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Open societies before market economies: Historical analysis

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Abstract

It is often assumed that the market economy and the open society reinforce each other and have risen together. Even those who are more skeptical about their long-run compatibility will usually agree that the rise of the two was part of a process of modernization, starting in early modern England and unfolding in the modern West. This article builds on the latest historical research to reject this assumption. It shows that several market economies existed much earlier in history. These were all preceded by social movements generating a more open society. In each of these cases, the functioning of the market economy slowly eroded social and, next, political openness, and later shriveled itself again. This endogenous, cycle-like process, in which the interaction of the market economy and the open society developed from positive to negative, may also be seen in modern cases, including the present USA.

Key words: capitalism, economic development, economic history, economic systems, institutional political economy

JEL classification: N0 economic history, P16 political economy, P51 comparative analysis of economic systems

1. Introduction

Only a few societies use the market as the dominant system of exchange and allocation not only for output but also for the production factors: land, labor and capital. These societies—labeled market economies here—are quite rare in history and they are found particularly in the modern period. The USA, the UK, several counties in continental Western Europe and several Western offshoots form the main cases—when applying the strict definition of 'market economy' proposed here. Open societies—societies with relatively high levels of social openness (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

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(North *et al.*, 2009). Again, the countries mentioned are the main cases 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. Friedrich Hayek, in *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 (for the influence of Hayek up to the present: Komlos, 2016). These 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' (Friedman, 1962, pp. 9–10). He sees the market as a natural, self-regulating phenomenon that can offer co-ordination without coercion, provides economic freedom, permits a wide diversity and prevents the concentration of power.

Especially in the 1970s, these ideas were accepted by broad groups in society. People placing themselves in the political Centre were easily won over to 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-1940s: an open, democratic polity through social security measures would translate the economic gains of the free market economy into social welfare (Goldschmidt & Wohlgemut, 2008). Even the political Left increasingly accommodated this latter view. The shifting attention of Left-wing politics from economic structures 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. Even though there were variants, especially regarding the extent 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 ingrained in the thinking and discourse of journalists, policy-makers and the general public.

In the past decades, the markets were often seen as abstract playing fields. Recent research, however, has brought institutions and social relations back to center stage in the conceptualization of the market. The field of economic sociology saw the work by Mark Granovetter (2001), who stresses that there are no "free", abstract markets where rational, atomized actors with perfect information operate, as markets rather are embedded in society and there are always social relations, rules and hence power disparities in play. 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 (Acemoglu *et al.*, 2005). Thus, there is not a single, universal type of market, in contrast to the abstract

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market of Friedman, but many different types, each with their own characteristics and their own positive or negative effects, depending on their institutional make-up.

These approaches have opened up opportunities to link the organization and functioning of markets to the interests of social groups and associated power disparities, and hence explain how it happens that many societies end up with obviously inefficient institutions, as with privileges or monopolies, because powerful groups or individuals create and sustain institutional arrangements that support their own interests, 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 (Acemoglu *et al.*, 2005, pp. 427–428). 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; instead, they best suit the interests of those in power.

These new institutionalist approaches rekindled the academic interest in the interaction between economic and political–social organization. The resulting recent work again mostly 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. Most notable among them are the grand historical narratives by Daron Acemoglu and James Robinson (2012), and by Douglass North, John Wallis and Barry Weingast (2009). The latter state that thriving market economies facilitate and sustain the stability of "open access societies". Competitive markets provide for long-run economic prosperity and thus promote the stability of societal organization. Also, the price mechanism of open markets signals disturbances and thus forces governments to act responsibly. Likewise, international competition in open markets prevents governments from resorting to rent-seeking policies, and it forces them to offer credible commitments and secure property rights (North et al., 2009, pp. 129–132).

Since the publication of these grand narratives, however, empirical historical research has yielded much more information and new insights about the development of pre-modern economy and society. This paper builds on the institutional approaches developed by North, Acemoglu and Robinson, but uses these recent historical insights to scrutinize the supposed favorable interaction between market economy and open society and the teleological flavor found in much of this and the related literature.

