Reshaping non-sustainable capitalist democracies. Towards a new social structure for capital accumulation

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Abstract:

The paper starts from the consideration of current unleashed forms of advanced capitalism, comprising Goodwin's distributive growth cycle in particular, and the anti-cyclical role monetary and fiscal policy can and must play in such a context in order to leash at least the financial markets of such economies. It then proposes as further reform a significant institutional change on the labor market, going beyond Esping-Anderson's `good' welfare state and the European concept of `flexicurity`. Our proposal is intended to overcome mass unemployment problems through a proper interpretation of the concept of flexicurity within the above leashed form of capitalism as well as the existence of really unskilled work and unsecure low income work. The implied concept of `Social Capitalism' is built on three essential pillars which only in their composition can really give rise to a new and promising social structure for capital accumulation.

Keywords: unleashed capitalism, social capitalism, safe life-course perspectives, comprehensive schools, democratic elite formation.

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1. Leashing current forms of unleashed capitalist `welfare' states

In this paper we start from a Keynesian macroeconomic model of advanced capitalist societies and briefly summarize on this basis the functional chains and their stability properties that characterize the working of such economies from the Keynesian perspective. We do so in order to provide a theoretical description of the status quo of such societies which we will then contrast in this paper with an ideal model of a flexicurity economy or, later on, of social capitalism and the three pillars, concerning labor market institutions, the educational system and the formation of elites, it is built on. Such an ideal construction is in fact needed before compromises with the status quo should be sought and investigated. Without an ideal, against which potential and actual reforms in countries like Denmark can be investigated, there is the lack of a coherent theoretical structure against which one can evaluate the sustainability of such reform proposals in isolation and in their interaction and also the kind of progress path in the development of capitalist societies they imply.

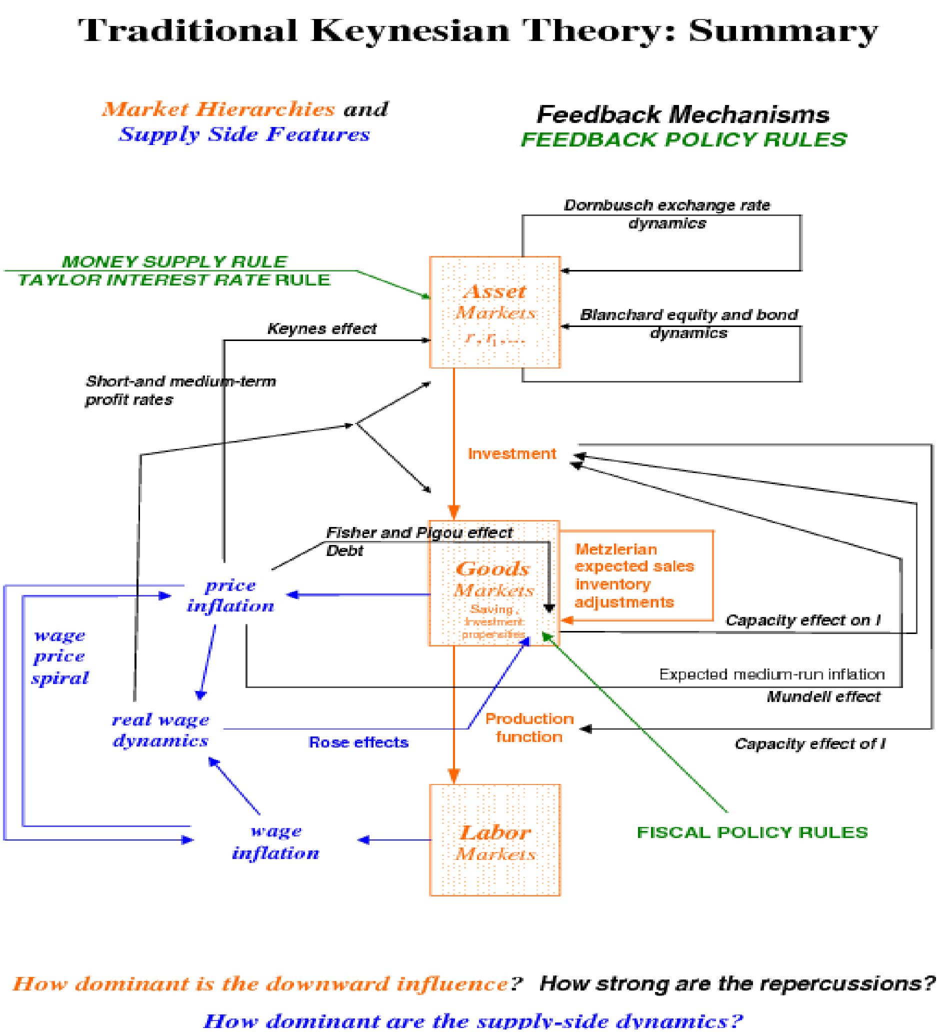
The model of a flexicurity society that this paper then presents in section 2 combines flexibility (a strictly competitive form of capitalism on goods and labor markets) with social security (concerning only employment and income) into a coherent and sustainable whole suggested to overcome the deficiencies of current ruthless forms of capitalism. When further developed into a model of social capitalism (in the section 3) we show that it preserves the necessary scope for the working of the *forces of production* of capitalism within a widely acceptable social system of *production relationships*, a synthesis which we believe is not only possible on the stage of development advanced capitalism has reached (in contrast to the times of Marx, who first distinguished these forces from the relations of production), but is also necessary when contrasted with the current severe economic and social imbalances in the world economy (under the world-wide dominant regime of unleashed capitalism). The paper however does not yet approach the factual analysis of the variety of current forms of capitalism, i.e., the status quo one has to consider when possible steps along a progress path towards social capitalism are to be formulated and discussed and when history has to be taken into account.

