileges or monopolies, simply because powerful groups or individuals create and sustain institutional arrangements that support their own interests, or protect their own investments, if necessary at the expense of aggregate welfare. This has resulted in an emphasis on the path-dependency of institutions, often combined with a 'social conflict view' on their development: the notion that institutions are the effect of a confrontation of various social groups.[11] Both views imply that the institutions in place are not automatically the most efficient ones for society at large, and are not easily adapted when economic, technological or ecological circumstances change; they instead best suit the interests of the group or groups in power.

These new institutionalist approaches thus brought incentives to intensify again the academic interest in the interaction between economic and political-social organization.[12] Much of the resulting recent work stresses the link, or even inseparability, of market economies and open societies. Their positive relationship was affirmed especially in some highly influential works that use history as an illustration of their argument. Apparently, reconstructions of long-term

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[9] Granovetter, 'Economic action and social structure'; Fligstein & Dauten, 'The sociology of markets'.
[10] North, *Institutions*; Williamson, 'The new institutional economics'.
[11] This point is made more generally in the literature on political economy, and was forcefully made again by Ogilvie, '"Whatever is, is right"?'. See also: Acemoglu, Johnson & Robinson, 'Institutions as fundamental cause', esp. 427-428.
[12] This had been a flourishing field in the 1950s to 1970s, with the work by Milton Friedman, but also, and rather more critical, by Robert Dahl and Charles Lindblom.

historical development lend themselves best to convey, or even prove, the idea of a positive feedback cycle between open market economies and open societies. Standing out among these grand historical narratives are those by Daron Acemoglu and James Robinson (2012), and by Douglass North, John Wallis and Barry Weingast (2009).[13] The latter make the robust claim that thriving market economies facilitate and sustain the stability of "open access societies", in several ways. Competitive markets provide for long-run economic prosperity and, therefore, promote the stability of the system, which in its turn provides for open markets. Also, the price mechanism of open markets promotes pluralism and civil society, since it signals disturbances and forces governments to act responsibly. Likewise, international competition in open markets removes the possibility that governments will resort to rent-seeking policies and it forces them to offer credible commitments and secure property rights.[14] That history proves the inseparability of market economies and open societies is a point also conveyed in the work by Francis Fukuyama, who aligns himself with those who see history as an evolutionary process of human societies towards liberal democracy and technologically driven capitalism.[15]

Since the publication of these grand narratives empirical historical research has produced much more information and insights about the development of economy and society in the pre-modern period. This paper uses these insights to scrutinize the supposed favourable interaction between market economy and open society. For this, it is relevant, first, to see what the authors mentioned say about the chronology of this favourable interaction. North, Wallis and Weingast date the rise of these open access societies with their open markets and open polities fairly late, in the nineteenth century, as first Britain and the United States made the decisive steps towards this type of society, but the first moves towards it, according to them, were made in the sixteenth to eighteenth centuries.[16] Likewise, Acemoglu and Robinson consider the English Glorious Revolution of 1688 the first, decisive step towards secure property rights, inclusive political institutions, the limitation of the arbitrary power of the king and a market economy.[17] Others, especially those working on Low Countries' history, suggested an even earlier start of these developments. Jan de Vries and Ad van der Woude posited that as early as the sixteenth century the western part of the Netherlands, Holland, possessed a highly developed market economy, characterized by a large degree of market

[13] Acemoglu & Robinson, *Why nations fail*, esp. 76-77; North, Wallis & Weingast, *Violence and social orders*, esp. 129-133.
[14] North, Wallis & Weingast, *Violence and social orders*, esp. 129-132. For the latter argument also: North & Weingast, 'Constitutions and commitment'.
[15] Fukuyama, *The end of history*, esp. p. xii and 60-68.
[16] North, Wallis and Weingast, *Violence and social orders*, 27, 71-72, 83-106.
[17] Acemoglu & Robinson, *Why nations fail*, 102-103.

freedom and efficient markets, and they hinted at the absence of a genuinely feudal past and the weak position of the nobility as the main underlying cause of the rapid growth of these markets.[18] Others associated the late medieval rise of dynamic land, lease and labour markets in the same region to the dissolution of manorialism and other forms of non-economic coercion there, and have shown how these reinforced each other in a positive feedback cycle.[19] Even though there is no unanimity about the direction of causality, with some (Hayek, Friedman) seeing the market and others (Acemoglu & Robinson) political freedom as the starting point, all studies seem to suggest that market development, increasing legal freedom (and the reduction of non-economic coercion) and political equity have reinforced each other, starting in Northwest Europe as far back as the late Middle Ages.

Some of the authors involved warn us that this was not an inevitable development. Still, they all have contributed to sketching out a process of progression or modernization, in which open polities and open markets jointly developed and reinforced each other, a process starting in Northwest Europe in the late medieval period, picking up speed in the modern period and from there spreading across the world. This links up with a more general dominance of linear thinking, in which developments lead to a certain final destination, generally of a positive nature, as found with those writers inspired by Adam Smith, Georg Hegel or Karl Marx, or, more recently, Douglass North and Francis Fukuyama.[20] Perhaps as a result of the Christian, eschatological legacy with which Western thinking is imbued,[21] and strengthened by the solid trust in infinite progress brought by the Enlightenment and the Industrial Revolution, and the associated technological progress, we envisage human history in terms more of linear progression than of cycles. Even those who feel that the combination of market economies and open, equitable societies are only one stage in history, and that the market economy at some point should give way to another allocation and coordination system, including Karl Marx and many who are inspired by him, follow the same type of linear thinking.[22] Most thinking about market economies and open societies is thus characterized by a teleological flavor.

On the basis of a historical analysis of the long-run development of market economies, including those of a more distant past, I reject this linear view. This I do not for the sphere of

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[18] De Vries & Van der Woude, *The first modern economy,* 159-165.
[19] Van Bavel, 'The organization and rise'; Van Bavel, 'The transition in the Low Countries'; Van Zanden, *The long road*, 294-299.
[20] Fukuyama, *The end of history*, esp. p. xii and 60-68; also North, Wallis & Weingast, *Violence and social orders*, despite their assertion that they do not want to tell a teleological story.
[21] Löwith, *Weltgeschichte und Heilsgeschehen*, 211-222.
[22] See for this teleological reasoning: Rigby, *Marxism and history*, 106.

technology, where we indeed do see steady progress over the past centuries, but for the organization of economy and society. Also, I argue that neither of the two positions regarding this organization (that market economies and open societies are inseparable or that they are incompatible) is correct. The relationship between the market economy and the open society is dynamic, as the two interact and alter each other, in a process that for all market economies is strikingly similar and can be best described as a cycle. This will be done by surveying the main historical cases of market economies (section 2), further analyzing the mechanisms within the cycle (section 3), and explaining the absence of effective counterbalances (section 4). Section 5 surveys the present-day developments and concludes.