In order to do so, it is relevant to first see what these authors say about the chronology of this favorable interaction. North *et al.* (2009, pp. 27, 71–72, 83–106) 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 USA 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. Likewise, Acemoglu and Robinson (2012, pp. 102–103) 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. Others inspired by this literature, and especially those working on Low Countries' history, suggested an even earlier start of these developments. They have associated the late medieval rise of dynamic land, lease and labor markets in the same region with the dissolution of manorialism and other forms of non-economic coercion there, and have shown how these reinforced each other in a positive feedback loop (van Zanden, 2009, pp. 294–299;

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van Bavel, 2010, pp. 86–92 and 173–176). 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 have all contributed to sketching out a process of progression, in which open polities and open markets jointly developed and reinforced each other. This links up with a more general dominance of linear or even teleological thinking, in which developments lead to a certain final destination, generally positive, as found with great thinkers like Adam Smith, Georg Hegel and Karl Marx or, more recently, Douglass North (despite the assertion of the latter in North *et al.*, 2009 that he does not want to tell a teleological story). Strengthened by the trust in infinite progress brought by the Enlightenment and the Industrial Revolution, and the associated technological advances, 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 is 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 inspired by him, follow the same type of linear thinking (Rigby, 1998, p. 106). Most reasoning about market economies and open societies thus—explicitly or more often implicitly—adheres to the idea of linear progression.

Karl Polanyi deserves a special place among the big thinkers about the market economy. His magnificent account of its nature and development (2001, orig. 1944) has been very influential, especially among non-historians, and it was a successful antidote to the propensity of scholars at the time to see markets and market economies everywhere. Less productive, however, was his assertion that a real market economy emerged only in the nineteenth century, and particularly the second quarter of that century in England, and that this happened in tandem with the rise of the modern state. As a result of this, Polanyi, probably inadvertently and while not himself adhering to a unilinear view of historical evolution, contributed to the notion that the rise of the market economy was part of a modernization process, spearheaded by England in the modern period. This is still the dominant view, even though it is crafted by non-historians and based on the limited knowledge of earlier societies which we had many decades ago, and as such it forms a main component in many of the unilinear accounts of historical development.

On the basis of recent empirical work and a historical analysis of the long-run development of market economies, including those of a more distant past, I reject this linear view. Also, I argue that neither of the two positions regarding the relation between market economies and open societies (that they are inseparable or that they are incompatible) is correct. Their relationship 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 argument will be made by surveying the main historical cases of market economies (Section 2), further analyzing the mechanisms behind their rise (Section 3) and those behind the downward phase in their development (Section 4), and explaining the absence of effective counterbalances (Section 5). Section 6 surveys the present-day developments and concludes.

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2. Market economies: the historical cases

Only very recently have we gained a better knowledge of early market economies. Thanks to the latest empirical research of economic and social historians about a dozen historical cases of market economies have come to light—that is, economies that have the market as the dominant system of exchange and allocation, not only for output, but also for land, labor and capital. In contrast to markets for output, which are ubiquitous in history, the latter is exceptional, and this dominance of markets in the allocation of inputs is what characterizes a market economy in my definition. This is a strict definition, which limits the number of market economies, especially compared to studies using the term “market economy” or “capitalist” in a looser way, including for economies where input markets exist—as they almost invariably do—but are not dominant in the allocation of land, labor and capital. By restricting the analysis to these cases, the following may help us to gain more insight into the functioning and development of the market economy than analyses for more mixed economies would.

Of the cases of market economies identified now, six have enough data to be thoroughly analyzed: early modern England, the modern USA and contemporary Northwestern Europe, and—perhaps surprisingly—early medieval Iraq, medieval Italy, late medieval/early modern Low Countries (see Figure 1). Thanks to very recent historical research the latter three cases can now be identified and analyzed as full-fledged market economies (as done in van Bavel, 2016, where more extensive discussions and references for each of the pre-modern cases can be found). The results of the analysis presented below show that all of these six cases of market economies at some point could be labeled an open society. It is striking, however, that in all of them it was the open society that developed first. It was only subsequently, and building on this foundation, that 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 gradually shriveled itself, a process resulting in the socio-institutional characteristics (distorted and weak markets, high-economic inequality, social closure and political inequity) which had prevailed before the emergence of the open society. The whole of this development, which can be described as a socio-institutional cycle, in each of the cases took some three to four centuries.

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 under way. Also, the first three 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 existed further away and interaction was very weak. Interaction between the modern cases is much stronger, making it more difficult to observe and analyze the cycle in isolation.

