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Abstract

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A Decent Capitalism for a Good Society

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A Good Society needs to be built on an economic system that differs significantly from the current finance capitalist models around the world. In light of the claim of personal freedom, emancipation and choice within and through a Good Society, a market system is the most functional, dynamic and feasible alternative on the table. However, a number of national, regional and global changes would be necessary to provide for the economic preconditions for a Good Society based on stable growth, equality and sustainability. In the following, we will sketch out the main arguments and pillars for a reformed capitalist model, which we labelled "Decent Capitalism".

Main Street Beyond Mainstream

'Capitalism' as a term is back on Main Street. Crashing, dismantling, reforming, repairing, restoring – all kinds of approaches to capitalism are discussed in the wake of the recent crisis. The debate has gained far more momentum today than it had during the past decade, though we had already witnessed a number of such crises. In contrast to the debates of the first decade of our century, policy alternatives to a wholesale freeing up of markets are suddenly being seriously discussed again. However in practice, the gap between regulatory rhetoric and actual reform of our economies is still considerable. Our systems remain at risk of ongoing instability. Crises will continue to be the norm rather than the exception, if we keep on working with the dysfunctions of current capitalism. Many of us will be unable to live a decent life under conditions of increased insecurity, inequalities and pressure in terms of wages, jobs, raising children and providing for old age. An excessive degree of unequal income distribution and personal insecurity is not only detrimental to a good life, it is also economically dangerous and inefficient. The reasons for economic crises and increasing inequality, which are symptom and root of personal and systemic insecurity and inefficiency alike, are manifold.

Most of today's mainstream economics books concentrate on the most obvious crisis factor, financial markets (see for example Wolf 2008, Posner 2009, Rajan 2010, Paul Krugman 2009). The sheer amount of books published in the wake of the crisis suggests a major shortcoming in this sphere of capitalism. And in fact finance has played a crucial role in most of the economic crises we have experienced since the 1990s. Financial markets are both gigantic amplifiers of imbalances within and between our economies and a root of imbalances themselves. Illuminating the cracks in finance is therefore the logical starting point for fixing or overcoming our current capitalistic system. Fundamentally correcting the influence and functions of financial markets is also the anchor of the political project of building a Good Society. However, one has to be very careful not to fall for the argument that the cracks are not that dramatic after all. Behind fancy finance talk of controlling credit default swaps and asset backed securities is sometimes the hidden agenda of scapegoating single financial instruments or actors in order to be able to leave the basic structure of the system untouched. Like the US economist Nouriel Roubini and historian Stephen Mihm, we think that a broader look at capitalism is necessary. We also agree that sticking to ideologies and taboos like the simple belief that free markets will always solve economic problems best unduly narrow our perspective of what is wrong with today's capitalism. As Roubini and Mihm (2010: 6) put it: 'It's necessary to check ideology at the door and look at matters more dispassionately.'

A sober and encompassing approach to today's economic dysfunctions is necessary, because the excesses of finance are only one part of the fundamental problems economies and societies are facing and which have contributed to the recent crisis. There are at least two dimensions of instability which are related to finance but go beyond the narrow instabilities of the financial system. First, imbalances between different sectors within economies have escalated. One expression of this is highly indebted private households as well as governments, as a consequence of real-estate and other bubbles, which were fuelled by the financial system. Second, international imbalances have never been as big as today – take for example the most prominent cases, the current account deficit of the United States and current account surpluses of China, Germany or Japan. Besides such instabilities, the neoliberal globalisation of the last decades led to income and wage disparities which had not been seen since the early times of brutal capitalism before the First World War. Without doubt a certain degree of inequality based on hard work or innovative entrepreneurship is the fuel of capitalism. When the degree of inequality – as it is today – becomes very high and the level of incomes loses all sensible relationship to an individual's effort or performance, however, the system begins to crack.