2. **Historical reconstruction: the cases**

Only very recently, thanks to the progress of historical research, we have gained a better knowledge on early market economies, knowledge not available yet to the scholars introduced above. As far as we can see now, about a dozen cases of market economies existed in history, that is, economies that have the market as the dominant system of exchange and allocation, not only for output, but also for land, labour and capital. The latter is exceptional, and it is what characterizes a market economy, in contrast to markets for output, as these are ubiquitous in history. Of these cases, six have enough data material to be thoroughly analyzed: early modern England, the modern United States and contemporary Northwestern Europe, and – perhaps surprisingly - also early medieval Iraq, medieval Italy, late medieval/early modern Low Countries. Thanks to very recent historical research the latter three cases can now be identified and analyzed as full-fledged market economies [23] The results of the analysis present below show that all of these six cases of market economies at some point could be labelled an open society. It is striking, however, that in all of these cases it was the open society that developed first, not the market economy. Only subsequently, and building on this foundation, a market economy grew. The functioning of the market economy in all of these cases subsequently eroded the open society (first its social and next its political openness) and later shriveled itself, thus resulting in a socio-institutional cycle, in each of the cases taking some three to four centuries in total.

This cycle can be illustrated most specifically by zooming in on the three earliest cases, since these have undergone the full cycle, in contrast to the modern cases that are still underway.

[23] As done in Van Bavel, *The invisible hand?,* where more extensive discussions and references for each of the pre-modern cases can be found.

Moreover, the three early cases all operated more or less in isolation, vis-à-vis possible market economies in other parts of the world. Either no other market economies existed at the time or they did exist in other parts of the world but further away and interaction among them was very weak. Interaction between the modern cases is much stronger, making it more difficult to observe and analyse the cycle in isolation. We will, however, return to the modern cases later on.

One of the early cases is Iraq in the early Islamic period. Land sales in the seventh and eight centuries period became widespread, while leasing and later sharecropping leasing also became important.[24] Much labour was performed within forms of tenancy or independently, but wage labour was also amply employed, both in town and countryside. Moreover, in the ninth and tenth centuries, credit and capital markets started to blossom, with the appearance of large numbers of money changers and merchant-financiers, who employed sophisticated financial instruments.[25] At the same time, the freeing up of land and capital for accumulation through the market, and the profitability of these assets in a market context, increased inequality and furthered the rise of new, elite groups.[26] One group became dominant in Iraq especially in the late eighth and ninth centuries, consisting of large landholding families who also acted as tax farmers, financiers and merchant bankers. They made huge profits, by combining their position in the markets with the acquisition of key positions in the fiscal regime, bureaucracy and finance. These positions were acquired especially through their dominance in financial markets and their capacity to advance cash to a state increasingly starved of liquid means. They thus acquired the political leverage to adapt the rules of market exchange, as they did with labour-renting contracts and sharecropping leases. This further fuelled social polarization. In the next stage, the changes increasingly hampered the functioning of markets, and the economy started to decline, inducing the elites to shift their wealth to non-market uses. This happened especially in the late ninth and tenth centuries, with the growth of tax-farming, the spread of the sale of offices, the growing use of coerced labour, and the immobilization of wealth in pious foundations.

The next case of a market economy is the centre and north of Italy in the late Middle Ages. Here, besides the already existing output markets, markets for land, lease, labour and capital also grew, from the eleventh century. They grew to dominance in the twelfth and thirteenth centuries. By 1300, for instance, up to three-quarters of the agricultural land was leased out on

[24] Van Bavel, Campopiano & Dijkman, 'Factor markets'.
[25] Fischel, 'The origin of banking'.
[26] Ashtor, *A social and economic history*, 109-114, 132-147 and 155-158; Van Bavel, *The invisible hand?*, 61-68 and 72-78.

fixed or sharecropping leases.[27] The main beneficiaries of the market development were the rising urban elites. The fourteenth and fifteenth centuries saw a growing inequality in the distribution of property ownership and political power, in which the urban market elites became dominant, and a growing distortion in the organization of markets, which became skewed towards the interests of the same wealthy urban elite, two developments that strengthened each other.[28] In the fifteenth century, political power in the urban communes came almost exclusively into the hands of the market elites, who owned almost all of the land and capital, dominated the fiscal system and military, and used the political and military dominance of the towns to coerce the surrounding countryside.

Shortly afterwards, in the thirteenth and fourteenth centuries, a similar rise of factor markets took place in the Low Countries. By the sixteenth century, these markets had become dominant and most of the land and very substantial shares of labour and capital were exchanged by way of the market, especially in the regions along the North Sea. Half to three-quarters of the land there was leased out for short terms in competitive lease markets and between a quarter and half of all labour, with peaks up to 60%, was performed for wages.[29] At the same time, and especially from c. 1600, wealth was accumulated by market elites in the large towns, most notably Amsterdam, by amassing landownership and capital and increasingly investing in the public debt. They subsequently strengthened their grip over government, using this to develop coercive means, as overseas through the Dutch East Asia Company.

The following, later market economies do not display a full cycle, since their cycle has not come to the final phases yet and there is a stronger interaction with other market economies, leading to temporary reversal (in the case of England) or the speeding up of the cycle (in the case of Northwest Europe).

England saw the growth of factor markets in the fifteenth and sixteenth centuries. Around 1600, up to three-quarters of all agricultural land was leased through the market, while the proportion of wage workers in the total rural population amounted to between a quarter and a third. In the seventeenth century, many of the remaining customary economic elements were further removed and replaced by the cash nexus, and England became a full market economy, with very substantial and dynamic markets for land, lease and labour.[30] Last to emerge was the financial market, in the late seventeenth century. At that point, investment capital had become

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[27] Cherubini, *Signori*, 73-83, 295-301 and 358-364. For sharecropping: Emigh, *The undevelopment*.
[28] For the early phases: Jones, *The Italian city-state*, 232-244 and 249-255; Cherubini, *Signori*, 450-453 and 538-546.
[29] Van Bavel, *Manors and markets*, 162-213; Van Bavel, 'The transition in the Low Countries'.
[30] Whittle, *The development of agrarian capitalism*, 227-231 and 305-310; French & Hoyle, 'The land market'.

abundant and financial services more advanced, while newly established joint-stock companies offered fresh opportunities for investment and speculation. In this market-dominated context, inequality grew, from the beginning of the nineteenth century at a quick pace. England, however, did not immediately enter the last phases of the cycle yet, as a result of the interaction with the continental European neighbors, where a new cycle started at that point (see below).

