

Is Capitalism Obsolete?

A journey through alternative economic systems

Giacomo Corneo
Free University Berlin

Motivation

Capitalism is:

- Inefficient
- Unjust
- Alienating

⇒ Longing for a better economic system

Refusal to deal with systemic alternatives:

- intellectual cowardice
- foregone opportunities

Outline of my book

- Prologue Father-Daughter
- 10 chapters on alternative economic systems
- Epilogue Daughter-Father

Fundamental issue: Is there an alternative that could generate at least as much economic welfare as the social market economy?

Double test:

- Cooperation
- Allocation

Maintained assumption: alternative systems must prove to work with people as they are *now*.

Overview of results

For systems relying on gift exchange (general common ownership, anarchist communism, etc.) we obtain

Proposition 1: Their cooperation problem can be solved if:

- People live in small stable communities
- High-tech Panopticum-style monitoring
- Moralism and identification with the polity.

Proposition 2: But those systems do not pass the allocation test...

Democratic, pure **planned economy** based on iterated procedures as developed e.g. by Arrow and Hurwicz

Proposition 3: A planned economy does not pass the test because:

- Information transmission is manipulable
- Limited computing ability
- Major obstacles to innovation

⇒ in order to solve the allocation problem in a complex economy, markets are necessary!

The second part of the book explores hybrid systems:

- Self-management
- Market socialism
- Basic income
- Stakeholder society
- Shareholder socialism (3 variants)

Proposition 4: The first four alternatives fail to pass the double test. Only shareholder socialism passes it; however, since it requires a set of novel institutions, uncertainty is large.

A comprehensive proposal

Strategy 1: Upgrading the welfare state

Strategy 2: Enhancing the role of public ownership of capital

Strategy 1: Welfare State

The welfare state is an outcome of a collective decision process

⇒ It is determined by the political preferences and the constraints faced by the government

Problems w.r.t. preferences:

- (i) Government (agent) vs. citizens (principal)
- (ii) Erosion of the electoral support

Problem w.r.t. constraints:

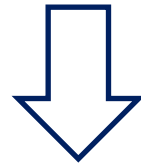
- (iii) International mobility of firms, top-income receivers, and financial capital

Solution:

- (i) More transparency and direct democracy
- (ii) High-quality public services
- (iii) International coordination of direct taxes

Strategy 2: Public Capital

Limited scope of egalitarian wage growth and tax-transfer-systems implies that some redistribution should occur at the level of primary capital incomes



Public ownership of capital should become a mainstay of the economic model of the 21st century

An evolutionary two-step approach

(1) Sovereign Wealth Fund

(2) Federal Shareholder

Step 1: Sovereign Wealth Fund

- Devoted to maximizing its risk-adjusted rate of return over the long run, mainly investing in world stock market
- Its returns accrue to the government and are earmarked to finance a **social dividend**
 - ⇒ Lasting reduction of income inequality
- Order of magnitude: SWF = 1/3 of GDP and net rate of return = 6 % ⇒ additional public revenues = 2 % of GDP (which translates into a social dividend of about 1,000 € per year in Germany)

Opportunities

- After age 20: Reinvestment of social dividend in an individual sabbatical account
- After age 40: Reinvestment of social dividend in an individual old-age account
- Ethical constraint on portfolio to promote peace, human rights, environmental sustainability

Step 2: Federal Shareholder (FS)

“Political influence is proportional to what one controls, not what one actually owns” (Morck et al., 2005)



- The country creates a novel public institution, the FS, with the aim of taking control of **large** firms – replacing capitalist control
- Institutional design must cope with two crucial issues:
 - **Incentive problem**: Making sure that public-democratic firms perform efficiently
 - **Partition problem**: Optimal subdivision of the sector between public and private control

Incentives

- 1.FS owns a majority (e.g. 51 %) of the shares of publicly-quoted firms and is not allowed to trade them; remaining shares are privately owned and freely traded in the stock market
- 2.FS exerts control through the corresponding rights associated with its ownership of shares
- 3.FS is politically independent – similarly to the central bank – and has the mission to maximize the long-run rate of return on its capital. Received dividends accrue to the government and are used to finance the social dividend

Incentives

4. FS is transparent. Performance-related pay (yardstick competition) is used to remunerate its personnel.
5. Civil society (trade unions, consumer organizations and environmental groups) gets facilitated access to relevant information
6. FS fosters co-determination and solidarity ethos in its firms, aiming at increasing productivity, wages and profits