1.1 Market hierarchies and feedback channels: The status quo

We start the discussion of the functional chains acting under the surface of the current forms of capitalism from the perspective of Keynes' (1936) summary of the `causal nexus' that is characteristic for such economies. In the `General Theory', Keynes based his analysis of the interaction of the financial markets with the goods markets (based on the concepts of liquidity preference and effective demand) on a strictly hierarchical ordering of the markets in an advanced capitalist economy, where financial markets are at the top of the hierarchy, with goods markets depending on the outcomes on financial markets and with labor markets at the bottom, depending in their behavior on the outcome on the market for goods. This hierarchy is shown in the middle of figure 1, but is already augmented there by a variety of repercussions from the lower markets to the higher ones which are to be added to the hierarchical perspective and of importance in the full dynamic evolution that is implied by this macroeconomic model, but which do not really question the downward chain, leading from a short-sighted `casino-type' scenario to the long-sighted tasks of debt-financed investment strategies of firms and from there -- via directly and indirectly induced income streams -- to further investment and consumption expenditures on the market for goods, the so-called dynamic income multiplier process. The employment on the labor market is by and large a result of this multiplier process and thus the weakest element in this downward dependency.

Monetary policy is impacting the financial markets via short-term interest rate steering and generally suggested to be responsible for the control of the price inflation, but -- as it has become obvious now – should be much more oriented towards and responsible for the behavior of financial markets, since inflation can (to a certain degree) be controlled by a well-designed anti-cyclical fiscal policy as well as through a corporatist (wage) income policy. We will return to the question of the appropriate choice of fiscal and monetary policy measures below, but will firstly now provide a brief summary of the feedback structures that characterize the working of the private sector of the economy.

Figure 1. The Keynesian view of the real-financial market interaction



We start with the financial markets in their internal interaction which is generally characterized by centrifugal forces, since increasing capital gain *expectations* generate – at least on an average and for some time – rising asset prices creating thereby the room for actually rises in capital gains which in turn stimulate the exception of further capital gains. This type of a primarily backward-looking `chartist' behavior can -- in certain cases -- be of a very naive type, but can also be – in other segments of the market -- as technical as modern computer algorithms do allow for this. The accelerating forces of such positive feedback mechanisms are of course subject to sudden turning points which however (when predictable) would make the predictors very rich. They are therefore very hard to explain even in qualitative terms since their occurrence may be very much dependent on actual news and other shocks that hit the financial markets. It can however be shown by means of macroeconomic portfolio approaches that financial markets with static expectations are exhibiting a stable adjustment behavior of asset prices towards their equilibrium positions implying that the formation of capital gain expectations is (but not always) indeed the `villain' in these asset markets.

There is next an across-market feedback structure, concerning the interaction of the financial with the goods markets, which also is of a destabilizing nature. We explain this cumulative process by using Tobin's q, defined as the total value of equities divided by the value of the capital stock of firms, as measure of the state of confidence characterizing the state of an economy. If this ratio increases, firms are evaluated in more positive terms which improves their financing position and on this basis their actual investment. Increases in investment in turn stimulates national income and output by the already considered Keynesian income multiplier process, which in turn raises the profitability of firms. Firms are then evaluated by the stock market through a further increase in Tobin's q which is a self-feeding, cumulative process of a real-financial market interaction.

Such an accelerating mechanism is also characterizing the goods market in itself where increases in the capacity utilization rate of firms stimulate their propensity to invest which via the Keynesian multiplier process increases income and output and thus leads to further rises in the capacity utilization of firms. A similar mechanism characterizes inventory adjustment in the manufacturing sector which becomes destabilizing when inventories are adjusted by firms with sufficient speed.

Of more importance -- in particular in the public debate -- are however the forces that generate goods price inflation in the goods market in isolation as well as through a wage-price spiral relating the goods with the labor markets. Goods price inflation can adjust in an explosive way by a accelerating mechanism that works in the market for goods solely (known as Mundell effect in the literature). This effect starts from the observation that rises in expected inflation reduce the expected real rate of interest which stimulates investment demand as well as the demand for consumer durables which in turn lead to increases in the rate of capacity utilization of firms. This stimulates current price inflation and thus leads – under appropriate circumstances -- to increases in the expected rate of inflation and so on.

However also the interaction of price and wage inflation can lead to an accelerating inflationary climate. One situation where this can occur is the case where overall goods demand depends positively on the real wage, i.e., the wage level divided by the price level, and where wages adjust faster than prices with increases in goods demand and the output of firms. Real wage increases then stimulate goods demand and thus the real wage, since the numerator in this expression increases faster than the denominator. The same upward spiral is also occurring when aggregate demand depends negatively on real wages and when prices are responding stronger than wages to increases in goods demand and output.

These mechanisms of course also work in a downward direction leading to deflationary spirals then, a situation which is much more dangerous than inflationary spirals. This is due to the fact that inflation can be stopped by sufficient increases in the nominal interest rate, but since this interest rate is bounded from below by zero, monetary policy may be totally ineffective in stopping a deflationary process. In such a case falling prices increase the real debt of firms which pushes their bankruptcy rate up and this the more the stronger deflation becomes.

This so-called Fisher debt effect can indeed lead to a complete collapse of the economy. One may argue that falling prices also increase the real wealth of households and thus stimulate goods demand (the so-called Pigou effect), but this effect will be dominated by the Fisher effect if deflation becomes really an issue. Moreover Keynesian liquidity preference (hoarding) may lead to rising nominal rates of interest and thus implies in the case of deflation that real interest, the difference between the nominal rate and price inflation, then rises due to two forces, as real interest rates are the sum of the nominal rate and the deflation rate in the case of negative inflation rates.

There is finally a Minsky moment in the evolution of financial markets (including banking and the credit market), a scenario which not only makes the economic agents in good times less and less risk-aware, but also more and more careless in their choices of new financial instruments (an example are securities) as the recent world-wide mortgage crisis and the resulting banking crisis has shown in a dramatic way. In addition, commercial banking and investment banking became more and more intertwined, leading to a situation where credit risks were significantly increased through the joint financial market operations of commercial banks.

1.2 Government: An indispensable anchor for capitalist market economies

One may ask in view of the above why capitalism has been so successful at all, instead of being always on the run into accelerating booms or busts. There are however inbuilt bounding mechanisms for these explosive tendencies in the private sector, increasing interest rates and increasing real wages in the boom (if investment demand decreases in a stronger way than consumption demand is increased in such a situation). Falling interest rates and real wages may do the same in the bust, while a floor to the downward adjustment of nominal wages (based on workers' increasing resistance to falling wages) and a similar floor to price level adjustment (based cost-plus pricing behavior of firms) can avoid the dangers of debt deflation. Moreover one may argue that the absence of any fiscal or monetary policy after World War II would have led indeed to accelerating boom or bust situations in the working of the private sector of the economy (Nixon's wage-price stop is one example and Japan's fight against deflation is another one).