In the United States, the development of a market economy or – as some would even have it – a market revolution, took place first in the North-eastern parts,[31] especially in the decades around 1800, as factor markets became more formalized, impersonal, open and voluminous. In rural Massachusetts, for instance, credit and capital markets swiftly rose from c. 1780 onwards.[32] Land markets in the first half of the nineteenth century boomed, and both rural and urban land was frenetically bought and sold, sometimes in speculative markets.[33] Wage labour, too, grew, especially in industries, first through apprenticeship and putting-out systems and later also within industrial sectors in which mass-production emerged, as early as from c. 1810 onwards.[34] Subsequently, in the nineteenth century, wealth inequality grew tremendously, from a level that initially had been low, and large corporations and tycoons came to dominate the economy. The process was temporarily halted by the Great Depression and the Second World War, and the resulting necessity and legitimacy of redistributive policies, but it resumed thereafter.[35]

The most recent market economy is that of continental Northwest Europe, where changes from the 1980s were profound. In a relatively short time span, these countries shifted from being mixed economies, with state and social security sectors of more than half of GDP in the 1970s and a well-developed corporatist organization, to a social variety of market capitalism, in the 1990s.[36] In the years thereafter, this process of marketization proceeded, or even accelerated, and many of these countries turned even more towards market-oriented or Anglo-Saxon type of arrangements. These shifts were in part stimulated by influences and pressures emanating from the United States. To mention a main one: the internationalisation of share ownership, and the growing need to attract foreign investors, especially English and American ones, made it ever harder for companies to resist the urge for shareholder value, as happened

[31] Being the locus of this emerging market economy, whereas the South, of course, displayed a very different social and economic constellation, including the use of coerced labour.
[32] Rothenberg, 'The emergence of a capital market'.
[33] Weaver, *The great land rush*, 76-81; Larson, *the market revolution*, 29, 63 and 71-72.
[34] Sellers, 'The market revolution', 24-28.
[35] More extensively below, section 5, xx-xx.
[36] De Jong, Roëll & Westerhuis, 'Changing national business systems', 778-794.

in the Netherlands from the late 1990s.[37] Gradually, the Northwest European economies are brought in sync with the American or Anglo-Saxon cycle.

It is striking that in all of the six cases the development of the market economy was preceded by a lengthy period of massive social movements that broke the power of a preceding "feudal" elite and brought freedom and relatively high degrees of political equity and material equality. Open societies in each of the cases were formed before a market economy developed. In Iraq, the social and political upheavals in the late Sasanian and early Islamic periods, in the sixth and seventh centuries in particular, had helped to break the ancient power elite of top noblemen and bring into being a relatively balanced socio-political structure, in which townsmen, merchants, clergy and village notables all had a share.[38] Italy saw a period of social and political agitation and change, gaining momentum in the eleventh century, which included mass actions, demonstrations and uprisings, as in Milan, where the merchants and middling groups successfully rebelled against the feudal elites, and likewise in the countryside.[39] In the decades around 1200, after the rise of the craft guilds, many communes, including Florence and Pisa, saw the establishment of regimes with the participation of the *popolo* (roughly the middle classes of merchants, bankers, the self-employed and craftsmen).[40] Likewise, the Low Countries in the centuries preceding the rise of factor markets, saw perhaps the most extensive wave of "silent" revolutions from below, in both town and countryside, with guilds, merchant associations, village communities and common organizations giving agency to ordinary people, a large say in decision-making processes and more equity in economic matters.[41]

England, in 1688, saw the Glorious Revolution, but this event was preceded by a wave of social revolts, in both towns and countryside.[42] These preceding revolts, and also numerous cases of local resistance, had gradually broken the power of the old rural magnates. How (the north of) the United States was built on egalitarian preferences, largely consolidated with the American Revolution is well-known.[43] Again this immediately preceded the rise to dominance of factor markets in the beginning of the nineteenth century. The same chronology holds for continental Northwestern Europe, that had seen a massive wave of self-organization, starting

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[37] Lazonick & O'Sullivan, 'Maximizing shareholder value'; De Jong, Roëll & Westerhuis, 'Changing national business systems', 792-793.
[38] Ashtor, *A social and economic History*, 30-38.
[39] Violante, *La societa Milanese*, 173 ff.
[40] Jones, *The Italian city-state*, passim.
[41] Van Bavel, *Manors and markets*, 94-101 and 111-121; Van Zanden, *The long road*, xx-xx.
[42] Hill, *The world turned upside down*. The emphasis on 1688 placed by Acemoglu & Robinson, *Why nations fail*, 102-103, is thus perhaps too exclusive. See also: Lachmann, *Capitalists*, 180-185.
[43] [Acemoglu & Robinson, *Why nations fail*,]

around 1870, with the foundation and rise of cooperatives, cooperative insurance companies, cooperative banks, farmers' unions, trade unions et cetera.[44] There was also the rise of all kinds of independent bodies, political parties and organizations, representing the interests of various social groups, often including ordinary people, and aimed at acquiring decision-making power and enhancing political equity and the extension of the franchise. The results of this movement in continental Northwestern Europe, a movement that at least temporarily counterbalanced and halted the downfall within the English cycle, were consolidated after the Second World War, with the establishment of social welfare states, immediately preceding to the rise to dominance of factor markets there.