One of the early cases is Iraq in the early Islamic period. Land sales in the seventh and eighth centuries became widespread, while leasing and, later, sharecropping leasing also became important (van Bavel *et al.*, 2014). Much labor was performed within forms of tenancy or independently, but wage labor was also widely employed. In the ninth and tenth centuries, credit and capital markets started to blossom, with the appearance of money changers and merchant-financiers. 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 (Ashtor, 1976, pp. 109–114,

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132–147, 155–158; van Bavel, 2016, pp. 61–68, 72–78). One group became dominant, 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. Through their dominance in financial markets, also vis-à-vis the state, they acquired the political leverage to adapt the rules of market exchange, as they did with labor-renting contracts and sharecropping leases. This further fueled 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 labor, 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, labor and capital also grew, from the eleventh century. By 1300, up to three-quarters of the agricultural land was leased out (Cherubini, 1974, pp. 73–83, 295–301, 358–364; Emigh, 2008). 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 (for the early phases: Jones, 1997, pp. 232–244 and 249–255; Cherubini, 1974, pp. 450–453 and 538–546; for the labor market: Cohn, 2007). In the urban communes, which in the twelfth and thirteenth centuries had seen a large degree of participation and access to decision-making for the middle classes (Jones, 1997, pp. 103–134 and passim; Section 3 below), the political power now came almost exclusively into the hands of a small market elite, 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 countryside.

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 substantial shares of labor 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 labor, with peaks up to 60%, was performed for wages (van Bavel, 2010, pp. 162–213). At the same time, and especially from c. 1600, wealth was accumulated by small market elite in the large towns, most notably Amsterdam, by amassing land ownership and capital and increasingly investing in the public debt. They subsequently strengthened their grip on government, in the course of the seventeenth century giving rise to a clique of regent-rentiers (Adams, 2005, pp. 39–42 and 69–72; van Bavel, 2016, pp. 192–200). Political counterweights, as had been offered earlier by the numerous local associations that had offered access to decision-making to large segments of the population (van Bavel, 2010, pp. 94–121; Section 3 below), were now eroded, or they became captured by elite members. These also used their dominance over the state apparatus to develop coercive means, as most notably overseas through the Dutch East India Company (Arrighi, 1996, pp. 151–158; Adams, 2005, pp. 49–58).

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These market economies all underwent a full cycle. The later ones did not, since their cycle has not come to the final phases yet or is subjected to a strong 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 labor (Whittle, 2000). Last to emerge was the financial market, in the late seventeenth century. At that point, investment capital had become abundant and financial services more advanced, while new joint-stock companies offered fresh opportunities for investment and speculation. In this market-dominated context, inequality grew from the beginning of the nineteenth century. England, however, did not immediately enter the last phases of the cycle, as a result of the interaction with continental Europe, when a new cycle started (see below).

In the USA, the development of a market economy or—as some would even have it—a market revolution, took place first in the Northeastern parts, while the South displayed a different social constellation, including the use of coerced labor (for the South: Larson, 2010, pp. 127–134 and 148–162). Developments were rapid especially in the decades around 1800, as factor markets became more formalized, impersonal, open and voluminous. In rural Massachusetts, credit and capital markets swiftly rose from c. 1780 (Rothenberg, 1985). Land markets in the first half of the nineteenth century boomed, and land was frenetically bought and sold, sometimes in speculative markets (Larson, 2010, pp. 29, 63 and 100–103). Wage labor 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 c. 1810 (Sellers, 1991, pp. 24–28; Larson, 2010, pp. 63–75 and 112–116). Subsequently, in the nineteenth century, wealth inequality grew tremendously, and large corporations and tycoons came to dominate. 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 (more extensively: Section 6).

The most recent market economy is that of continental Northwest Europe, where changes from the 1980s have been profound. In a relatively short time, 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 (De Jong et al., 2010, pp. 778–794). In the decade thereafter, this process of marketization proceeded, with several of these countries shifting towards becoming liberal market economies. These shifts were in part stimulated by pressures emanating from the USA. To mention a main one: the internationalization 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 in the Netherlands from the late 1990s (Lazonick and O'Sullivan, 2000; De Jong et al., 2010, pp. 792–793). Gradually, the Northwest European economies are brought more in sync with the American or Anglo-Saxon cycle.

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3. The start of developments: social movements and self-organization

It is striking that in all six cases the development of the market economy was preceded by a lengthy period of massive social movements that broke the power of a '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 (Ashtor, 1976, pp. 30–38). Italy saw a period of social and political agitation and change, gaining momentum in the eleventh century, which included mass actions, demonstrations and uprisings. 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 middle classes of merchants, bankers, the self-employed and craftsmen (Jones, 1997).

Likewise, the Low Countries in the centuries preceding the rise of factor markets saw perhaps the most extensive wave of 'silent' revolutions from below, with large numbers of guilds, merchant associations, village communities and commons being formed in the thirteenth and fourteenth centuries (van Zanden, 2009, pp. 50–55, 293–296; van Bavel, 2010, pp. 94–101, 111–121). Through their elections, deliberations and council meetings, they offered large segments of the population access to decision-making, and even the opportunity to serve as a board member, and they gave agency to ordinary people. Both in Italy and the Low Countries the results of social movements and self-organization by ordinary people were thus realized most conspicuously at the local level, outside the sphere of the state, and before the rise to dominance of factor markets (see Somers, 1993, for early modern England).

