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JEL Classification: B1, D01, D02, D21, D31, D82, D86, D90, O31

Keywords: Inequality, Power, paradigm, Principal-agent model, classical liberalism, Keynesian social democracy, neoliberalism, Ethics, Civil society

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Shrinking capitalism: Components of a new political economy paradigm

Samuel Bowles and Wendy Carlin[1]
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1. Introduction.

The defining feature of capitalism is that, in return for wages, employees work under the direction of a manager or owner of the capital goods used producing output to be sold on a market for profit. When paired with a liberal democratic political regime, this economic system has sometimes delivered substantial and broadly shared gains in material living standards, as occurred, for example, in the higher income countries during the three decades following World War II, termed the "golden age of capitalism".

Since the late 1970s, however, "shared affluence" has given way to dramatic increases in inequality and stagnant real wages in many countries, and this development tops many lists of "what has gone wrong," often in association with concerns about the rise of authoritarian and nativist political movements. For others, the climate emergency exemplifies what has gone wrong.

A remedy commonly proposed is a more interventionist and egalitarian state, a form of social democracy now recast to include environmental protections – the "green New Deal" in the US, for example. Although a necessary component of a solution, capitalism with shared affluence plus sustainability would not be an adequate "fix". There are two reasons.

First, it neglects the fact that capitalism is shrinking and, on conventional welfare economic grounds, should be shrunk. In large parts of the knowledge- and care-based sectors that dominate the contemporary high-income economy, much of the work done does not take place in capitalist firms. And where it does, it is governed poorly because the complex, nuanced, and team-based nature of the work – contributing to the design of a new app, preparing meals in a restaurant, educating the young and caring for the old – requires a less hierarchically structured workplace.

Second, social democratic parties are in decline: a morally compelling and politically viable program to address our current challenges must go beyond shared affluence and sustainability to include a more encompassing standard of justice based on equal dignity and equal voice.

These reasons to doubt that a green social democracy will be an adequate fix also provide some guidance about what a more promising response might be. We propose that a sea change of the magnitude achieved by neoliberalism in the last quarter of the past century is needed and possible. This will require a fundamental reorientation not only of economic policies and the economic models underpinning them, but also a transformation of the normative framework and rhetoric in which they are advocated. We term this a new paradigm for political economy, equivalent in scope with not only neoliberalism, but also social democracy and classical liberalism.

Because a change of such fundamental scope may appear to be unlikely, we will make the case that much of the normative framework and economic modelling required for a new paradigm is already available. Equally important, there are good reasons to believe that the nature and seriousness of the problems afflicting the economy, social system and biosphere will constitute increasingly favourable conditions for its broad acceptance.

2. The rise and demise of paradigms in political economy.

To make concrete the idea of the paradigm we are proposing, we first take up past and still contending paradigms in Table 1. (We introduce a "new paradigm" shown in the bottom row in section 5). The key content for considering the feasibility of constructing a new paradigm is the relationship between the "problem addressed" and "reasons for eventual failure" columns.

The classical liberals targeted chartered monopolies conferred by royalty and the social inequalities of rank in traditional hierarchies. They did this not only for normative reasons, but also because the mitigation of these problems would contribute to a dynamic, growing economy. The increased role of markets in turn provided a liberal and decentralized rather than a Hobbesian top-down solution to the problem of economic and social governance.

The massive and persistent unemployment during the Great Depression challenged the adequacy of the classical representation of the demand for labour and the determination of wages and employment by a clearing labour market. After World War II, the social democratic paradigm addressed this failing of classical liberalism through a combination of demand- and supply-side policies, inaugurating in many countries an unprecedented era of shared affluence and reduced economic insecurity.

However, the social contract forged in conditions of rapid growth and falling unemployment proved to be fragile under the full employment policies mandated by many democratic polities. In the late 1970s, conservative and centrist politicians persuaded the public – in Sweden, the US, the UK and elsewhere – that the state was no longer the solution; it had become the problem, a development that we term state fatigue.

Beginning in the 1970s, the success of the neo-liberal paradigm spawned policies of deregulation of markets as a response to state fatigue , and in many countries weakened the bargaining power of labour and enhanced the market power of firms sufficiently to restore after-tax profits. This occurred even in the many economies in which attempts to shrink state expenditure failed.