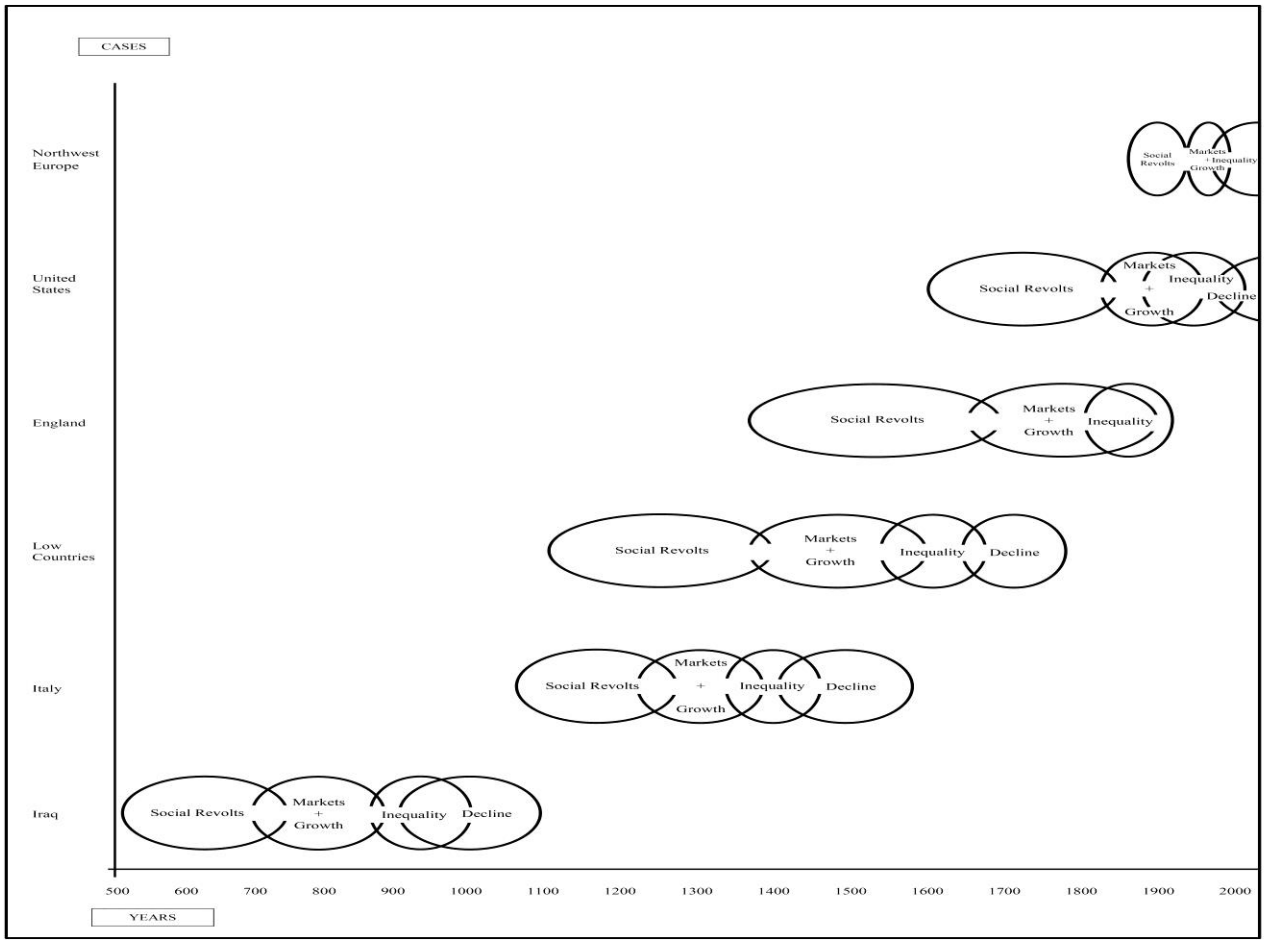

Figure 1 Schematic representation of the stages of the cycle in each of the six cases of market economies.

3. An analysis of the cycle

[44] [Müller-Jentsch, 'Gewerkschaften und Korporatismus'.] Van Zanden & Van Riel, *The strictures of inheritance*, 292-295 and 329-330.

The emergence of factor markets in all of these cases took place within a situation of social balance, that is, a wide distribution of power and property over social groups and people at all levels of society. In all cases analyzed, this balance originated from a series of large-scale social revolts, social upheaval and growing freedom and self-organization of ordinary people, in which the power of old, feudal elites was broken and gave way to a relatively wide dispersal of property and power. At the same time, the systems of exchange and allocation connected to these old elites were undermined or even done away with, whether they were systems of serfdom and manorialism, arbitrary levies by lords or heavy taxation by state elites.

The destruction of these allocation systems also meant that exchange and allocation of land, labour and capital by way of the market became more feasible. The restrictions on the transfer of land, labour and capital that were connected to these older systems and imposed by these older elites, as within the systems of manorialism, state taxation and lordship, were now weakened or removed by the new social groups and associations of ordinary people rising in this period.

The crucial element in the rise and favourable development of these market economies was thus the presence of a social balance, based on a wide distribution of property ownership, relatively wide access to political power and possession of the means of self-organization, which originated in a preceding period of great social upheaval. The balance between the social actors did not yet enable one group to incline the market institutions to their own interests at the expense of others. It also increased the likelihood that individual, private interests and collective, public interests would be aligned. Likewise, this balance explains the positive role played by public authorities and the state, at least in this stage of developments, since no interest group was powerful enough to use the state as an instrument to promote its own, specific interests. On this social and institutional foundation, factor markets rapidly grew.

During this growth, the economic and political role of non-market associations was slowly diminished. These organizations, including the commons and the guilds, which had been mostly formed by independent producers, were built on informal institutions such as mutual trust, cooperative behaviour, desire for equity among their members, and sociability, and they attempted to avoid or alleviate the corrosive effects of the market on the position of the independent producers.[45] Within the nuclei of market development these organizations were slowly eroded, as the roles of guilds and commons were usurped or superseded by the market, and many of these organizations became marginalized or even dissolved. This marginalization

[45] [Van Zanden, *The long road*]; [Jones for the Italian guilds]

often happened through the actions or even outright attacks by the new market elites and public authorities who came to be aligned with these market elites, promoting the further growth of land, labour and capital markets and, indirectly or directly, pushing aside the associations that stood in the way of this further growth.[46]

In the next stage, developments became more negative. New dependencies and hierarchies arose, installed by new market elites who had come to the fore through the functioning of factor markets. The new dependencies they created were now often linked to the market, including the dependency of pauperized wage labourers or debtors on powerful entrepreneurs or creditors, a type of economic dependency growing with the rise of material inequality. In each of the market economies, wealth inequality indeed rose to very high levels. Increasingly, the new market elites started to use their growing economic wealth to turn this into political leverage and, next, used this to introduce "new" forms of inequity, including market monopolies, legal inequality, fiscal exploitation and coercion of labour. The leverage they had acquired through the functioning of factor markets now thus came to be used by these markets elites to get a hold over the wider political and institutional organisation of society, even outside the realm of markets.

Financial markets play a prominent role in this process. At first, the rise of financial markets – always the last factor market to emerge - may have had positive effects, especially on technological innovation and economic growth, since we can assume that they enabled quicker decision-making on investments, a better spread of risks and resources, and they helped to pool capital in order to make large investments.[47] As increasing surpluses were accumulated in the further phases of the cycle, the rise of financial markets became unstoppable and inextricable, while at the same time their nature and effects changed, as they became a goal in itself, that is, they became the easiest and most secure way to make accumulated capital profitable. Financial markets in a way started to dominate and suffocate the real economy. Moreover, not only economic actors but also states became ever more dependent on credit and loans, giving the lenders political leverage, as observed for ninth-century Iraq, the fourteenth-century Italian city-states and the seventeenth-century Dutch Republic.

The mounting public debts in each of these cases formed a main instrument for the new market elites to get a hold on government. With every financial crisis, the position of the government's creditors was strengthened, and gradually they acquired control over public

[46] As with the semi-coerced privatization of commons or the abolition of marginalization of guilds: see the examples in Van Bavel, *The invisible hand?*, 103, 125, 175, 185 and 215-217.
[47] Sylla, 'Financial systems and economic modernization'.

expenditures, taxation and monetary policies and even took over the state, as in the market cores of Genoa and Florence in the fifteenth century.[48] Also, in this phase, the military role of ordinary people dwindled, as their militias or conscript armies were disbanded and replaced by armies of professional soldiers or mercenaries, hired in the labour market and often financed by way of debts contracted in the capital market. The capital and labour markets thus formed crucial elements in the shift from broad participation to the dominance of market elites in the political-sphere.