For England, regarding socio-political changes, most general literature puts a lot of emphasis on the central state level and on the famous Glorious Revolution of 1688 (Acemoglu and Robinson, 2010, pp. 102–103). However, a closer look reveals how this political event was preceded by a wave of social unrest and revolts (Whittle, 2000, pp. 276–315 for Norfolk; Lachmann, 2000, pp. 180–185). This was combined with a strong current of self-organization and broad participation, particularly in the pastoral areas of England (Somers,1993). In the course of the fifteenth to seventeenth centuries, these components all gradually undermined the position of the old feudal elite and broke its arbitrary, coercive power. How (the north of) the USA was built on egalitarian preferences, largely consolidated with the American Revolution, is well-known. Again this immediately preceded the rise to dominance of factor markets at the beginning of the nineteenth century. The same chronology holds for continental Northwestern Europe, which had seen a massive wave of self-organization, starting around 1870, with the foundation and rise of cooperatives and unions (van Zanden and van Riel, 2004, pp. 292–295 and 329–330). There was also the rise of all kinds of independent bodies, political parties and organizations, 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 English cycle—were consolidated after the Second World War, with the establishment of social welfare states, immediately preceding the rise to dominance of factor markets there.

The emergence of factor markets, and their rise to dominance, thus in all of these cases took place within a situation of social balance, that is, a wide distribution of power

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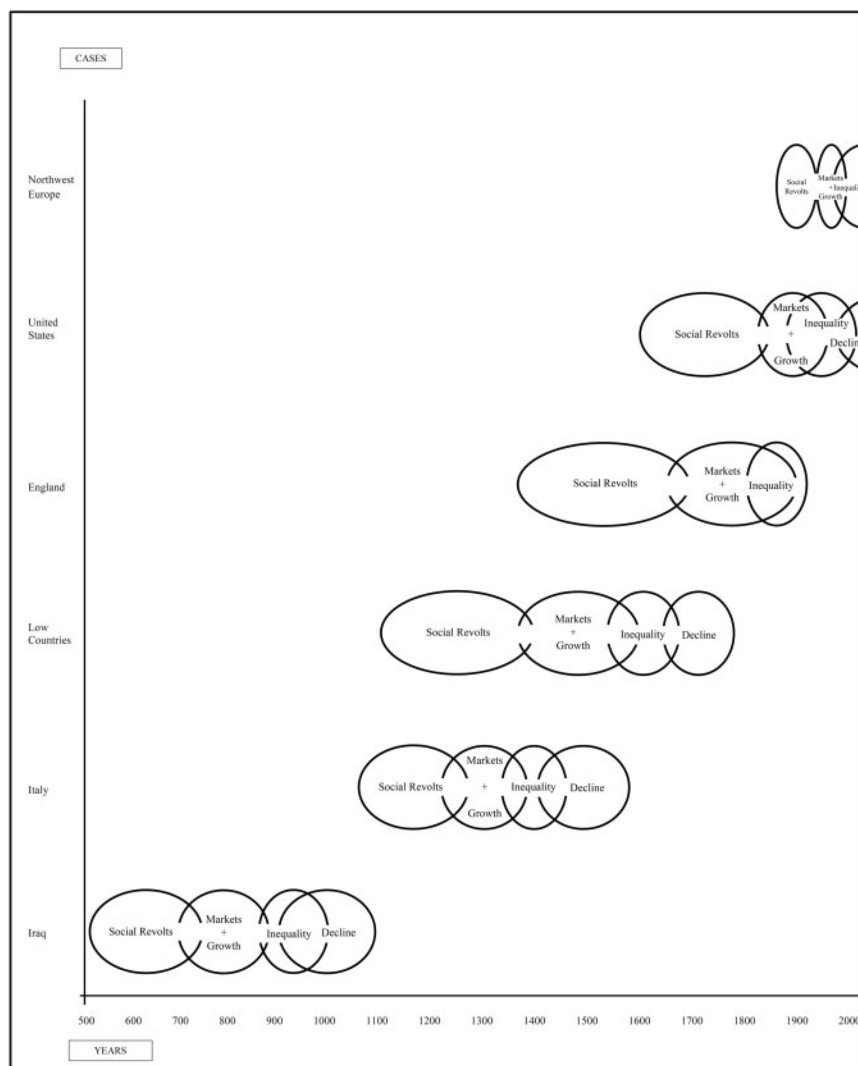

Figure 1 Schematic representation of the stages of the cycle in each of the six cases of market economies.