In recent years these responses have given way not only to authoritarian statist policies by populist leaders but also to widespread demands for the re-regulation of financial markets and aggressive public policies to address the climate emergency and mounting inequality. The challenges posed by the pandemic of 2020-2021 further discredited the pursuit of individual self-interest and a minimalist state as an adequate basis of societal governance. Seeking to understand the leftward shift of the newly elected Biden administration, the *New York Times* columnist Ezra Klein captured a shift in the rhetoric: “stagnating wages and a warming world and Hurricane Katrina and a pandemic virus proved that there were scarier words in the English language than “I’m from the government, and I’m here to help,” as Ronald Reagan famously put it.”

Table 1. The rise and demise of paradigms in political economy.

Paradigm	**Intellectual origins**	**Problem addressed**	**Aspirations**	**Supplanted because …**
Classical liberal	Mandeville, Hume, Smith, Paine, Ricardo, Bentham, Mill (J.S.)	Chartered monopolies, traditional social hierarchies.	A system of governance consistent with individual freedom and a dynamic economic order	The Great Depression and the rise of Fascism made unemployment a central problem in economics and policy
Keynesian social democracy	Tawney, Beveridge, Marshall (T.H.), Pigou/Marshall Webb (B. & S.), Keynes, Meidner/Rehn, Kaldor, Rawls	Economic insecurity, inequality of income	Marriage of capitalist dynamism and social solidarity: shared affluence	Distributional conflict and the great stagflation demonstrated the limits of Keynesian aggregate demand management; also, state fatigue
Neo-liberal	Von Mises, Hayek, Gauthier, Nozick, Buchanan, Becker, Friedman	Overreaching states, nationalism, encroachment on profits	Global competition to select winners and losers and to curtail states; economic and political liberty.	Failure to regenerate growth, financial instability, growing inequality, climate emergency, threat of authoritarian statist populism.
New paradigm (see below)	Marx, Coase, Hayek, Ostrom, Schumpeter, Harrington, Dahl, Sen, Pettit, Van Parijs, Anderson; behavioural, identity, and information economics	Inequality of wealth, dignity and voice, pervasive external effects, climate crisis. Concentrated private power.	Sustainable biosphere; good jobs, redistribution of wealth and voice widens participation in innovation, both local and global identities /communities.	

The necessarily brief entries in the cells are illustrative, not exhaustive.

3. The economics of shrinking capitalism.

Other less noted trends further exposed the limitations of the neoliberal paradigm. Among these is a dramatic shift in the nature of work away from routine tasks that increasingly can be accomplished by computers, robots, and algorithms, and towards work performing more nuanced and complex tasks, whether they be interpersonal, cognitive, or analytical. This trend is augmenting the shift from the more easily monitored production of goods to the difficult-to-monitor production of services (only one in seven US workers are engaged in manufacturing, mining, or agriculture).

This is important because in the production of both goods and services the non-routine tasks that are less subject to automation are also more difficult for employers to monitor, more reliant on intrinsic motivation and less well-suited to the hierarchical structure of the capitalist firm. Roughly (and overstating to clarify the point): if the employer has sufficient information to write an algorithm that will direct a machine to execute a task, they usually can also specify that task in the terms of an enforceable contract with a worker. So, if a computer or a robot cannot do it, then it also is likely to be difficult for an employer to verify (in a legally binding way) whether the task has been done well, or at all. As a result, quite apart from the shift from goods production to services, the jobs within a given sector that remain after those that are subject to automation have been eliminated, will be more difficult to monitor.

Under these conditions three solutions to the fundamental problem of getting the work done are evident.

The first is epitomized by the reputation-based rewards, intrinsic motivations and information sharing that characterizes much of the open-source knowledge and open science communities and exemplified by the unprecedented speed with which new vaccines were developed during the COVID-19 pandemic. The solution relied on intrinsic motivation and a cooperative way of getting the work done and is a partial move away from the capitalist firm, particularly when paired with the more equal and gain-sharing reward structures often required to support it.

The second and third ways of getting the work done both exploit the surveillance capacities of the new information technologies that are in part underlying the trends in the nature of work, but in radically different ways.

The second solution uses new information technology to monitor workers' second by second actions. This solution is epitomized by work relations at Amazon's warehouses, but it is commonly in use wherever the employer can determine what the worker should be doing and measure the worker's actions with sufficient accuracy.