It is not surprising that 'equality' is back on the agenda when discussing the successes and the future of market societies. Influential books in that matter include *The Spirit Level* by Richard Wilkinson and Kate Pickett (2009) and *Animal Spirits* by George Akerlof and Robert Shiller (2010). Increasing inequality is a phenomenon which can be found in almost every country. High inequality does not only provoke a feeling of 'unfairness' in and between societies; it also hinders social mobility, has negative impacts on health and also on productivity. Hungry wolves do not hunt best – in fact, the very opposite is true for our today's economies. The American dream of high social mobility within a society and the opportunity for anyone to become rich if they work hard enough is in fact little more than a mirage. Today, mobility within society is more of a reality in the Nordic countries of Scandinavia, where equality is higher than in the Anglo-Saxon world of capitalism (Lind 2010). This is an important insight for redesigning capitalism in the sense of a Good Society.

Capitalism has other problems: in the past, it has led to a very special type of technology, production and consumption growth which is blind to ecological problems and the fact that natural resources are limited. Prices systematically fail to incorporate ecological dimensions and the deterioration of nature in an adequate way, and give the wrong signals for the direction of innovation as well as of production, consumption and the way we live. After experiencing a number of regional ecological disasters in the past century, the world is now heading for a global ecological disaster, unless fundamental changes take place very soon. This makes the search for solutions very complicated: The present crisis is not only a deep crisis of traditional capitalism, but it has emerged at a time when a deep ecological crisis is also evolving. To solve only one of the two crises is not enough to provide humanity with sustainable and acceptable living conditions.

Main features of a new economic model

A decent capitalism should include three interrelated dimensions. First, the model should be ecologically sustainable: preventing global warming, changing to a renewable energy basis and preventing other problematic developments such as a reduction in biodiversity. Second, it should be formed in such a way that the targeted growth process is not jeopardised by either asset-market inflation or ensuing deflation (boom-and-bust cycles), and does not result in the excessive indebtedness of individual sectors or even whole economies, thereby leading inevitably to the next crisis. At the same time, such a model should promote innovation and, therefore, technological development necessary both for solving ecological problems and, in the medium and long term, increasing labour productivity and so holding out the possibility of growing prosperity for all. Third, in our view, it is critical that all population groups have a share in social progress. Inequality of income and wealth distribution must be at politically and socially acceptable limits. Everybody should have a decent living, which is the basic thought of the Good Society project.

Focus on demand and green growth

At first, we want to address the question, which the drivers of growth are in a Decent Capitalism. A society's volume of production is ultimately determined by its level of demand; the latter is made up of investment demand, consumption demand, government demand and exports minus imports. If demand and production volume increase more slowly than productivity, the employment of labour falls. If working time and labour participation remain unchanged in such circumstances, unemployment rises. If development is to be lasting, the volume of demand must grow at a stable and adequate rate. That requires a certain proportion between the different components of demand. For example, it makes no sense to build up economic capacities through high investment if consumption and the other components of demand are too weak to make full use of these capacities. As consumption demand is the biggest demand element (usually between 60 and 70 per cent of GDP) it is important to have a regular expansion of consumption demand based on the incomes of households.

Of paramount importance is, of course, investment demand, which comes from private sources and also from public households. Investment does not only create demand; investment goods embody new technology and are vital for economically sustainable growth in the future.

In order to allow sufficient demand growth on the part of private households, it must first and foremost be ensured that the wage bill – at least over the economic cycle – increases at the same rate as GDP. It is true that, ultimately, profit income also flows to private households. For most households, however, wage income represents the bulk of their earnings and so defines their consumption possibilities. Furthermore, experience shows that the consumption rate is much lower in the case of profit income than in that of wage income. An increase in profits and thereby of household incomes with a high savings rate, without a corresponding increase in incomes in general, therefore does not suffice as a driver of demand. In such a scenario, households dependent on wage income could increase their consumption sufficiently only by increasing their debt. Primarily credit-driven consumption demand is not sustainable and extremely dangerous, as the subprime crisis has clearly demonstrated.