We conclude that unleashed capitalism – accompanied by more or less conventional macro-policies -- may work for some time, but will in good times undergo a development which more and more endangers its stability through the innovations in the financial sector in particular, on the basis of which a casino-type of behavior becomes more and more dominant. Ideal (radical) macro-policies which could stop and reverse such an evolution are here briefly enumerated and given by the following list of policy measures:[3]

1. A 100% Tobin-type tax on capital gains or financial transactions which makes speculation meaningless or sufficiently costly and supports the social obligation of financial markets to serve the real economy and not vice versa.
2. A 100% Fisher-type reserve ratio which allows credit creation only out of time deposits and not out of checkable deposits which serves the social function of channeling interest-bearing savings of households into investment of firms without the possibility of bank

[3] See Asada et al. (2010) for a detailed discussion and proof of these propositions.

runs (on immediately checkable deposits).

3. An independent fiscal authority besides an independent central bank which pursues a strictly anti-cyclical demand management out of funds it can raise independently from the government. This would reduce business fluctuations to a certain degree and thus also contribute to price stability.
4. A corporatist regime in the labor market (wage management) whereby wages are made independent from employment and utilization rate fluctuations by way of a scala mobile endorsement. This would further reduce inflationary processes and would also help to avoid time-consuming wage negotiations between capital and labor (and the possibility of strikes when such negotiations fail).
5. Anti-cyclical open market policies of central banks in risky assets (treasury bonds or even equities) in place of the current orientation of monetary policy towards the short end of the financial markets. This would stabilize financial markets even further and also contribute to a reduction in business fluctuations, in addition to above fiscal policy measure.

One can show for the above Keynesian representation of the working of the macroeconomy that this will make its business cycles damped and its financial markets and the banking system stable and this in a way that does not significantly encumber the savings-investment channel where rates of interest play an important role, without interference from speculation about capital gains into such a lending – borrowing relationship. The current discussions in Europe about Tobin transaction taxes on financial trade, about the fiscal mess in Greece, about the return of the narrow banking idea, of the corporatist regimes in the Nordic countries and of Keynes' (1936) suggestion that the central bank must be prepared to trade in long end of financial markets all show that all of these reform agendas are currently of a topical nature. We stress however again that the above proposals are still ideal ones which have to be compromised with the actual status quo, but which represent a coherent whole on the basis of which these compromises have to be and can be found.

Concerning the present financial crisis one may add here that it had its point of departure in the careless and excessive supply of subprime mortgages by commercial banks and other financial institutions with a high default risk due to the income and wealth situation of the households to which these mortgages where given. Subsequently, these subprime mortgages were reallocated and used to sell them in the form of securities to other financial institutions around the world. This process of securitization of risky and later on toxic credits thus spread the risk associated of these initial loans to numerous financial institutions which thereby became endangered by the massive credit default that occurred in the US housing sector. The thread of bank runs and bank bankruptcies spread around the world and was largely prevented by huge amounts of money supplied to the financial sector and the bailout policy of central banks. The impact of the financial crisis on the real sector of important economies was moreover neutralized to a larger degree by the reoccurrence of anti-cyclical fiscal policies (generally viewed as representing straw fires in the pre-crisis political and academic debate). In Germany labor market policy also was fairly successful in preventing significant increases in unemployment rates, in contrast to what happened for example in the USA. In view of what we discussed above, we may therefore conclude that the current crisis in the world economy was to a larger extent due to the Minsky moment characterizing banks behavior towards risk in the subprime mortgage markets (which calls for better risk management behavior and regulating rules), the possibility of shifting such risk to other parties in the financial sector (which calls for rules regarding the process of securitization), and the danger of subsequent banks failures through bank runs (which would not exist if checkable deposits were subject to a Fisherian 100% reserve ratio requirement. Moreover, the countercyclical fiscal policy rule and the independent fiscal policy we considered above would have prevented the type of fiscal policy we observed in particular in the case of

Greece, but which however must be discussed in its details in much more depth than was done in this section.

All of the above reforms are only (though surely important) steps in the improvement of already existing institutions and regulations – which are discussed in the political debate, with the exception maybe of the construction of an independent business-cycle oriented fiscal institution. From the perspective of Marx's (1954) `Capital, Vol. I' one might however argue (or face the argument) that the fundamental conflict in capitalism is the one between capital and labor about income distribution and within production which can only temporarily be overcome by corporatists regimes and welfare state regulations.

Against this argument, the main focus of the paper is to what extent we can establish a system of labor market reforms that go much beyond processes of wage management in that they remove from an efficient functioning of capitalism the recurrent need for a substantial reserve army of unemployed, the creation of a substantial low income work sector, and the existence of pauperism in a dead segment in the labor market. Capitalism, it may be claimed, cannot remain profitable in the long run without the existence of these disciplining devices for the fluid part of the labor market. We do not share this opinion however.

On the contrary, due to social segmentation processes and resulting social conflicts and more, these disciplining devices will create in a democratic society in the long-run, the ruthless form of a conflict-driven capitalism is not a sustainable one, in view of the severe social degradation processes it implies. The present paper will argue that a competitive form of capitalism can work under persistent full employment (employment guarantees by an employer of first resort) in a society with no unskilled workers and an educational system that counteracts social segmentation and that is also able to elect responsibly acting elites for the political and the economic conduct of the country. These are the three pillars, adequate labor market institutions, a well-reflected educational system and responsibly behaving elites which are elected not by their habitus, but by competitive democratic decision rules, which we will briefly investigate one by one in the final section of the paper, devoted to a sketch of our new conceptualization of a "social capitalism" as improvement of what is currently discussed as flexicurity economy in the European Union. This discussion will lead us much beyond the current discussions on workfare or flexicurity towards a truly new and balanced social architecture for capital accumulation.

1.3 Steps in the evolution of the welfare state: Misleading compromises

In this section we only briefly consider the actual evolution of and the academic discussion on the welfare state. Its purpose solely is to put the consideration of flexicurity economies into perspective regarding the attempts made and discussed during the evolution of welfare capitalism and their impact on the society.[4]

To start with, chancellor Bismarck's welfare program in the second half of the 19th century in Germany was clearly one that was motivated by the conflict between capital and labor and was thus oriented towards mitigating this conflict and weakening the socialist movements of his time by offering insurances against accidents, for medicare and more. There was -- under President Roosevelt and thereafter -- the New Deal in the 1930's in the USA which had to cope with the economic and social consequences of the financial crisis of the late 1920's and the social turmoil they implied.