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, as the systems of manorialism, tax-collecting despotic states and lordship, and the associated forms of coercion, patronage and hierarchical bonds, were undermined or even done away with.

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The destruction of these allocation systems also meant that exchange and allocation of land, labor and capital by way of the market became more feasible. The restrictions on their transfer that were connected to these older systems and imposed by these older elites, as most notably, the prohibition of the sale of land and free movement of labor, were now weakened or removed by the new social groups and associations of ordinary people. This allowed factor markets to emerge. It also allowed these markets to be organized in a balanced setting, not geared towards the interests of a single interest group. These favorable markets next, in the course of decades or up to a century, started to attract the former, feudal elites for two reasons: the rising costs of maintaining their coercive power in the face of the growing self-organization and societal leverage of ordinary people, and the rising opportunities for profit-making through these markets (for the interaction between these push and pull factors: van Zanden, 2009, pp. 294–299; van Bavel, 2010, 86–92 and 173–176).

The crucial element—or even a precondition—for the rise and favorable 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. This balance precluded the possibility that one social group would skew the market institutions to their own interests at the expense of others or would be able to use the state as an instrument to promote its own, specific interests. Built on this favorable social and institutional foundation, factor markets 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 and were solidified by informal institutions such as mutual trust, co-operative behavior and sociability, attempted to alleviate the corrosive effects of the market on the position of these middling groups (van Zanden, 2009, pp. 50–55). Within the nuclei of market development these organizations were eroded, however, as their roles as systems of exchange and allocation were usurped or superseded by the market. Increasingly, this marginalization also happened through direct actions or even attacks by the new market elites and public authorities who came to be aligned with these market elites, as happened with the semi-coerced privatization of commons or the abolition or marginalization of guilds (van Bavel, 2016, pp. 103, 125, 175, 185, 215–217). This resulted in the further opening up of land and labor for the market, and formed the completion of the rise to dominance of factor markets, but now as a result of violence from above.

4. The downward phase of the cycle: inequality and new dependencies

The final step towards market dominance was thus associated with the erosion of the non-market associations. This happened in a slow and protracted process, taking roughly one to two centuries in each of the cases, interrupted by the resistance offered by these organizations and their members, most fiercely and for longest by the guilds and other craftsmen organizations in the towns. Rural associations proved much more vulnerable and were dismantled more rapidly. In the same phase, new dependencies started to arise, installed by new market elites who had come to the fore through the functioning of factor markets. The dependencies they created were often linked to the market, including the dependency of pauperized wage laborers and debtors on entrepreneurs and creditors. This economic dependency grew with the rise of material inequality. In each of the market economies, wealth

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inequality indeed rose to very high levels. Subsequently, the new market elites started to use their growing wealth to turn it into political leverage and, next, used this to introduce "new" forms of inequity, including market monopolies, legal inequality, fiscal exploitation and coercion of labor. These market elites thus acquired a hold over the wider political and institutional organization 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—had mainly positive effects, especially on technological innovation and economic growth. As increasing surpluses were accumulated in the further phases of the cycle, however, the rise of financial markets became virtually unstoppable, 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. Not only economic actors but also states became ever more dependent on credit and loans, giving the lenders political leverage. With every financial crisis, the position of the government's creditors was strengthened, and gradually they acquired control, first over taxation and monetary policies, later over public expenditures and finally even over the state itself, as in the market cores of Genoa and Florence in the fifteenth century (Arrighi, 1996, pp. 103–104, 111–126).

The acquisition of political leverage by the market elites led to a deterioration of the market organization. Factor markets in these cases were initially organized in an open way, and favorable to all participants, but a century or two after their rise their development took a negative turn through the actions of the new economic-cum-political elites they had generated. Northern Italy in the fourteenth century, as urban market elites had firmly established their dominance, forms a clear case in point. In legal cases between urbanites and countrymen, the courts often sided with the urban landowners, creditors and speculators, thus undermining the security of property rights for the rural population. Also, litigation became more expensive, making it difficult for villagers and poorer people to undertake legal action at all. Likewise, the organization of the sharecropping system, and the way it interlinked dealings in lease, labor and credit markets, became skewed towards the interests of the small group of urban landowners reducing entrepreneurial opportunities for the large rural population (Emigh, 2008; van Bavel, 2016, pp. 114–116, 133–134). Moreover, labor laws were enacted which froze wages, forced laborers to buy their food at high prices from urban vendors and restricted their mobility (Cohn, 2007).