Government demand is also important. Governments deliver many important public goods like education or health care and in this way structure consumption in a society in a positive way. Governments are also of key importance in delivering infrastructure, as well as for ecologically sustainable growth. Many of the economically most successful countries in the world have a high proportion of public expenditures to GDP, as for example in the Scandinavian countries. If governments have to deliver important public goods and also want to modify unacceptable market-given income distribution, public households cannot be made ‘lean and mean’.

A country can stimulate its demand by focusing on exports and pushing for trade and current account surpluses. Such export-driven growth is, however, naturally a zero-sum game, as the export surpluses of one country lead to import surpluses in others. Excessive and enduring export-driven growth strategies of single countries are therefore generally harmful for the rest of the world and would have to be limited by global regulations.

There is a fundamental conflict between the present method of production and consumption on the one hand, and ecological needs on the other. If we do not quickly begin to tackle ecological problems, the survival of large parts of the world population will be endangered, creating extreme conflicts about areas in the world in which to live and work, about water and food, and last but not least about natural resources like oil. It is clear that the notion of a Good Society is by definition a global project and cannot be pursued in an isolated way. What we see today is an enormous and lethal failure of the market mechanism to combine economic growth and ecological needs. This does not only involve present methods of production and consumption; it also involves the type of technological development which has been taking place over the last two centuries. That development is not the fault of individual firms and consumers. It is the failure of the price system which for centuries sent out wrong signals about technological development, production and consumption. In spite of this fact, we do not see a fundamental conflict between growth as such and ecological needs like the prevention of global warming or finding methods of production and consumption without depleting non-renewable resources. With radical changes in the structure of production and consumption and technological developments, which will of course deeply affect our way of living, green growth without negative ecological effects is possible. We do not assume that growth is needed forever. Whether growing prosperity based on technological development takes the form of higher consumption or more leisure time is a question that a society must ask itself once a certain stage of development and level of living standards have been reached.

The neoliberal globalisation project has been combined with the unsustainable accumulation of debt in many sectors. For example, even if the private household sector as a whole has a creditor position, it is detrimental to the stability of an economy if a substantial proportion of private households have extremely high debts. Governments too have become highly indebted (measured in per cent of GDP), as have whole states. It also makes a difference which sector is in question. The enterprise sector, for example, can be indebted to a much greater extent than private households, because the latter cannot engage in production and value creation on the market. However, enterprises and financial institutions in the neoliberal era have also neglected to increase their equity sufficiently.

The fact is that growth in demand cannot be generated on a lasting basis if one individual economic sector builds up excessive debts, while other sectors accumulate surpluses. The same applies, in global terms, to individual economies. It is not necessary for the balance sheets of individual economic actors, sectors and economies to be identical. In fact, that would be extremely harmful. But indebtedness (always measured as a percentage of GDP) should keep within certain limits to avoid the over-indebtedness of sectors or of entities within sectors.[i]

Consumption demand and investment demand under a *laissez-faire* regime do not automatically develop in ways that allow stable and sustainable development. What is needed is a coordinated grip on consumption and investment demand in the interest of the economy and society as a whole. Achieving steady and satisfactory demand growth without dangerous tendencies towards indebtedness requires the imposition of a certain framework and economic intervention by the state. The institutional framework must be worked out in a way that leads to a relative equality of income, and that reverses the redistribution that has worked to the heavy detriment of lower-income groups. At the same time investment has to be stabilised by government interventions. A public enterprise sector can play an important role here, as well as infrastructure investment and cooperation between the private and the public sector.

To change production and consumption in an ecologically sustainable way will require a major change in the way energy is produced, mobility is organised, and houses are built. Such a fundamental change will inevitably have to be combined with a massive wave of new investment. The next decades, if fundamental ecological change happens, will lead to new private and public investment and GDP growth.