These were political answers to the social occurrences of their times, while Beveridge, though

[4] We have to thank Gunnar Stollberg for stimulating discussions on the evolution of the welfare state. Of course, usual caveat apply.

politically influential, supplied academic analyses of the welfare state of his times, even leading him to the consideration of full employment capitalism in Beveridge (1944).
Keynes (1936) provided an economic and social philosophy of how to deal with the problem of mass unemployment and saw a necessity for the social planning of the difficult role of innovative real investment behavior and contrasted this with the casino capitalism of (not only) his time. Some social planning and a theoretical movement towards the consideration of public planning and the welfare state were therefore clearly visible before the event of World War II, certainly also motivated by the success of Lenin's revolution of the political system in Russia and the rise of the Soviet Union in this part of the world.

The end of World War II brought about a significant increase in the movements towards the welfare state as an alternative to the Soviet type of socialism that was now spread towards many countries to the Eastern part of Europe. Perhaps most typically there was the move towards social market economics in the Western part of Germany and the adoption of Keynesian fiscal policies in most Western countries, maybe starting with president Kennedy's stimulus package in the USA in the early 1960's. Yet one confusion or maybe euphemism in the rapid rise of the economic power of Germany was the fact that it only referred to markets as coordinating devices and not to capitalism as such. The same political confusion applied to the discussion of market socialism in the tradition of the Lange – Lerner debate on an alternative way towards socialism.

The basic issue (confusion) here is -- in terms of Marx's (1954) `Capital I' -- that market economies are only characterized by the exchange chain:

C(ommodity)—M(oney)—C'(ommodity),

a chain which ends with each exchange that is performed in this way. Capitalism is however a perpetuum mobile based on the chain of events

M(oney)—C(ommodities)—M'(oney)

and thus can become a ruthless objective in itself. Only this type of exchange relationship was able to create the Schumpeterian process of creative destruction that has led us to the globalization in real, financial and communication markets we are now facing. Social market economics was therefore a misguided concept from its very beginnings, the so-called Freiburg school.

Kalecki (1943) already pointed to the limits of the welfare state and its full employment perspectives, a view that was totally neglected when the social democrats came into power in Germany, in particular by the renowned German chancellor Willi Brandt in his full employment promises in the late 1960's. Kalecki warned that industrial leaders would not like full employment situations at all and would sooner or late find renowned academic economists that would 'prove' that such full employment situations were manifestedly unsound. The stage was therefore set for the rise of Milton Friedman and the monetarism of his time which declared that an unemployment rate below a certain level was 'unnatural' and thus to be avoided by any means, as done through Thatcherism and Reaganomics later on. Kalecki therefore foresaw the limits to the evolution of the welfare state as they at least were established by the creation of mass unemployment in the UK and the USA. The Nordic states in Europe might be a different case in this scenario, see Esping-Andersen (1990) in this regard, but the gradualism of Germany in particular was no real alternative to the cold turkey strategy of the UK and the USA.

The reserve army mechanism and the role of mass unemployment played in any case an essential role in the evolution of Western capitalist economies in the 1970's and 1980's. It let to a decline in inflation rates, but also to a decline in economic activity and a return to laisser-faire strategies and the processes of deregulation this implied (which in part were successful, but in other sectors devastating). This all happened despite the continuing existing of Eastern Socialism, though of course coupled with an overall decline in the cold war and iron curtain scenario. This was possible, since the central authorities in the Soviet Union became weaker and weaker, while the logic and intentions of decentralized business became more and more influential. The result was Gorbachev's perestroika and the dissolution of the Soviet Union as a powerful political center in the world economy.

This dissolution was paralleled by the introduction and later on the pronounced switch from welfare to workfare systems in the Western capitalist economies (in the Nordic countries, as new New Deal in the UK and still later as Hartz IV in Germany). The main aim of such workfare systems is to generate an extra contribution to society from welfare recipients, by getting unemployed people back into paid work, thus reducing or eliminating welfare payments to them and creating an income that generates taxes. Furthermore, it is argued that once a person has recent employment experience, they are better enabled to obtain long term employment later on. The main disadvantage of workfare systems from the social point of view is that they removed the barriers to such an extent that atypical work, low income work and similar forms of degraded work could become a significant portion in the work-profiles of countries like Germany, leading to a dramatic increase of impoverished elderly in the course of time.

This in sum means that welfare systems were indeed asymmetric and therefore nonviable constructions after World War II which led to a Kaleckian type of political 'business' cycles that were aimed at reducing again (in favor of capital) the increase in welfare arrangements (in favor of workers) in the distributive cycle of the 1950's and 1960's, based on the monetarist attack on Keynesianism that started in the late 1960's and that found its political culmination point during the times when Ronald Reagan was president of the United States (1981-1989) and Margaret Thatcher the prime minister in the United Kingdom (1979-1990). The workfare systems that followed had their origins more in labor oriented parties, but besides attempting to make the welfare state less biased to the provision of benefits without demanding for contributions from the thereby protected ones, it also opened the gate towards the degradation of work towards low-skilled temporary jobs and on this basis towards low and irregular income receipts over the life-course of a significant part of the working population and the impoverishment of them that is still to come. We conclude that neither welfare nor workfare are the right answers to the economic and social needs of democratic Western capitalist market economies.

2. Full employment flexicurity capitalism

We assume in this section that fiscal and monetary policy concerning the goods and the financial markets are already administered in an adequate way, so that the issues dealt with in the section 1.3 have found a positive solution. We go on from there now to a deeper consideration of the working of labor market institutions in view of the discussed *social* problems caused by recurrent (mass) unemployment and existence of low income work and their implications for the development of the society and its political structure.

2.1 Full-employment capitalism: Ideal, status-quo, compromises

We start here from a definition of the concept of flexicurity as it is discussed in the European Union.