The political leverage acquired by the market elites led to a deterioration of the institutional organization of the markets. Even if factor markets were initially organized in an open way, and favourable to all participants, a century or two after their rise to dominance there was a tipping point, after which the negative effects came to predominate through the actions of the new economic-cum-political elites who had emerged out of market developments. They invested in retaining the institutional organization of market exchange even in cases where it was no longer conducive to welfare or growth anymore because of changing conditions. In other instances, the quality of this framework of exchange even deteriorated, with markets becoming distorted towards the interests of the market elites, transaction costs rising and accessibility of markets declining. For example, in Florence and Siena in the fourteenth century, as urban market elites had firmly established their economic and political dominance, in legal cases between urbanites and countrymen the courts all too often ruled in favour of the urban landowners, creditors and speculators, thus undermining the security of property rights for the rural population.[49] Also, the costs of litigation and legal aid were raised, making it difficult, or even impossible, for villagers and poorer people to undertake legal action. Likewise, the institutional organization of the sharecropping system, and the way dealings in lease, labour and credit markets were interlinked in this system, became skewed towards the interests of the urban landowners.[50] Another point in case are the oppressive labour laws enacted after the mid-fourteenth century, laws that froze wages, forced labourers to buy their food at high prices from urban vendors and restricted their mobility.[51]

A growing skwedness towards the interests of the wealthy was also found in the organization of the fiscal system, which increasingly benefited the wealthy. Buyers of state bonds, for instance, were often granted tax exemptions, as in seventeenth century Holland, which favoured large-scale owners. Also, taxes predominantly came to be levied on consumption, in

[48] Epstein, *Genoa*, 277-281; Arrighi, *The long twentieth century*, 103-104 and 111-126.
[49] Osheim, 'Countrymen and the law'.
[50] Emigh, *The undevelopment of capitalism*, passim; van Bavel, *The invisible hand?*, 114-116 and 133-134.
[51] Cohn, 'After the Black Death'.

the form of excises, and to a lesser extent on visible wealth, most notably houses and land, and to an even lesser extent on movable capital goods, shares in trade companies and shares in public debts. In the market cores during their last phases these forms of movable wealth, held almost solely by the rich, were not even taxed at all.[52] Since many of the tax revenues were used to pay the interest payments on mounting public debts, as found in all cases during the latter phases of the process, and the shares in the public debts were mainly owned by the wealthy, this system entailed a redistribution from the poorer to the richer parts of the population.

As the institutional deterioration of markets and their diminishing openness led to economic stagnation or even decline, as observed in all these cases, the market elites were forced to further pursue this policy in order to protect their absolute levels of income and wealth. This created a lock-in effect, as it in its turn further contributed to the relative or even absolute decline of the economy in question. At this point, elites there became tempted, or even forced, to develop more non-economic, coercive instruments, in order to maintain their position in society, even if it was at the expense of economic growth.

4. Possible counterbalances and the role of the state

The process of growing economic and political inequality seems to have been inevitable in these cases of fully developed market economies, at least after a certain point of no return. The accumulation of changes in power and property as a result of the negative feedback cycle analysed here slowly pushes the system to a tipping point, even if each of these changes in itself is fairly small. From that point onwards, the system loses its self-correcting ability, and a return to the previous situation is no longer possible.[53] As I will argue in this section, the market system in the last phase cannot count on deliberate interventions from within or without in order to restore the previous situation. I will discuss how two main components play a role in this: the disembeddedness of the market in its outcomes and the capture of the economy by the market elites it generates.

The first component is the result of a fundamental difference between the market and other systems of exchange and allocation such as the family, associations, communities, cooperatives or the state. These other systems, implicitly or even explicitly, have multiple goals, including

[52] van Bavel, *The invisible hand?*, pp. 127 (Holland), 132 (Genoa) and 197.
[53] See for the concept of tipping points: Scheffer, 'Complex systems'.

societal ones, such as achieving security, long-term continuity, sustainability, equity and enhancing the welfare of those involved, and they are expected to achieve several of these goals at the same time, and can be held responsible and accountable for the results by their members or associates.[54] Besides organizing exchange, they are also expected to promote the welfare of its members, to organize reciprocity and redistribution, and to dampen the negative externalities of exchange, in order to achieve these multiple goals. In contrast, the market is merely aimed at economic functions, and lacks these multiple, social goals. Even though the market is socially embedded in its formation and organization, as repeatedly argued by Mark Granovetter and many others,[55] the market is not socially embedded in its ends. One could label this the embedded disembeddedness of markets.

Still, even if the market would not explicitly have these social goals, many would argue that the rise of markets, or capitalism, at least indirectly brings social benefits. This argument is made along several lines. A few authors, including Deirdre McCloskey,[56] claim that markets through generating wealth and cities make people more civilized, and that they even foster and stimulate cooperative behaviour and solidarity, but this claim is contested. Most would argue, instead, that the markets involves competition and the pursuit of self-interests. More widely accepted is the argument that the market generates growth and equity by itself, as it is a neutral, highly efficient system for the allocation of production factors. Also, there is the position that the market offers more agency and freedom to vulnerable groups, including women, as found by Laurence Fontaine.[57] While this may hold for the first phases of development, as women can be co-opted as cheap labour and this may help them in achieving more freedom, the preceding shows that the market in the last phases rather produces inequality and serves as an instrument for oppression and coercion of men and women alike by the new market elites.

Even if the market in the longer run thus does not deliver its assumed benefits, not many people would hold it responsible for their non-delivery. When land, labour and capital become fully commodified, and society is increasingly driven by market ends, this disembeddedness of market outcomes grows.[58] This is especially the case as markets become more complex, competitive, abstract and impersonal, and also with the growth of the scale of exchange, even more so as in these market economies invariably the belief grows that the outcome of open markets is inherently just and equitable and thus need not, or even should not, be opposed.[59] If it

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[54] The classical account: Streeck & Schmitter, 'Community, market, state - and associations?'.
[55] Granovetter, 'Economic action and social structure'.
[56] McCloskey, *The bourgeois virtues*, 4, 23-27, 126-138 and 483. Note, however, that she only loosely defines capitalism and focused more on commodity than factor markets.
[57] Fontaine, *Le marché,* 193.
[58] Gemici, 'Karl Polanyi and the antinomies of embeddedness', 9-10.
[59] A mechanism also applying to present-day democracies: below, xxx-xxx.

is assumed or believed that perfect markets in principle produce efficient and economically justifiable outcomes, and they justly match achievement and reward on the basis of voluntary transactions, as is the case among many political strands, opinion leaders and among the public more generally,[60] there is hardly an incentive to sustain or develop legal, fiscal or juridical counterweights to these outcomes.

In this sense, Karl Polanyi was right to note that economic considerations will dominate the other ones within a market economy, in contrast to other systems of exchange and allocation which enable society and social considerations and values to predominate in the economy.[61] In addition, as remarked above, the market has no membership, and it cannot be held accountable, in contrast to these other allocation systems, whether guilds, associations, communities or nation-states, which mostly possess associated organizations with a membership or citizenship. The more general this membership is, it may be argued, the more likely it is that the pressure of the members to counteract the negative effects of exchange will generate a positive outcome for society as a whole.[62] The market, however, does not possess such a mechanism through membership.