A growing bias towards the interests of the wealthy was also found in the organization of the fiscal system. Taxes came to be levied predominantly on consumption, and only to a lesser extent on residential property 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 taxed at all, and the same held for commercial profits and foreign investments (Adams, 2005, p. 144; van Bavel, 2016, pp. 127 [Holland], 132 [Genoa] and 197). Since much of the tax revenue was used to pay the interest on public debts, which were mounting in this phase of the process, and this debt was mainly held by the wealthy, this system entailed a redistribution from the poorer to the richer population.

As the institutional deterioration of markets and their diminishing openness led to economic stagnation or even decline, the market elites were forced to 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.

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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, while in its turn this response by the elites further eroded social and political openness and equity.

The end-situation of material inequality and political inequity, and of monopolized, shriveling markets, could remain for centuries. Much more so than the situation of an open society combined with an open market economy, which is dynamic and of a passing nature, this is a stable situation. After the decline of the open market economy, it remained in place in Iraq up to the present, so for more than a millennium, and in Italy for half a millennium. In the Netherlands, the negative end-situation remained in place for a much shorter period, for only two centuries, as it was broken by a new and massive wave of social organization from the end of the nineteenth century (see Section 3). From that moment, a new cycle started, but there is nothing automatic in this, as is evident from the many cases where such a cycle did not start and the situation of material inequality, political inequity and distorted or weak markets remained for long.

5. 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 analyzed 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. 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, co-operatives or the state. These other systems have multiple goals, including societal ones, such as achieving security, long-term continuity, sustainability, equity and enhancing welfare. 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 (Streeck and Schmitter, 1985). 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. The market is socially embedded in its formation and organization, as repeatedly argued by Mark Granovetter (2001) and many others, but the market is not socially embedded in its ends. One could label this the disembedded embeddedness of markets (see also below).

Still, even if the market did not explicitly have these social goals, many would argue that the rise of markets, or capitalism, at least indirectly brings social benefits. A few authors, including Deirdre McCloskey (2006, pp. 4, 23–27, 126–138 and 483), claim that markets through generating wealth and urbanization make people more civilized, and that they even foster and stimulate co-operative behavior and solidarity, but this claim is contested. Most

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would argue, instead, that the market rather involves competition and the pursuit of self-interest. More widely accepted is the argument that the market generates welfare and equity by itself, as it is a neutral, 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 (Fontaine, 2014). While this may hold for the first phases of development, as women can be co-opted as cheap labor 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 coercion of men and women.

Although the market in the long run thus does not deliver its assumed benefits, few people would hold it responsible for their non-delivery. When land, labor and capital become fully commodified, and society is increasingly driven by market ends, this disembeddedness of market outcomes grows. In the resulting situation, and even though markets always remain socially embedded, the market economy dictates social relations and dominates society, instead of the other way around, as aptly described by Polanyi (2001, p. 60) (see also Gemici, 2007). This disembeddedness of outcomes increases as markets become more complex, competitive, abstract and impersonal, and also with the growth of the scale of exchange. Disembedded outcomes are even more readily accepted 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. If it is 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 (Streeck, 2014, pp. 61–63), there is hardly an incentive to sustain or develop legal, fiscal or juridical counterweights to these outcomes.

Economic market considerations will thus come to dominate social considerations and values within a market economy. In addition, the market has no membership, and it cannot be held accountable, in contrast to these other allocation systems. 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. 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 to change the arrangement of the market in order to balance or reduce negative externalities, gradually lost their economic and political power. Opportunities 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. Division among the elite would open up opportunities for fundamental changes (Lachmann, 2000, pp. 58–64), but the preceding shows 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. This happened in northern Italy in the Renaissance and the Dutch Republic in the seventeenth and eighteenth centuries, which not coincidentally are the examples that Richard Lachman (2000, pp. 70–72) provides of elite entrenchment.

The preceding also holds relevance for the probability that societal institutions in modern democracies would be able to counterbalance the negative effects of dominant factor markets. The dominant view in literature is that they are. This is based, for instance, on the assumed robustness of liberal civic values (Bowles, 2011, pp. 70 and 75–78). These values, as

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argued by Samuel Bowles, are underpinned by an open law system and a high level of social mobility, but we have seen instead that these are undermined with the rise of a well-entrenched market-elite. Others place their hope in the counterbalancing role of democratically controlled governments. This holds for the German proponents of the *soziale Marktwirtschaft* after the Second World War, who assumed that these governments would even translate the assumed gains from market activity into social welfare (Goldschmidt and Wohlgemuth, 2008; for a similar optimism: Komlos, 2016, pp. 496–499), and for the European Union, that has thus formally committed to being a social market economy. More abstractly, Acemoglu and Robinson 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 (Acemoglu et al., 2005, pp. 395–396; Acemoglu & Robinson, 2012, pp. 74–81). Only a few scholars (Streeck, 2014; Merkel, 2014) postulate that even modern-day democracies run the risk of succumbing to the pressures exerted by capitalism.