> *The concept of 'flexicurity' attempts to find a balance between flexibility for employers (and employees) and security for employees. The Commission's 1997 Green Paper on 'Partnership for a new organization of work' stressed the importance of both flexibility and security to competitiveness and the modernization of work organization. The idea also features prominently in the 'adaptability pillar' of the EU employment guidelines, where 'the social partners are invited to negotiate at all appropriate levels agreements to modernize the organization of work, including flexible working arrangements, with*

> *the aim of making undertakings productive and competitive and achieving the required balance between flexibility and security.' This 'balance' is also consistently referred to in the Commission's Social Policy Agenda 2000-2005 COM (2000) 379 final, Brussels, 28 June 2000).*[5]

The concept of 'flexicurity' was introduced on the political level in Denmark by the social democratic prime minister Poul Nyrup Rasmussen in the 1990's and it was introduced into the academic literature by Ton Wilthagen, see Wilthagen (1998) on the Dutch origins of the flexicurity model. The role of the flexicurity approach for the performance of the Danish economy is critically investigated in Anderson and Svarer (2007). For further critical assessments of the discussion on flexicurity the reader is referred to recent contributions by Funk (2008) and Viebrock and J. Clasen (2009). We stress in this context that our following approach to flexicurity is an ideal and primarily macroeconomic one that in particular abstracts from the difficulties of how to implement under flexicurity the coordination and incentive principles which are needed on the micro-level from the economic, the social and the juristic point of view.

Our approach to labor market institutions of the flexicurity type differs significantly from the Basic Income Guarantee (BIG) and Employer of Last Resort (ELR) approaches of the literature as they are compared for example in Tcherneva and Wray (2005), though the intention of these and our approach have many things in common. Our approach can be characterized as an abstract modeling of a full-employment economy comparable in spirit to the Tableau Economique of Quesnay. It therefore represents an ideal economy to be compared with the status-quo of actual developed capitalist economies. Such a comparison should then allow us to formulate compromises between the ideal and the status-quo of actual economies, like the United States of America or Australia, as described in Tchernova and Wray in the first case and in Quirk et al. (2006) with respect to Job Guarantee (JG) principles in the second case. We would however argue here that these latter approaches are in fact presenting compromises without really formulating an ideal on the basis of which these compromises can be discussed.

We just do the opposite here and may therefore be considered as complementary to the ELR and JG approaches. However, in the ideal we have dismissed the concept of un- or low-skilled labor as representing a significant portion of the working population, since we believe that an ideal schooling system can overcome this factual situation to a large degree.[6] We thus have an Employer of First Resort (EFR) in our model who has to provide employment guarantees (not JG's) to skilled or even high-skilled persons, while the buffer stock principle of an ELR must of course take account of the actual situations on the labor markets of given capitalist economies.

From a general point of view we however share the view of Tchernova and Wray (2005) of the superiority of the ELR procedures over the BIG procedures, but go on from there to the EFR modeling of the interaction of the labor markets in the private sector and the public one. Moreover, we think that the design of the educational system as well as the selection of elites (in the sense of section 3 of this paper) are of decisive importance for the proper functioning of a flexicurity-based social structure of capital accumulation or briefly social capitalism. Nevertheless, the JG system in practice proposals by Quirk et al. (2006) for example represent valuable inputs also for flexicurity modeling on our abstract macroeconomic level.

2.2 Basic principles of a flexicurity system

The flexicurity concept – primarily discussed with respect to the Nordic economies – intends to combine two labor market components which – as many economists might argue – cannot be

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[5] http://www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/flexicurity.htm

[6] Of course, there is simple work to be done in firms. But this can definitely be organized as part of the work of skilled and high-skilled workers.

reconciled with each other, namely workplace flexibility in a very competitive environment with income and employment (but not job) security for workers in this economy. The problem here is to find the appropriate mix between these two aspects of labor market institutions, intended to overcome both the case of flexibility without much security (free hiring and firing under ruthless capitalism) as well as the case of security without much flexibility (past Eastern socialism).

Basic aspects, questions and problems of the search for such a combination of flexibility with security (where many alternative ways of solving this task are conceivable) are the following ones:

1) How much flexibility in:
   a) hiring and firing and job discontinuities?
   b) wage and price setting?
   c) technical change (creative destruction) and life-long learning?
   d) coping with the forces of globalization and financialization?
   e) skill differentiation and the selection of elites?
2) How much security in:
   a) base income payments?
   b) employment protection?
   c) location of the working places?
   d) the avoidance of atypical employment and the gestation of skill preservation?

In this paper we will provide a theoretical model which reconciles the aspects 1.a/b with the problems 2.a/b, where the other aspects of the enumerated points remain however excluded. Moreover we shall simply assume here that the societal issues in the last block are developed to such an extent that the proposed model is not only transparent to the citizens of the considered capitalist society, but has indeed led to basic agreement on how the economy has to be organized and the society to be developed further. Against this background, we now design as a theoretical alternative to the many current forms of capitalist economies with their income distribution driven cyclical processes of overaccumulation (in their prosperity phase) and mass unemployment (in the stagnant phase), as we have observed them after World War II, and as formalized by Goodwin's (1967) growth cycle model. We describe a type of capitalist economy that rests on a second labor market – in place of a reserve army of unemployed – which through its institutional setup guarantees full employment in its interaction with the first labor market, the employment in the industrial sector of the economy, which is modeled here as highly flexible and competitive.

2.3 Core sectoral accounts in flexicurity economies

In the basic framework that follows we are considering – for reasons of simplicity – an economy that exhibits a stationary population and workforce (in all of its components). We have three labor markets (private, public, EFR) and two skill levels on them (skilled and high-skilled). The labor markets in the private sector are not segmented from the other ones, since the latter – in particular the third one – to a certain degree represent a buffer for the first one. We first consider the sector of firms in such an economy, the workforce indexed by 1:

Table 1. Firms (the forces of production):

Production and Income Account:	
Uses	Resources
Depreciation	depreciation
wages for workers of type a	consumption of workers in labor markets 1,2 and consumption of pensioners

wages for workers of type b	government consumption
profits = income of firms	investment = income of firms
output of firms	output of firms
pension fund payments to the retired and pension fund accumulation	pension fund savings of industrial workers

This account is still a simple one. Firms use their capital stock to employ high-skilled labor as well as normal (skilled) labor force, the latter at a wage which is a constant fraction of the wage in the high-skill labor market. Both skilled and high-skilled workers are working overtime or undertime when needed by the goods demand firms are facing. Besides primary labor markets (in the privately organized industrial sector) we have a second labor market for both skilled and high-skilled workers (that is organized by government agencies and indexed by 2 and indirectly also a third labor market (where the government is acting as employer of first resort, and which is indexed by 3).