A financial system for economic prosperity and innovation

Financial systems represent something like the brain of the economic system. They are of crucial importance for dynamic development, although they can also drive economies to ruin. In fact, a well-functioning financial system has at least four tasks in a modern economy which are indispensable for sustainable growth.[ii]

First, by means of creating credit it enables enterprises – and, in particular, innovative enterprises – both to invest and to produce. The credit system can create money and credit, so to speak, *ex nihilo*, without the need for previous savings. These funds can be made available to entrepreneurs, who can use them to purchase materials or machines for production. The circuit closes when the investments of an individual enterprise increase the capital stock and so the production potential of the economy, as well as incomes and savings, thereby ensuring, almost retrospectively, the financing of investment. Since this process often goes hand in hand with innovation, the financial system supports the development of productivity in an economy at a crucial point.

The second central task of the financial system is the redistribution of risk. Although this function has fallen into disrepute somewhat in the wake of the subprime crisis, the redistribution of risk between different economic entities remains an important function of the financial system. Investments in individual projects often bear an enormous risk, up to the point of total failure. Individuals would therefore be reluctant to bear such risks alone, or would do so only with the promise of substantial returns. However, since the financial system makes it possible to spread the risk among many investors, and moreover individuals are not compelled to commit their entire assets, the aggregate willingness to invest in such projects increases.

Banks' credit allocation is an important part of the liquidity and risk transformation of the financial system. The banking system amasses the short-term deposits of the general public while at the same time granting long-term loans to investing enterprises. Stock markets can take on this function, because shareholders buy a long-term investment in the form of a share which they can sell at any time on the secondary market. Non-bank financial institutions such as investment banks, which are usually more risk-prone, also finance risky activities and can (provided they are properly regulated) support growth. A society in which the financial sector provides more liquidity and risk transformation will have a higher capital stock, and thus higher labour productivity and also higher material prosperity, than a society which lacks such a financial sector.

The third task of the financial sector is to make capital and credit available to the sectors and enterprises which offer the most promising investment projects. By exploiting economies of scale in the procurement of information, the financial system tends to judge better than individual investors which projects are likely to bear fruit. The allocation mechanism for the distribution of financial resources to their most efficient application is compatible with low general returns. Thus the general rate of return could fall to almost zero, and income from technology for innovative companies could become the sole substantial source of higher returns.[iii]

The fourth function of a financial system consists of accumulating the assets of small investors and using them to enable much bigger investments.

Against this background there can be no question of striving for an economic order that tries to manage without a financial system or without the indebtedness of individual sectors. The problem is that, over the past few decades, a financial system came into being which either does not carry out the above-mentioned functions or does so only in a form which leads to instability. In our view, there are five basic dimensions with regard to the necessary regulation and reform of the financial system.

First, risk-taking non-bank financial institutions like investment funds and hedge funds should be separated from commercial banks. The latter should not be allowed to give loans to non-bank financial institutions and there should be no proprietary trading by commercial banks – an idea, which was put forward by former Fed Chairman Paul Volcker. Such a framework would still provide sufficient capital for riskier ventures.

Second, it is not acceptable to allow the development of a shadow banking system which, by exploiting regulatory loopholes and shifting activities to less regulated areas of the financial system or even to states with wholly unsatisfactory regulation, systematically withdraws transactions from the regulated financial system. All financial institutions have to be regulated. Financial institutions have operated not only with ever-greater leverage, but also in a riskier, more short-term, more speculative and more return-demanding manner, with yield expectations climbing to irrational heights. It is equally unacceptable that financial institutions have been able to constantly reduce their equity capital ratios, ending up with little in the way of an equity capital buffer when crisis hit.

The third dimension consists of the creation of anti-cyclical instruments for macroeconomic governance in general and of the financial system in particular. In financial markets in particular – even with the best regulation – excesses regularly arise which have the potential to destabilise the rest of the economy, unless the state intervenes. This tendency of financial markets has been intensified by misguided supervisory regulations and accounting reforms. The rules of the game in the financial market, therefore, must be substantially rewritten in order to make the financial system once again capable of performing its important functions in the economy.