The second component in the absence of counterbalances is central to this paper: the fact that in the course of the cycle described here, those groups and organizations in society who would aim for changing the arrangement of the market in order to balance or reduce negative externalities, gradually lost their economic and political power. Possibilities to ameliorate the effects of the market economy from without are thus reduced. This is also because of the gradual consolidation and entrenchment of the market elite. If an elite is divided by dissent and conflicts, this opens up opportunities for fundamental changes, as argued by Richard Lachmann.[63] The preceding shows, however, that exactly in the last phases of the cycle the market elites instead closed their ranks, also by realigning and combining economic and political interests. Not coincidentally, the historical examples that Lachman provides of the situation in which the elite becomes firmly entrenched, include northern Italy in the Renaissance and the Dutch Republic in the seventeenth and eighteenth centuries, that is, exactly the cases discussed here during their last stages.

The preceding also holds relevance for the probability that modern societal institutions can counterbalance the negative effects of dominant factor markets and this would prevent or mitigate the process at least when it concerns modern democracies. Samuel Bowles suggests that

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[60] Streeck, *Buying time*, 61-63.
[61] Polanyi, *The Great Transformation*, 71-75.
[62] Conversely, the more particularistic these groups are, the less likely or smaller this positive effect (or even negative) on society as a whole will be: Ogilvie & Carus, 'Institutions and economic growth', 428-436.
[63] Lachmann, *Capitalists*, 9, 58-64 (on elite divisions) and 70-72 (on closure).

liberal civic values are fairly robust against the corrosive effects of markets.[64] This is based, however, on his assumption that an open law system and a high level of social mobility keep on underpinning these values, while we have seen instead that the organization of the legal system in the course of the process is affected and that social mobility is declining, with the rise of a well-entrenched market-elite.

Others have placed their hope more particularly in the counterbalancing role of democratic governments. The German proponents of the *soziale Marktwirtschaft* after the Second World War, for instance, voiced optimism about the possibility of having the negative effects of dominant markets counteracted by democratically controlled governments and even translating the assumed gains from market activity into social welfare.[65] The European Union, that has formally committed to being a social market economy, subscribes to the same idea. In a similar vein, others have suggested that a favourable, inclusive political system would be able to prevent a negative feedback cycle between economic dynamics, inequality and politics. Acemoglu and Robinson, for instance, argue that inclusive, pluralistic political institutions, a broad distribution of power and a state that holds a monopoly on violence jointly may provide a check on the concentration of property and production factors.[66] As opposed to this, other scholars, including Wolfgang Streeck, postulate that even modern-day democracies run the risk of succumbing to the pressures exerted by capitalism.[67]

The findings summarized in this paper, using a longer time frame, endorse the latter view. None of the different types of states or government systems in the long run was able to sustain or protect the relatively broad distribution of property and power found initially in these societies that became dominated by factor markets, for instance by devising redistributive mechanisms.[68] Rather, in all these cases, the state increasingly came under the influence of those who benefited most from the market system and did not have an interest at all in redistribution. This becomes clear when looking more closely at the role of the state in the process and how this role shifted over time.

In the first phase of the cycle, in each of these cases, the role of the state was not yet very prominent, and it figured next to all kinds of other organizations and associations that fulfilled semi-public roles. These associations did so either directly within their sector or community or

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[64] Bowles, 'Liberal society', 50, 70 and 75-78.
[65] Goldschmidt & Wohlgemuth, 'Social market economy'. This optimism is shared by Komlos, 'Another road to serfdom', 496-499.
[66] Acemoglu, Johnson & Robinson, 'Institutions as a fundamental cause', 395-396; Acemoglu & Robinson, *Why nations fail*, 74-81 and passim.
[67] Streeck, 'The crises'. 25-28. See also: Merkel, 'Is capitalism compatible with democracy?'.
[68] This leaves open the possibility that such counterforces may prevail in societies that have factor markets but not dominant ones.

indirectly through the local governments they controlled.[69] In the second phase, that of rising factor markets, states together with local administrations started to act as the guarantor for the protection of property rights to land, labour and capital, which was vital in reducing insecurity and transaction costs.[70] In this way, states indirectly promoted the rise of factor markets. Also, they increasingly stimulated the rise of markets in more direct ways, induced to do so because of fiscal reasons. These markets, with the associated monetization and the commodification of land and labour, enabled them to tap resources and tax transactions and wealth more easily than with other forms of exchange and allocation, such as barter or communal redistribution. Also, the markets allowed the mobilization of capital and labour to fulfil the state's needs, for instance in infrastructural works and military operations. Especially where states did not have access to resources in a direct way, or by way of coercive means, markets formed an apt road to accessing them.[71] In a yet later stage, the states themselves came under the dominance of the market elites, through public debts, acquisition of state offices and the other processes highlighted above, and still later they even became instruments of coercion by these elites. Through the state, these elites used capital and labour markets, and bent the organization of these markets, in order to exercise control over economy and society. This is most strongly expressed in the use of hired soldiers, whose salaries were financed by way of public debts and who were hired in order to crush popular revolts against the market elites or the states dominated by them.

In the process, factor markets cum market elites and states cum state elites came to overlap and make each other stronger, instead of counterbalancing each other. This is what Fernand Braudel labels the "triumph of capitalism". At this stage, capitalism became identified with the state, and capitalist elites even became the state, a process Braudel illustrates by pointing to the same cases as discussed here: the Italian city states, the Dutch Republic and later England.[72] Factor markets cum market elites and states cum state elites jointly tended to destroy the self-organization of ordinary people. States in the process needed factor markets to strengthen themselves (by way of public debt and hired soldiers) and market elites needed strong states to defend their property rights, even more so in the face of growing inequality and the resulting need for repression of the disadvantaged. Each of the cases discussed saw growing state repression, armed violence and warfare by states and public authorities, now dominated by market elites, in the last stage of the cycle. It is telling that this was done after the militias of ordinary people were replaced by professional soldiers,[73] hired in the market and being more

[69] Except for the case of Iraq, where imperial rule and state bureaucracy were stronger from the outset.
[70] Along the lines of North, *Institutions*; but not as part of a linear or teleological development.
[71] See for ancient economies: Garraty, 'Investigating market exchange', 20-24.
[72] Braudel, *Afterthoughts*, 64-65.
[73] For late medieval Italy: Caferro, 'Warfare and economy'.

dependent on their employers than the independent producers in the former militias were. Here, again, markets were an integral part of the dominance of the market elites, now also acquired in the political-military domain.