This third labor market is operated under the same remuneration and workload conditions as the second labor markets (which gives the reason why we do not consider here the government as being an employer of last resort). We also stress that there is no labor market segmentation between the first and the second labor market, since skilled or high-skilled workers for the first labor market are selected on the basis of equal opportunities principles where there is no discrimination concerning sex or ethnicity (due to working conditions in industry there may however exist some discrimination with respect to age, in the form that workers tend to work in the second labor market in a later phase of their working life).

The output of firms is sold to three types of worker households, the industrial workers who have to pay all taxes and government transfers out of their salaries, the workers in the public sector and the retired households, to the investing firms and to the government. Deducting from this output of firms their real wage payments to skilled and high-skilled workers (and depreciation) we get the profits of firms which are here assumed to be fully invested into capital stock growth.

We next consider the skilled and high-skilled household sectors which are composed of two types of workers, one working in the private sector and the remaining part in the public sector of the economy. We are assuming here a given population with constant deterministic age structure. We moreover assume here that the work life of high-skilled workers is the same as of skilled workers minus their time at university. We finally assume that there is a given ratio of students having just finished their schooling years who are (by exit or entry exams) qualified to enter the phase of higher education (leading to high-skilled degrees at ‘universities’ and other tertiary education institutions). Given the constant vintage structure within the population we thus have a given workforce of skilled workers in the economy (who start their working life directly after (primary and secondary) schooling, plus a given number of high-skilled (academic) workers of the considered economy who enter their work-life after university. Year-in year-out the economy has therefore a given amount of school students, university students, high-skilled workers, skilled workers and retired workers (the latter contributing work according to their willingness and capability) for which it must organize education and work in the primary and the secondary labor markets (including the government activities as an employer of first resort: EFR).

Table 2. Households I: High-skilled (a) and skilled (b) workers in primary labor markets

Income Account (Households A,B):	
Uses	Resources
consumption out of income after taxes of workers in sector 1 with given tax and consumption ratios	
taxes out of wage income of workers in sector 1	
wage payments to workers 3 of type a from the EFR benefit system	
wage payments to workers 3 of type b from the EFR benefit system	
base pension payments to the retired workers	
savings of workers in the first labor market	total wages of workers 1 of type a,b
total wage income of workers a,b in market 1	total wage income of workers a,b in market 1

Both households of type A are taxed at the same tax rate and consume with the same marginal propensity to consume. They pay (all) income taxes and they pay in addition – via further transfers – all workers' income in the labor markets that is not coming from firms and from government tax revenues (which is equivalent to an unemployment insurance and therefore indexed with an index 3). Moreover, they pay the pensions of the retired households and accumulate their remaining income in the form of company pensions into a fund R that is administrated by firms (with inflow through these savings, see the sector of households and with the outflow: company pension funds payments to the retired). Wage rates are determined by wage-negotiations of high-skilled workers in the industrial sector, while all other real wages are constant fractions of these negotiated wages and are uniform for all skilled workers in the government sector and for retired persons (who however receive extra company pension payments according to their accumulated contributions to the type 1 work, their occupation time in the primary sector).

The transfers to the EFR workforce can be considered as solidarity payments, since workers from the primary labor markets who lose their job will automatically be employed in the third labor market where full employment is guaranteed by the government (as employer of first resort). We consider this employment as skill preserving, since it can be viewed as ordinary office or handicraft work (subject only to learning by doing when such workers return to the first labor market). The secondary sector of households is here modeled in the simplest way that is available: Households employed in the secondary labor markets pay no (explicit) taxes (since they are paid by the government) and totally consume their income. Retired worker households are treated in the same way and are not really inactive in this society, but offer work according to their still existing capabilities and willingness that can be considered as an addition to the supply of work already organized by the government, i.e., the working potential of the officially retired persons remains an active and valuable contribution to the working hours that are supplied by the members of the society. It is obvious that the proper allocation of the work hours under the control of the government needs thorough reflection from the microeconomic and the social point of view, which however cannot be a topic in a paper on the macroeconomics of such an economy.
Next we briefly summarize the government sector of the model, which is of course of

fundamental importance for the working of flexicurity societies.

Table 3. The Government (the foundation for proper social relations of production):

Income Account: Fiscal Authority / Employer of First Resort	
Uses	Resources
government commodity expenditures as a constant fraction of taxes	wage taxes in the first labor market
government labor type a expenditures as constant fraction of taxes	
government labor type b expenditures as residual	
EFR payments to workers of type a	EFR transfers from workers in labor market 1
EFR payments to workers of type b	EFR transfers from workers in labor market 1
base pension payments to the retired	base pension transfers from workers in labor market 1
government transfer outflows	government transfer inflows

The government receives income taxes, the solidarity payments (employment benefits) for the secondary labor markets paid by workers in the primary labor markets and old-age pension payments. It uses the taxes to finance government goods demand and the surplus of taxes over these government expenditure to actively employ both skilled and high-skilled workers in the government sector. In addition it employs the workers receiving 'unemployment benefits' and it in fact also employs the 'retired' persons to the extent they still contribute to the various employment activities. We therefore have the fact that the total labor force in the secondary labor markets is employed through the government and which is organized by government in the way it does this in the administration of the state in all modern market economies.

In sum we get that workers are employed either in the primary labor market and if not there then by the government sector concerning public administration, infrastructure services, educational services or other public services (in addition there is potential labor supply from the retired households, which due to the long-life expectancy in modern societies can remain effective suppliers of specific work over a considerable span of time). In this way the whole workforce is always fully employed in this model of social growth (and the retired persons according to their capabilities and willingness) and thus does not suffer from human degradation in particular. Of course, there is a variety of issues concerning state organized work that point to problems in the organization of such work, but all such problems also exist in all actual industrialized market economies in one way or another.