The findings summarized in this article, using a longer time frame, endorse the latter view. In societies dominated by factor markets, 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 initially found there. Rather, in all these cases, the state increasingly came under the influence of those who benefited most from the market system and had no interest in redistribution.

In the first phase of the cycle, in each of these cases—except for Iraq, where imperial rule and state bureaucracy traditionally were very strong—the role of the state was not yet very prominent. It featured next to all kinds of other organizations and associations that fulfilled semi-public roles, especially at the local level. 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, labor and capital, which was vital in reducing insecurity and transaction costs. In this way—in line with North's account (1990) but not as part of a linear or teleological development—states indirectly promoted the rise of factor markets. Also, they stimulated the rise of markets in more direct ways, for fiscal reasons, since these markets, with the associated monetization and the commodification of land and labor, enabled them to tap resources and tax transactions and wealth more effectively than with other forms of exchange and allocation, such as barter or communal redistribution. Also, the markets allowed the mobilization of capital and labor to fulfil the state's infrastructural or military needs. In the next stage, these states came under the dominance of the market elites, and still later they even became instruments of coercion by these elites, who combined this with their use of factor markets. This is most evident in the growing use of soldiers hired in the labor market, who replaced the voluntary militias of ordinary people, and whose salaries were financed by way of public debts contracted in the capital market and who were frequently employed precisely to crush popular revolts.

Instead of counterbalancing each other, the two spheres and their elites thus came to overlap. 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 ordinary population. Each of the cases discussed in its last stages saw growing state repression, armed violence and warfare by states and public authorities, now dominated by market elites. Even in a context where representative bodies, estates or parliaments

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initially had been strong, the state did not offer a check on developments, but instead became an essential part of them (for the Middle Ages: Ogilvie and Carus, 2014, pp. 419–426; for the modern period: Section 6, below). 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 the cases.

6. 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, labor 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 they employ this power to skew the institutional framework of markets and political decision making, going along with growing coercion and curtailing freedom. Also, people start to retreat from the market, and factor markets shrivel again. So, first the open society is eroded, starting with the social openness and followed by the political openness, and next the market economy itself implodes. In this protracted process, economy and society revert to the state they were in before the start of social movements and self-organization by ordinary people, that is, to a state of high material inequality, the dominance of a closed elite, the presence of elite privileges and a firm grip of the elite on the political system. In this sense, the process can be described as a socio-institutional cycle, which in all of the historical cases takes three or four centuries from beginning to end. That this holds in all cases is a striking observation, in view of the fact that developments take place in very different historical contexts.

Another finding is that the crucial variable in the interaction between the market economy and the open society 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.

The emphasis placed here on the role of wealth inequality differs from the dominance of the issue of income inequality in societal and academic debates of recent decades (to which Piketty, 2014, and the ensuing debate formed a valuable antidote). The distribution of income may be highly relevant from 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, labor and capital helps elites, or nascent elites, to break up restrictions on the accumulation of land and capital. Moreover, wealth

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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, many households have no wealth at all, while a few amass wealth tens of thousands of times larger than modal wealth.

It is this very large wealth that is especially relevant for the process analyzed here, as it offers power. First, 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 labor can be made profitable. The idea pushed by Friedman (1962) was that the market would offer decentralized decision-making power, 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, large wealth can easily be transformed into political influence. Opportunity costs of investing in political leverage are far lower for large wealth than for large income, as the differential is much larger. Moreover, the gains of policy changes regarding the exchange and use of land, labor and capital are relatively large for possessors of large wealth.

The preceding reconstruction of historical cases suggests that there is a certain 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 exceeded. In view of the different historical contexts it 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 (van Bavel, 2016, pp. 72–73, 128, 194–195). Similar levels are reached now in the Western market economies. The distribution of private wealth in the United States and also in Germany, the Netherlands and Sweden is at levels of 0.8 to 0.9 again (Saez and Zucman, 2016). 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. They had inherited these low levels from the previous period of social movements, and as such these had formed a cornerstone of their growth and prosperity, but as a result of their own, internal dynamics these market economies gradually moved to the highest levels of wealth inequality.