These changes in the political constellation in their turn, in a feedback loop, also affected the markets. The new market elites used state power and coercion to maintain or further increase their profits. In the process, by establishing monopolies, by consolidating oligopolistic positions in the market, by skewing the legal framework, by dominating the judiciary, by creating linkages between markets, by introducing coercive elements in the labour market, etcetera, they increasingly hindered the open and free functioning of markets. The market economy was, as it were, taken hostage by these elites, through their growing economic weight and also their hold on state power. This happened even in a context with strong representative bodies, estates or a parliament, as these became part of the process instead of being able to counteract it.[74] Thus the state did not offer a check on developments, but instead, it became an essential part of them. It is telling that this applies to all cases of market economies, including the modern ones, even if the type of political organization differed widely between them. The result is an ongoing and virtually unstoppable cycle.

5. Conclusions and outlook to current developments

In all of these cases of market economies, an open society developed first, with massive social movements creating freedom, relative economic equality and relatively broad access to political decision-making for ordinary people. On the basis of this, and through the opening up of land, labour and capital as a result of the breaking of the previous "feudal" or coercive elites, a market economy developed. The dynamism of the market, combined with the opening up of land and capital for accumulation through the market, led to material inequality, as a result of market competition and the ways the market enabled a few groups to privatize and accumulate land and natural resources, financial assets, and services, and to make them profitable. Next, the process engenders growing political inequality, as these new market elites translate their economic wealth into political leverage. In the last stage of this cycle, taking roughly three or four centuries in total, they employed this power to skew the institutional framework of markets and political decision-making, going along with growing coercion and unfreedom. Also, people start to retreat from the market, and factor markets shrivel again. So, first the

[74] Compare for the Middle Ages: Ogilvie & Carus, 'Institutions and economic growth', 419-426. See for the pre-modern cases section 2, xxx-xxx, and for the modern ones section 5, xx-xx.

open society is eroded, starting with the social openness and followed by the political openness, and next the market economy itself implodes.

The crucial variable in the relationship between markets economies and open societies is the social distribution of property, or the wealth distribution, an element missing in most neoclassical and neo-institutional analyses of the link between market economies and open societies. As the historical analyses show, the tipping point in this relationship is reached when a market economy produces a high level of wealth inequality, and it is passed when the owners translate this wealth into political leverage.

This analysis differs from the current emphasis on income inequality. The distribution of income may be highly relevant for the viewpoint of social justice, consumption opportunities, societal cleavages, anxiety and the economic growth potential, but for the process under scrutiny here it is much less relevant than that of wealth. Wealth concerns the ownership of the building blocks of life: land and natural resources, and capital. Whereas non-market systems of allocation potentially act as powerful brakes on accumulation of land and capital, the dominance of markets for land, labour and capital helps elites, or nascent elites, to break up restrictions on the accumulation of land and capital, to better gain access to surpluses and to acquire and accumulate more capital and land. Moreover, wealth concerns a stock and not a flow, and it can be unendingly accumulated, and, in contrast to income, it can be transmitted through inheritance, thus solidifying inequalities. This leads to distributions that are far more skewed than those regarding income. In market economies in their last stages, even though they had a relatively equal distribution of wealth at the beginning of the cycle,[75] many households have no wealth at all, while a few amass wealth hundreds, thousands or even ten-thousands of times larger than modal wealth.

It is especially this very large wealth that is relevant for the process analyzed here, as it offers power. Firstly, it offers the economic power to decide on the allocation of land, resources and capital, while in a market-dominated context characterized by high wealth inequality it also controls the only way that labour can be made profitable. The idea pushed by Friedman was that the market would offer decentralized decision-making power,[76] but a dominant market economy combined with high wealth inequality rather centralizes decision-making power, into the hands of the few owners of very large wealth. Secondly, and even more importantly for the process under scrutiny here, large wealth can easily be transformed into political influence.

[75] This type of societal contextualization is perhaps underrepresented in the great study by Piketty, *Capital*, with its focus on general laws that seem to be applicable to all types of societies.
[76] [Friedman, *Capitalism and freedom*.]

Opportunity costs of investing in political leverage are far lower for large wealth than for large income, as the differential is much larger. Moreover in a market-dominated context with high wealth inequality the gains of policy changes regarding the exchange and use of land, labour and capital are relatively large for possessors of large wealth, even for individual ones, let alone for groups, organizations or corporations that combine the interests of several of them.

The preceding reconstruction of historical cases may lead to the intuition that there is a certain or level of wealth inequality where this mechanism of conversion of economic wealth into political leverage starts to occur and the tipping point in the process is surpassed. In view of the different historical contexts is would be wrong to suggest that this level of wealth inequality can be pinpointed in absolute terms, but when we look at the previous market economies with hindsight, we can see that the Gini coefficient for wealth inequality reached levels of 0.85 (Amsterdam, 1630, Florence 1427) or even more (Iraq, early tenth century) at the point where the downward phase of the cycle started.[77] Similar levels are reached now again in the Western market economies. The distribution of private wealth in the United States but also in Germany, the Netherlands and Sweden is at levels of 0.9 again. To be sure: non-market economies can also attain such high levels of wealth inequality, although not often, but the crucial point here is that these market economies initially had relatively low levels, forming the foundation of their growth, but in the process moved to the high end of the distribution, allowing for a translation of this economic wealth into political leverage and thus the erosion of the open society that formed the foundation of the same market economy.

Many thinkers, however, would suggest that our modern societies are more robust and less susceptible to this next phase in the development of market economies, that is, the translation of this material inequality by market elites into political leverage. They point to the counterweights offered by political and legal institutions, by the popular will and vote and by democratically elected governments.[78] There are two reasons to doubt whether modern Western democracies are uniquely shielded from this effect, however. First, this would be an underestimation of the political equity and broad decision-making power in the other market economies discussed. Each of these belonged to the most equitable societies of their times. The Italian city-republics in the thirteenth century offered substantial shares of the population, around half of all heads of households, access to political decision-making and even self-rule, a system that was built on a thriving civil society, with associations, guilds and fraternities

[77] Goldsmith, *premodern financial systems*, 153-154 and 204-206; Van Bavel, *The invisible hand?*, 72-73, 128 and 194-195.
[78] See section 4, xx-xx, and the studies by Bowles, Acemoglu & Robinson and Goldschmidt & Wohlgemut mentioned there.

offering organizational power to ordinary people.[79] The level of self-organization and broad influence on decision-making was arguably even higher in the late medieval Low Countries, where most of the decision-making was located in independent bodies formed, governed and staffed by ordinary people, including water management organizations, guilds, village and town communities, commons, hospitals, etcetera.[80]

Second, we actually do see in the northern Atlantic market economies with their democratic systems how material inequality is translated into political leverage. This applies most conspicuously to the United States, where the present cycle started earliest, and which had become a market economy in the first half of the 19th century, but to a growing extent this also applies to Western Europe, where the current cycle started later, but is sped up by, or even absorbed by the United States' one. Wealth inequality in the United States has been rising since the late 1970's, with the top 0.1% expanding its share in total wealth from 7% in 1978 to 22% in 2012.[81] To what extent is this wealth really translated into political leverage? This risk that American public policy would become the captive of big business and wealth through lobbying, political donations and shared interests, was already a concern to some in the 1960s.[82] There are reasons to think this concern has materialized in the 2000s and 2010s.