Partition: capitalist vs. democratic

- Optimal partition between public and private firms cannot be determined ex ante
- We need a fair tournament as an evolutionary device to determine the optimal partition
- Fairness requires not only equal treatment but also transparent processes so as to guarantee that profits obtain from genuine market activities and not from political entrenchment



Relative financial performance will determine the relative growth of the two forms of governance (democratic vs. capitalist)

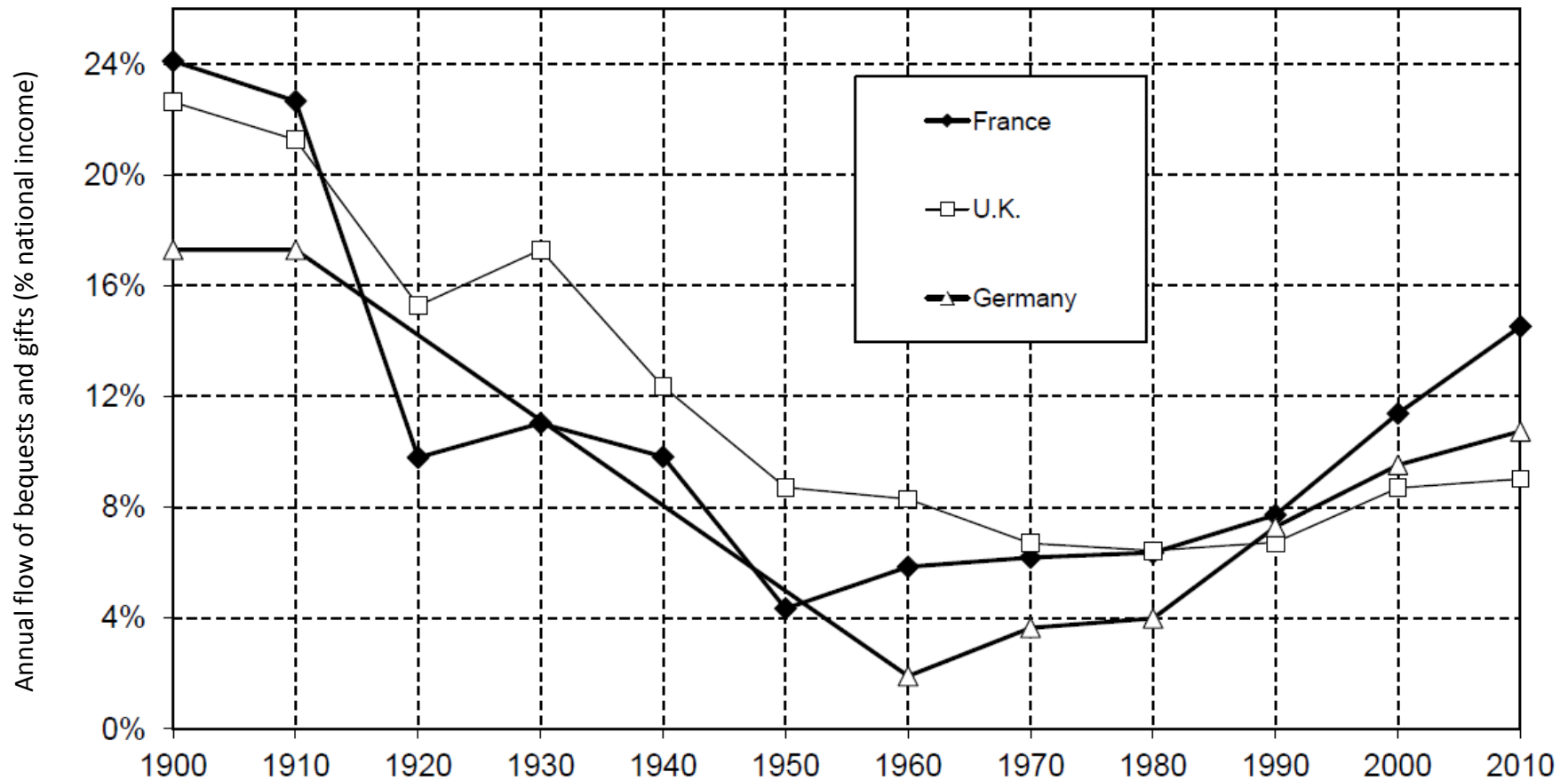


Pragmatic way to converge to the socially optimal structure

Summary of claims