Within the framework of anti-cyclical policies, the central bank as well as the finance ministry attains a key position in the financial system. As soon as matters appear to be going off course, as in the case of a real-estate bubble, it must be possible to counter it by administrative means. Interest rate increases to stop bubbles are not sufficient, and are potentially harmful for the whole economy. Other policies should also be deployed more robustly in order to correct certain macroeconomic mistakes. For example, tax policy can combat excesses in real-estate and stock markets by taxing speculative profits.

Fourth, all financial products (especially all types of derivatives) need to be approved by a supervisory agency before they are allowed onto the market. Trading has to take place in organised exchanges only. These rules would allow sufficient opportunities to hedge risks and do not increase costs for firms in any relevant way. Rating agencies also should be supervised by public authorities as well as institutions defining international accounting standards.

Fifth, International capital movements pose another problem. Individual central banks are barely able to influence them by means of interest rate policy, but they can lead to huge current account imbalances and destabilising exchange rate turbulence. Here, too, central banks are in need of additional instruments to enable them to intervene in international capital movements. On the whole, the developments of recent decades appear to us to be misguided, since the instruments at central banks' disposal dwindled progressively, until finally they were left with nothing more than interest rate policy. Central banks should once again be furnished with instruments with which they can actively combat domestic asset-market bubbles and unstable international capital flows. Such instruments should be part of the normal toolbox of central banks.

More equitable income distribution

In recent decades, a marked inequality has increasingly arisen with regard to income distribution. This jeopardises the social and political cohesion of societies. Apart from that, income distribution which is too unbalanced is economically destabilising. If households consume primarily from their income, an increasing inequality in income distribution comes to have a detrimental effect on consumer demand, because those with high incomes have a higher savings rate. Germany and Japan are typical examples of substantial changes in distribution, with the growth in precarious living conditions further choking off consumer demand. In other countries – for example, the United States and United Kingdom – household consumption has been maintained, despite increasing inequality of incomes, by the increasing indebtedness of private households. These countries experienced higher growth from the 1990s until the outbreak of the subprime crisis, but this was accompanied by the build-up of financial instability. Such a model cannot be sustained in the long term, since it leads to the excessive indebtedness of sections of the population.

A decent capitalist model must reverse the negative changes in income distribution and grant all population groups an adequate share in the wealth created in society. One secret of the success of regulated capitalism after the Second World War was the increasing mass purchasing power of workers, based on growing incomes and relatively equal income distribution. It is now becoming clear that the old model has to be regenerated.

Income distribution has three important components: functional distribution of income in wages and profits, distribution within the national wage sum and the national profit sum, and state redistribution policy. A fall in the wage share is the result of a higher profit mark-up. The latter was possible, according to our analysis, on the basis of deregulation, in particular due to the increasing power of the financial sector and its willingness to take risks in pursuit of higher returns. The shareholder-value approach and the increasing role of institutional investors drove enterprises to pursue higher profit mark-ups. Correspondingly, the structures and rules of the game in the financial sector must be changed in such a way that the profit mark-up falls again.

The profit mark-up also depends on the level of monopolisation and power structures in goods markets. The task of competition law is to prevent the monopolisation of individual markets, because growing market power tends to go hand in hand with increasing monopolistic or oligopolistic profits, which in turn lead to more marked income inequalities and so to problems with steady demand growth in the economy as a whole. On the one hand, neoliberal globalisation intensified competition on goods markets, and on the other hand, multinational companies are becoming bigger all the time, due to growth, mergers or takeovers, so that the level of competition is decreasing. In many cases, natural monopolies – such as energy and water supply or the railways – were privatised without creating sufficient competition, as a result of which high profits have been made in these sectors. There is no need for privatisation in these fields. If state organisations were to take over production and service provision in sectors characterised by a natural monopoly, this could also reduce the profit share.