Several ways exist along which the economic wealth of market elites in the United States, and increasingly also in Northwest Europe, is translated into political leverage. A main mechanism is through lobbying and political donations, activities that are highly stratified among individuals and even more among organized interests, and thus skewed towards the interests of large wealth. In 2012, some 40% of individual campaign contributions was made by the top 0.01% of donors, a share having risen from some 10% in the early-1980's.[83] Legislation to counteract the effect of large wealth on political elections was passed in the 1970's but is easily circumvented. Large sums are also spent on lobbying. In 2009, this was some $3.5 billion, often used in ways invisible for the public, for instance through offering technical or legal input to civil servants or politicians.[84] The legal freedom to use economic resources to influence political outcomes is large in the United States, while at the same time the societal

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[79] Jones, *The Italian city-states*. 499-519.
[80] Van Bavel, *Manors and markets*, 93-123.
[81] Saez & Zucman, 'Wealth inequality in the United States'.
[82] A concern expressed by President Dwight Eisenhower in his last presidential address in 1961: Reference
[83] Bonica, McCarty, Poole & Rosenthal, 'Why hasn't democracy', pp. 111-112; Nownes, *Interest groups in American politics*, pp. 141-157.
[84] [Baumgartner, Lobbying and policy change]; Anthony Nownes, *Interest groups in American politics*, pp. 92-96; K.L. Schlozman, *The unheavenly chorus*, 19-21, 282-288 (figure on p. 283) and 305-308 (on donations).

counterweights offered earlier by unions, cooperatives and other organizations representing ordinary people are reduced in strength.

The translation of wealth into political leverage also works through the ownership of media, as in the case of the Fox Network and the News Corporation, owned by billionaire Rupert Murdoch.[85] Murdoch controls an important switch board between political, economic and media interests, allowing him to influence public opinion and, by using his wealth, to intervene in the political sphere, as with shaping regulatory decisions affecting his economic interests.[86] The impact of economic elites and organized business interests on the United States government policy is substantial. Average citizens may sometimes seem to get their preferred policy outcomes, but a statistical analysis shows that they actually have little or no independent effect on policy at all.[87]

The outcome of political decision-making in recent decades is indeed very much skewed towards the interests of wealth owners, as with the reduction of corporate tax rates, lowering of wealth taxes and the reduction or abolition of the inheritance tax. In all Western market economies, the weight of inheritance taxes has shrunk to insignificance since the 1970s and makes up only a very small share of total state revenues, usually lower than one percent.[88] Also, restrictions on the investment and mobility of capital have been removed, while the resulting international competition in financial markets, in turn, has forced many Western governments have to adopt a milder fiscal regime for the capital of private owners and businesses.[89] These policy shifts all concern taxes on wealth: the result is a further increase of wealth inequality and a strengthening of the feedback loop.

There are also more indirect, non-political ways in which material wealth is translated into political leverage. Liquid financial markets and high public debts, found with all market economies in the last stages, have made states dependent on the trust of creditors, that is, wealth owners, they continuously have to satisfy.[90] Although there are many holders of government bonds, the distribution measured in volume is very skewed. This offers the owners of this wealth leverage vis-à-vis the indebted governments, indirectly through the threat of shifting their capital and directly through the actions of large investment funds.[91]

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[85] [Bartels in: Skocpol (ed.), *Inequality and American democracy*].
[86] Arsenault & Castells, 'Switching power'.
[87] Gilens & Page, 'Testing theories of American politics'.
[88] Bertocchi, 'The vanishing bequest tax'.
[89] Devereux, Griffith & Klemm, 'Corporate income tax reforms'.
[90] Streeck, *Buying time*, 72-96. For the following: Hager, 'What happened to the bondholding class?'
[91] Streeck, 'The crises'; Merkel, 'Is capitalism compatible with democracy?, 120-121.

Then there is the indirect influence by way of think tanks, many of them funded by wealthy individuals and corporations (Volker, Koch), and by transnational organizations, including the International Monetary Fund, the World Bank and the World Trade Organization, organisations which are easier influenced by wealth than similar organisations at the national level, and which have inspired, or even forced countries to liberalize and deregulate markets and privatize services. The idea that shareholders' value should be dominant over stakeholders' interests, for instance, was propagated by the Organisation for Economic Cooperation and Development, as it declared in 1999 that corporations should principally be run in the interests of the shareholders.[92] Again, these shareholders are the owners of wealth.

In this process, the opportunities of wealth are ever further enlarged, while obstacles or taxation are reduced. A possible exception is a situation of mass mobilization in times of war. During the two World Wars and the Cold War the military role of ordinary people as soldiers was a main motivation of governments to accommodate their desires. More specifically, recent research shows that the only period that democracies substantially increased the inheritance tax – crucial in breaking the permanency of large wealth – was during mass mobilization for a war.[93] Democracy, and the widening of the franchise, did by itself not lead to substantial and progressive inheritance taxes, not even in a context of high wealth inequality. This is relevant for present developments, as in Western market economies drafted civilians in recent decades are increasingly replaced by professional soldiers and, later, hired security personnel.[94] The process goes along with a further privatization of state violence, with a growing role of large security companies, and a replacement of capital goods (costly arms, drones, robots) for people. A potential counterforce to the dominance of market elites is thus removed, or even turned into a component in the growing influence of private wealth in present market economies.

The preceding shows that even democracy does not shield a modern market economy from losing many of its characteristics of an open society, most notably its material equity and equal chances, but later on also its political equity and broad access to decision-making. Even the democratic political system itself is, along several lines, in danger of being captured by large wealth: through large campaign donations, funding of lobbying activities, media ownership, financial markets and ownership of public debts and its prominent role in transnational organizations and military organization. As the effect is the enlargement of the profitability of

[92] Lazonick & O'Sullivan, 'Maximizing shareholder value', 14.
[93] Scheve & Stasavage, 'Democracy, war and wealth'.
[94] Avant, *The market for force*.

wealth and a reduction of the taxation of wealth, and thus the further growth of large wealth, this is a self-reinforcing process.

This paper, by adopting an historical perspective, helps to avoid an one-sided view on the relationship between the open society and the market economy. It shows how in an early stage of the cycle, in the United States largely spanning the nineteenth century and first half of the twentieth century and in Western Europe large parts of the twentieth century, the two actually did go hand in hand. The historical perspective of this paper also helps to see why the paradisiacal situation of that period was not a kind of final destination of human development, but a temporary state that we now are losing, just like in all earlier market economies. There is, therefore, not a fundamental incompatibility or compatibility of the market economy and the open society, but a dynamic relationship, as the two interact and alter each other, in an endogenous process that slowly develops from a positive interaction to a negative one.

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