2.4 Stable and sustainable balanced reproduction

We have sketched in the preceding subsection basic features of a flexicurity economy and enumerated some assumptions in order to indicate to a certain degree what is needed to show some basic propositions on the working of such an economy. A detailed treatment of this scenario is provided in Flaschel, Greiner and Luchtenberg (2010), while the above must here suffice as motivation of the following propositions. These propositions describe the evolution of the economy by assuming that real wages in the primary labor market are adjusted in view of the over- or undertime work the workers in firms are subject to. In technical terms this is a real wage Phillips curve which shows that real wages are subject to change in view of the utilization rate of workers in the industrial sector of the economy. These changes are accompanied by capital stock growth based on the investment decisions of firms and technical change of a so-called Harrod neutral (labor saving) type. On the basis of these two laws of motion of the economy one can then show:

> **Proposition 1** *The balanced growth path of the economy is a global attractor, i.e. the economy is subject to damped fluctuations around this growth path and even converging monotonically towards it when the existing flexibilities on the primary labor markets are further increased.*

We thus get that the adjustment of real wages according to the state of the business cycle is not a problem in this type of growth model, in contrast to what has been asserted as a general feature of capitalism by the Monetarist school in economics in particular. The natural rate hypothesis – whereby employment rates above a natural rate are always destabilizing -- does not hold in a flexicurity economy.

We have briefly discussed that only workers in the primary labor markets save and thus contribute to capital accumulation in this way. Their savings flow into a company pension which in addition to normal pension payments by the government to the retired pays extra pension to the retired in proportion to the time they have worked in the private sector of the economy. In principle these savings can be negative and are presenting a problem for the working of the economy. In view of this one has to postulate a sufficient degree of labor productivity in industry and its sufficient growth over time. These are conditions that a flexicurity economy must generate in competition with the countries that are surrounding it.

> **Proposition 2** *The stationary state of the law of motion for company pension funds per unit of the real capital is a global attractor. The economy is therefore also converging to a steady growth path of company pension funds.*

These two propositions indicate the considered flexicurity economy can be a viable one, and one where full employment is actively constructed -- on the basis of a clear-cut system of taxes and transfers – and not just assumed as it is usually the case in neoclassical theories of economic growth. There remains a number of issues to be considered in detail in future work such as the provision of credit out of pension funds, the introduction of equities as further financing instrument of firms and as claims on the capital stock of the private sector of the economy, of corporate and government bonds and money (whereby Keynesian effective demand problems come to the surface) and also of Schumpeterian creative destruction of old capital through innovating firms.

3. The road ahead: Social capitalism

In this concluding section we consider the concept of a flexicurity economy from an enlarged social perspective which extends the security aspect to the whole life-course perspective of the household sector (which includes besides employment and income security also the aspects of medicare over the life-course of the individual families and also the form of pensions on the basis of which they live and contribute to the evolution of the social economy when retired). A second pillar of extension of flexicurity to a truly social form of competitive capitalism is the educational system that is underlying its occupational structure of skilled, high-skilled workers and also professional elites. We therefore now extend the flexicurity model towards the integration of an educational sector that is adequately structured concerning the objectives of such a society. A third pillar of the flexicurity based form of social capitalism we are portraying is the formation and conduct of the economic and political elites of the considered society which must be thoroughly based on the educational system, must be democratic in nature and must solve coordination problems as well as incentives problems on all levels of the considered society. We stress here that the three pillars are not to be considered as only providing `welfare' to the household sector, but also expecting contributions from its various components, through participation in activating labor market policies (where necessary), through active engagement in the process of life long learning and through adequate contributions to the solution of economic and social coordination problems as well as incentive formation.

3.1 Pillar I – Households' life-course perspectives: Full Employment, Income, Medicare and Care for the Elderly

So far we have considered households working in private sector as supplying the payments for those employed on basis of an Employer of First Resort (a quasi unemployment insurance for this sector) and also the base pensions of the retired households. Under social capitalism we would assume instead that the latter transfer is made out of the budget of the government (out of ordinary tax payments) as are the now added medicare expenses (including the care for the elderly). Taxes in the government sector can be netted out, so that taxes in the private sector must be sufficiently high now to cover all these expenses.

There is a ministry for health services as well as a ministry for pension issues (including company pension funds regulations) who are in charge of organizing these fundamental sectors for the life-course of the citizens of the society. `Pay as you go' and related characterizations are thus no longer relevant in these central components of life-course security since these ministries will have a budget like any other ministry in the government where efficiency issues as well as equity issues have to be solved on the micro-economic level in addition. The provision of medicare can thus in principle (ignoring actual deficiencies) be organized as in countries like Sweden, where sufficiently high taxes are accepted for solving the problems of health insurance. In contrast to the EFR transfers which depend on the state of the business cycle, these government provisions are of a fairly regular nature and based on health requirement conditions and life expectancy statistics. We do not yet discuss the accumulation of funds for the three transfer payments for the life-course structure of the household sector, but assume sufficient flow of funds in this respect.

We view the provision of such a life-course perspective for the household sector as laying the proper foundations for the acceptance of the capitalist conduct in the private sector of the economy that is indispensible for a proper functioning of the considered new social structure of capital accumulation.

3.2 Pillar II - The educational systems: Equal opportunities, skill formation, life long learning and citizenship education

We assume in our model only two types of workers: skilled and high skilled ones which demands that all students will pass a secondary school certificate like Abitur or A-level. Therefore, a strict concept of demand and support is necessary as well as the rules of equal opportunities in order to eliminate all hindrances for children to participate in an education that fits their abilities and allows them to meet the requirements of the schools. It is the task of education to provide students in (pre)schools not only with the necessary skills to become adequate workers in their later professions and jobs but also to help them to understand this system and to integrate themselves into it.

Our educational system begins for children at the age of 2, though nursery schools may be available for younger kids if parents prefer this. All forms of schooling are thought to be all-day institutions though families may have a choice of lesser schooling until the child is 3 years old. Following the Scandinavian model of schooling, all children will be together in a general school at least until grade 8 or 9 when they are about 15 or 16 years old after a common kindergarten from 3-6. There will be no grading or class repeating. When students have to opt for different types of secondary (or high) school thereafter they can be aware that all types will lead them to a matriculation certificate though with different focuses (either more academic or more technical) and a different length of schooling (between 2 and 4 years depending on the preferences of a student) so that they are able to plan their secondary school time with the help of their teachers, following their individual abilities and interests.

This school system needs to bring to life all abilities and interests a child may have, since otherwise the ambitious aim of a final certificate for all cannot be reached. Education has to improve its didactics and methods, so that each child can be supported in its special competencies, and furthermore that each child can be supported individually so that he/she will be able to pass a successful school. This strong focus on individual support in relationship with the common aim of reaching the final certificate demands not only a well equipped school with regard to teaching personnel, further personnel such as social workers, psychologists, librarians, medical helpers and close relationships with professionals from outside such as sport trainers, artists etc., but it also demands a well equipped school with attractive rooms and more. All teachers from Nursery School onwards will have to get a university certificate.