Recent decades have been characterised by significant wage dispersion. In almost all countries in the world the low-wage sector, as well as that of precarious employment and informality, has increased, especially in the sector of goods and services that are not internationally tradable. Globalisation trends, therefore, cannot directly explain the emergence of these sectors. They are the result of labour market deregulation. These unjustified income inequalities among wage earners must be dismantled by means of labour market reforms. The collective bargaining system must be strengthened, backed up by other labour market institutions to achieve the decent work conditions stressed by the International Labour Market Organisation. Minimum wages and social security guaranteed by the state also play a crucial role in this.

Even with strict regulation, markets do not lead to a politically acceptable income distribution. In addition to that, not everyone has equal chances in the market. The disadvantaged – whether on the basis of gender, childcare responsibilities, handicap, age, race and so on – can drop out of the market and be deprived of an income, or at best obtain only an inadequate one. Ultimately, by no means all incomes are obtained on the basis of personal achievements; consider, for example, large inheritances, which are an intrinsically alien element with regard to capitalism. Tax law and social systems must be deployed in order to organise income distribution in a socially acceptable manner. Tax law should therefore include a clear redistributive component, and this need becomes more pronounced the more evident it is that market outcomes alone will lead to growing inequality. Against this background, not only is a markedly progressive tax system important, but above all regulations which ensure that incomes from capital are adequately taxed. Tax evasion, for example, should be combated by the 'draining' of offshore centres and other measures. Public spending can also be used to reduce income inequalities, for example by providing public goods, such as education, health care and public transport. This also applies to state transfer payments and social security systems, which can contain markedly redistributive components.

Robust financing of state budgets

We have already mentioned that economic sectors should not constantly register increasing debt ratios. This also applies to state budgets. A very high public debt stock, measured as a percentage of GDP, has a number of negative effects. First, a high level of public debt can lead to negative redistribution effects, for example if state interest income flows into higher income brackets and taxes are paid by medium or lower earners. Second, a period of high interest rates, coupled with a high public debt, can cause the budget deficit to escalate to such an extent that budgets face refinancing difficulties. Third, state budgets can also become excessively indebted and cut off from the credit market. This typically occurs when the debt is in foreign currency, and has afflicted numerous less developed countries that have experienced currency crises in recent decades. But it can also happen when the debt is in the domestic currency. An example is the debt crisis of Greece and other counties in the EMU. A very high level of public debt ultimately limits governments' room to manoeuvre. In turn, it can cause legitimate demands for currency reform or other ways of alleviating public debt which are hotly contested politically and can be destabilising.

We are not calling here for the fixing of a particular debt ratio for public budgets, and certainly not for the fixing of a ratio for new borrowings. During sharp economic crises, such ratios cannot be maintained in the short term. Moreover, they could be harmful in the current economic circumstances, for example if the fiscal policy required by the economic situation is hindered by regulations on indebtedness, of whatever kind. Our argument is that the public budget should be divided into a consumption budget and a capital budget, with the latter financing public investment. The consumption budget should be balanced in the medium term and ordinarily financed by taxes and contributions. For public investment, public debt is justified, especially if measurable returns in the form of revenues from investments can be expected. However, in the long term a stable percentage of public debt to GDP should be achieved. In the short term, an active fiscal policy with sharply fluctuating budget balances is compatible with these norms.

At this point, the distinction between a capital budget and a current budget is helpful. The current budget includes state consumption expenditure and should be balanced in the medium term, while public investments are entered in the capital budget, which can be financed by long-term credit. In order to stabilise demand across the economy, first and foremost the capital budget should be deployed, bringing forward or putting off public investments in accordance with the economic situation. In the current budget however, the automatic stabilisers which result from changes in tax revenues and public spending due to the economic cycle should be accepted, as only a medium-term balancing of the current budget is needed.