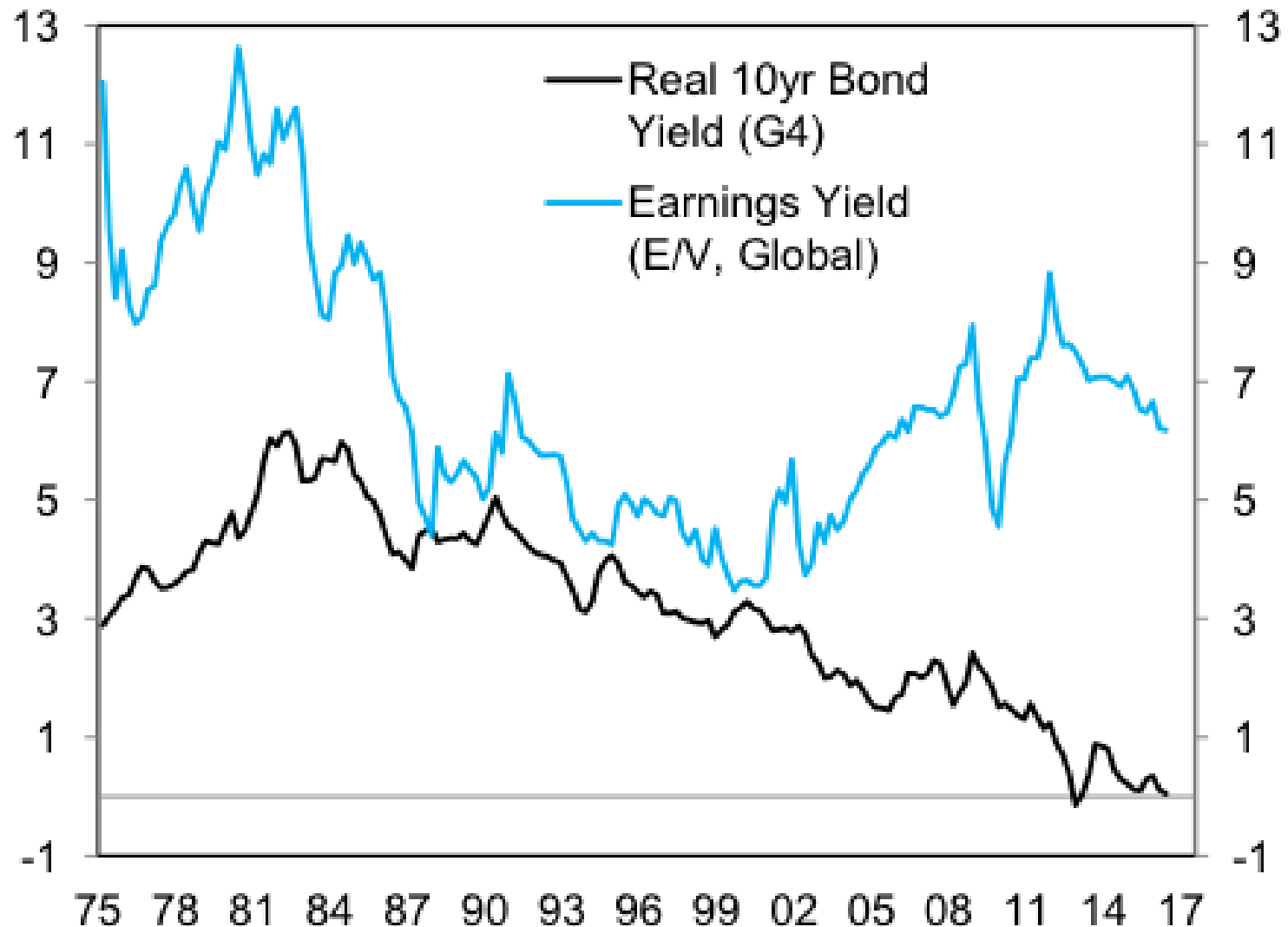
- Markets and entrepreneurship are necessary for shared economic prosperity, but not sufficient
- A modernization of the social market economy and an enhanced role of public capital are in order
- Modernization should focus on rejuvenating democracy, high-quality public services, and coordinated tax policy
- The governance of public capital should be assigned to two novel institutions: SWF and FS

The inheritance flow in Europe 1900-2010



Source: Piketty and Zucman (2015)

Global earnings yield, real ex ante 10-year government bond yield



Source: Goldman Sachs Global Investment Research/Daly (2016)