Equal opportunities are thus an aim in the school system but also the way in which the ambitious aim of a final certificate for all can be reached. About half of the students with the final certificate are supposed to become high skilled workers in our model. Of course, there are exceptions to these rules to be allowed for, such as they are for example given by open universities for the skilled segment of the labor market (based on the possibility of only part time occupation or simply by a voluntary utilization of leisure time of the accordingly motivated members of the skilled workforce).

Students who finish school with the final certificate and enter the workforce as well as those who do so after having obtained a University degree are already well trained in organizing their learning processes so that Life Long Learning will be no problem for them the aim of which is not restricted to skills and competencies with regard to later employment, but is regarded as important within a personal, civic or social perspective as well. The idea of lifelong learning adds to the concept of equal opportunities, since the personal access to knowledge and competencies is increased by the possibilities of learning independently of age or position.

Political learning plays an important role in education, especially in a model where the state has a major role as employer and provider of social services. Political learning, which is often referred to as citizenship education, is of high relevance in a system that depends on individual skills and knowledge of its workforce, and that at the same time demands a high amount of social commitment and acceptance of different work places (though no unemployment). Furthermore, the principles of equal opportunities, on which we have commented above, have to be integrated in more general political concepts such as Human Rights, whereby that the necessity of political learning is again emphasized. Political learning will be part of school education as well as of lifelong learning.

Besides the acceptance of the considered social structure of capital accumulation, this second pillar thus has to provide a the foundations for an understanding of the socio-economic structure within which the citizens of the country are constructing their life-course pattern.

3.3 Pillar III - Microeconomic and political conduct: Democratic competition and elite formation

Following Higley (2006) we define for our brief discussion of the role of elites under social capitalism members of elites:

> *as persons, who by virtue of their strategic locations in large or otherwise pivotal organizations and movements, are able to affect political outcomes regularly and substantially.*

This is a functional definition of elite members (not a factual one and not one that analyses the current and past power elites, their habitus and their formation rules) which must be made more concrete by considering the formation of elites, their areas of operation, their conduct and remuneration as well as their failures and democratic control for our envisaged new social structure of capital accumulation, in clear distinction from the status quo of actual developed capitalist economies. Note also that elites in this sense must be distinguished from prominence (artists, philosophers and also entertainment).

Elites in the considered society must be well-educated, well-trained and also well aware of their citizen obligations as well as of their role as top decision makers, moral institutions and leading representatives of the political and cultural system they are belonging to. Education of elites is a crucial element in any society, not only from the point of view of preparing such talented persons for their later occupations, but also with respect to their ethical conduct in a pluralistic democratic society and their role as citizens of such a society. This includes not only the reflection of the factual origins of elite formation, their habitus and their full participation in a multi-faceted democratic society, but also the reflection of elite failures, in particular in their professional conduct, in the misuse of their power and the violation of human rights.

It has to be taken into consideration here that it cannot be predicted whether a child will become a member of elites as an adult even if the social and intellectual background of his/her family may give reason for such an assumption. Therefore, it is absolutely necessary to support each child in his / her progress so that he/she can develop all his/her skills, competencies and talents. This demands an education as we have shortly described it in the preceding section, which starts early and is capable to support each child in his/her individual progress. The necessity of an early support of the development of children is one of the reasons why not only teachers, but all educators need a tertiary education at a university.

The individual support of all children in preschool and school is mainly due to the underlying concept of equal opportunities, which also includes the support of gifted and highly gifted children. Since there has to be consensus in the considered society about the necessity of elites, it is also a duty of schools to keep in mind that some children will develop their skills, behavior and responsible commitment such that they will belong to this group in their later adult life. Elites should be high-skilled persons (with an appropriate university degree), of course with the exception of political elite formation who should be open to all adult citizens of the country.

Social capitalism also demands for new property and control rights, on the level of small firms (private ownership), medium-sized firms (mixed ownership) and large firms (equity owned, with upper limits to individual ownership). They demand for the democratic election of supervisory boards in the latter two cases (composed of representative of the owners, the workers and the government) and from there the implementation of a board of managers (with an elected executive person at the top, currently called a CEO).

In the political sphere we propose – following Schumpeter (1942) – majority voting, in the interest of the formation of governments that are capable of acting in a decisive way, in contrast to the clumsy coalition formation processes that can happen under percentage voting in the case when a larger number of parties is elected into parliament. The basic aim of a democracy is not to represent the will of the citizens (which is not possible both from the theoretical as well as from the practical point of view), but to change governments -- within the frame of democratic separation of power rules – in a civilized way towards a government that is capable of acting (by its sufficient majority in the parliament). Of course, elected governments have the ethical obligation – to be supported by the educational system – to improve the social cohesion in its country in the many aspects this may be demanding for.

Parallel to his figure of `the dynamic entrepreneur', Schumpeter (1942) also formulated political competition under democratic competitive socialism, the architecture of which he was designing in this book. In our view this would give rise to the addition in majority voting systems that there should always be two candidates (among them on outsider) for the same party in the same voting district in order to avoid that parties control their seats in parliament solely from the above.

Summing up we stress again that flexicurity systems (though much less biased than welfare states) concentrate on the economic aspects of societal evolution and ignore more or less the social aspects of it, which are however needed in order to provide sustainability for the evolution of Western capitalist democracies, the type of economy on which this paper was focused. Besides its acceptance based on pillar I and the understanding of it created in pillar II, the considered society must also solve the coordination and incentives problems inherent in its reliance on a strictly competitive form of capitalism shaped in particular through the institutional changes brought about by its economic and political elites. Definitely, this is not a perspective for the future evolution of capitalism that can be considered as being in line with the following characterization of capitalism by Marx:

> "A rise in the price of labour, as a consequence of accumulation of capital,
> only means, in fact, that the length and weight of the golden chain the wage-worker has already forged for himself, allow of a relaxation of the tension of it. In the controversies on this subject the chief fact has generally been overlooked, viz., the differentia specifica (defining characteristic) of capitalistic production. Labour-power is sold to-day, not with a view of satisfying, by its service or by its product, the personal needs of the buyer." (Marx, Capital I, 1867, 579-80)

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