Levels of regulation

The fundamental problem of the globalisation model of the past few decades lies in the asymmetry between economic globalisation and the largely still national regulation. Existing structures for the regulation and governance of the world economy are too weak or have too little reach, although economic processes have long had a global dimension. This is not confined to the economy in the narrow sense, but also encompasses many other areas, such as environmental problems. The lack of global governance also manifests itself in the fact that the production of international public goods, such as the prevention of further global warming, coordination of global economic policies or the provision of a stable international reserve medium, is inadequate.[iv] One function of global governance is to establish a more stable international exchange rate regime and a mechanism which prevents excessive current account imbalances. Without a certain degree of control of international capital flows, such a system is difficult to establish. To be sure, free capital flows are not a value in themselves as has long been claimed by the protagonists of the Washington Consensus. In many cases they increased volatility, created shocks and currency crises and were definitely not growth and efficiency promoting.[v]

Not everything can or should be regulated and governed at supranational level. A great deal can remain at the national level. Which measures should be regulated at which political level should be decided on a case-by-case basis. In summary, what is needed is to furnish economic policy institutions with macroeconomic governance mechanisms – either by introducing new ones or by restoring some which have been lost over the past few decades – in order to be better able to control and correct market developments which jeopardise the stability of the national and global economy or even the future of humanity.

The market is a good servant, but a bad master

In order to avoid misunderstanding, a decent capitalism does not provide carte blanche for regulation and state intervention of all kinds – this is by no means a precondition for building a Good Society as well. Not all forms of intervention by the state are capable of or suited to promoting stable economic growth or the steady development of incomes and demand. A number of forms of intervention are even harmful over the medium and long term. Within a state-given framework that takes account of ecological needs, the liberalisation of markets for products and services is the driver of innovations which increase productivity and living standards. The enormous impetus given to innovation by telecommunications in recent decades would not have been possible in a more heavily regulated market with higher entry barriers.

The costs of state intervention must, therefore, always be weighed against their benefits. Since the notion of a Good Society is a dynamic and not a static one, it must above all be ensured that intervention does not nullify elements of the market economy which ensure that product and process innovations occur of the kind which brings about higher productivity or simply higher living standards. As Joseph Schumpeter and Karl Marx showed, fair competition between enterprises and the possibility of achieving above-average returns by means of innovation are drivers of the development of the economy's productive forces. The possibility of achieving success in the market, as well as of failing in the market, is a central element in economic dynamics. This is the mechanism which underlies the market economy's superiority over attempts at central economic planning.

Furthermore, despite their many negative elements, markets must be regarded as an emancipatory achievement which increases the space for individuals to decide how they prefer to work and consume. For example, from research into happiness it is known that the self-employed tend to be more satisfied with their lives due to their largely self-determined daily work routine. As long as a move to self-employment is not the result of the economic pressure imposed by unemployment and does not lead to constantly deteriorating working conditions, the opportunity to start up a business must be considered a positive instance of freedom. Markets which are as open as possible without unnecessary red tape are important here because they tend to allow more people to choose how they want to live.

There is also no question of transplanting the economic system back to the regulatory situation characteristic of, for example, the 1960s or 1970s. Instead, the general principle underlying the new framework and state intervention must be to retain the emancipatory elements of liberalisation that have appeared over recent decades, while bringing the destabilising elements of deregulation back under control.

Markets and financial markets in particular tend towards excesses. Because these markets – in contrast to, say, the market for shirt buttons – have an effect on the economic system as a whole, the state must step in when correction is needed. Other markets, such as the labour market, also tend towards socially undesirable outcomes. And there cannot be any doubt that the market has been leading to a gigantic failure in the area of ecological problems. In a nutshell: the market is a good servant, but a bad master of any society. It must be given clear tasks, clear rules and clear limits in order to provide for the basis and frame for the project of a Good Society.

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i In a growing economy, this is entirely compatible with significant surpluses or deficits. With growth in nominal GDP of 5 per cent (3 per cent real and 2 per cent inflation), a sector can show a financing deficit of 3 per cent of GDP forever, without its net indebtedness ever rising above 60 per cent of GDP.

ii For a more detailed description of this and other functions of the financial system, see Priewe and Herr (2005: 140ff).

iii This was stressed by Keynes (1936).

iv The economic historian Charles Kindleberger (1986) provides a convincing account of this.

v For an analysis of the inner life of the Washington Consensus, see Kellermann (2006).