This socio-institutional dimension is not really brought out in the important work by Piketty (2014), who labels all late nineteenth and twentieth century societies he discusses with the umbrella term 'capitalist economies' and wants to show how wealth inequality and its growth are ruled by general laws. I rather think that the analysis would gain in depth and relevance by better including the specific rules of the economy and society under consideration, which either push up or reduce wealth inequality, and how these rules change over time (for a related, sharply formulated criticism: Acemoglu and Robinson, 2015).

The analysis here shows how the rise of top wealth in all market economies subsequently allowed for the translation of economic wealth into political leverage and thus the erosion of the more equitable, open society that formed the foundation of the same market economy. Many thinkers, however, would suggest that our modern societies compared to earlier ones are more robust and less susceptible to this next phase in the development of market

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economies—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 (see Section 4). The present study offers two reasons to doubt whether modern Western democracies are uniquely shielded from this effect, however. First, as this article shows, this would be an underestimation of the political equity and broad decision-making power in the other market economies discussed. Each of these in the early phases of the cycle 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 offering organizational power to ordinary people (Jones, 1997, pp. 499–519). The level of self-organization and broad influence on decision-making was arguably even higher in the late medieval Low Countries (van Bavel, 2010, pp. 93–123). Still, this broad participation and the related organizations only slowed down the process, being unable to stop it.

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 USA, where the present cycle started earliest, and which had become a market economy in the first half of the nineteenth 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 USA's one. Wealth inequality in the USA has been rising since the late 1970s, with the top 0.1% tripling its share in total wealth from 7% in 1978 to 22% in 2012 (Saez and Zucman, 2016).

There are several ways in which the economic wealth of market elites in the USA, and increasingly also in Northwest Europe, is translated into political leverage. They have all been discussed in the literature, but often separately or within other contexts, so it may be useful to assemble them here and to show how each of them is connected to the presence of very large wealth and—even though their concrete manifestation is different—not dissimilar from the processes at work in earlier market economies at the start of their downward phase. A main mechanism of transforming this large wealth into political influence 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 (Schlozman, 2012, pp. 19–21, 282–288 and 305–308). The legal freedom to use economic resources to influence political outcomes is large in the USA, while at the same time the societal counterweights offered earlier by unions, co-operatives and other organizations representing ordinary people are reduced.

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. This ownership offers him a 'switchboard' between political, economic and media interests, allowing him to influence public opinion and to intervene in the political sphere, for instance in order to shape regulatory decisions affecting his economic interests (Arsenault and Castells, 2008). The impact of economic elites and organized business interests on the US 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 (Gilens and Page, 2014).

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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 (Bertocchi, 2011). 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 to adopt a milder fiscal regime for the capital of private owners and businesses. These policies further increase top wealth and thus strengthen 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 (wealth owners) they continuously have to satisfy (Streeck, 2014, pp. 72–96). 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 (Merkel, 2014, pp. 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, organizations which are more easily influenced by wealth than their counterparts at the national level, and which have inspired, or even forced countries to deregulate markets and free them of 'obstacles', that is, from possible counterweights offered by societal and political actors. Likewise, the idea that shareholders' value should be dominant over stakeholders' interests, for instance, was actively propagated by the Organisation for Economic Cooperation and Development, declaring in 1999 that corporations should be run principally in the interests of the shareholders (Lazonick and O'Sullivan, 2000, p. 14), that is: the owners of wealth.

In this process, the opportunities of wealth are ever further enlarged, while wealth taxation is reduced. A possible exception is a situation of mass mobilization in times of war; the only period when democracies substantially increased the inheritance tax—crucial in breaking the permanency of large wealth (Scheve and Stasavage, 2012). Democracy, and the widening of the franchise, did not by itself 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 hired security personnel (Avant, 2005). The process goes along with a further privatization of state violence, with a growing role of large security companies, and a replacement of people by capital goods (costly arms, drones, robots). 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 in danger of being captured by large wealth through the mechanisms highlighted above. As the effect of this political capture is the enlargement of the profitability of wealth and a reduction of its taxation, and thus the further growth of large wealth, this is a self-reinforcing process. This is an insight reinforced by the historical analysis presented in this article. It suggests that the present development, most

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clearly seen in the USA, is not a coincidence or an aberration but part of a fundamental process. Also, the article suggests that this process will likely proceed and that the present societal and political counterforces will be unable to stop it, let alone turn it around.

This article, by adopting a historical perspective, helps to avoid a 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 USA 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. This has clearly inspired many scholars and thinkers of the period to assume that they are inseparable. The historical perspective of this article, however, 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 are losing now, just as 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 positive to negative.

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