The third also deploys the new information technologies but instead of monitoring the employee's effort at a task, it monitors the result of her work, that is, the good or service produced. Where the nature of the job allows the output of a particular worker to be measured with sufficient accuracy to write it into a contract, pay can take the form of piece rates rather than an hourly wage – a given amount for the Uber ride completed or the TaskRabbit job done. Designating this kind of work as employment rather than contracting for a good or service has been an effective political and legal strategy to improve conditions for gig workers and their advocates. But unless people are paid by the hour and not by the task, it is not employment in the conventional sense of the term. It is a throwback to the putting out system that preceded capitalism in the production of textiles, shoes and other goods.

By reducing the share of economic activity over which capitalist firms have a comparative advantage, the first and the third solution – team-based open source and the gig economy – shrink capitalism. The second – Amazon-type monitoring – has convinced many that capitalism should be shrunk. It is seen by many as a privacy-invading assault on the dignity and autonomy of workers that cannot be compensated by higher wages, perhaps contributing to the now substantial fraction in the US who report that the term "capitalism" has negative connotations.

4. Requisites for successful paradigms

The successes both of the Keynesian-social democratic (including the US New Deal variant) and of neoliberal paradigms have taught us that a new paradigm becomes a force for change when it is constituted by four complementary attributes: new *economic thinking* capable of addressing the pressing current societal problems is integrated into a powerful *moral framework*, illustrated by *emblematic policy* innovations, and articulated in everyday conversations by means of what we term a *new vernacular economics*.

Central to the success of a paradigm is the synergy between the normative foundations and the economic model: the pursuit of the ethical values animating the paradigm must contribute to the performance of the economy as represented in the model. This synergy is the basis for what we term emblematic policies – such as the abolition of the Corn Laws for the classical liberal paradigm in Great Britain – that were taken up by political parties to improve the functioning of the economy and that found their way into everyday language.

We call these policies emblematic not for their importance in terms of societal impact but instead for their distinctive character in marking a paradigmatic shift. An emblematic policy must marry the paradigm's new values with its new economic model and rhetoric. School vouchers were by no means the most important of neo-liberalism's policies – tax cuts and deregulation were far more consequential. But "school choice" neatly combined rolling back the state, utilizing local information and giving families freedom to choose as a route to improved performance of the economy.

Table 2 illustrates each of the levels of a successful paradigm, characterizing the distinctive features of classical liberalism, Keynesian social democracy and neoliberalism. We return in section 5 to the 'new paradigm' in the final row.

Classical liberalism, for example, rested on commitments to order, anti-paternalistic liberty, autonomy, and utilitarianism, which dovetailed with its economic model characterized by competitive markets, division of labour, and specialization. Free trade and antitrust were its hallmark policies. Widening participation in business and in the exploitation of the growth of knowledge spurred a dynamic economy. Ordinary discourse took up its truths, as when Alice (in *Alice in Wonderland*) reacted to the Queen's "Oh 'tis love, 'tis love that makes the world go round," by whispering: "Somebody said that it's done by everyone minding their own business."

The more recent economic paradigms were also founded on a synergy of complementary values and economic models.

. Keynesian economists combined an ethical commitment to reducing economic insecurity and raising the incomes of the less well-off through government programs and trade union bargaining, with a set of economic propositions about saving behaviour, automatic stabilizers, and aggregate demand. Both the coherence and the rhetorical power of the Keynesian paradigm depended on the belief – very plausible under the circumstances – that the pursuit of its advocates' egalitarian values through economic policy and organization would improve aggregate economic performance by sustaining higher and more stable levels of output and employment. In turn, government commitment to support aggregate demand was made credible to business by new domestic and international policy frameworks, which produced buoyant "animal spirits" and high investment by capitalist firms. Shared prosperity and dynamism were complementary, each reciprocally providing conditions that enhanced the other.

In like manner, what has come to be called neoliberalism rested on two normative pillars. The first was "freedom from" government coercion (rather than a more expansive "freedom to" and the absence of domination in private or public spheres). The second was a procedural view of justice, which deems outcomes– however unequal– as fair so long as the rules of the game are fair.

Cementing neoliberalism's philosophy to its economics was an economic model in which people are individualistic and amoral and they interact in the economy through exchange in competitive markets under complete contracts. Complete contracts cover all aspects of the exchange of interest not only to the exchanging parties but to anyone affected by the exchange. This device ensured against market failures arising from "spill overs" or "external effects," such as epidemic spread or greenhouse gas emissions.

Extending the assumption of self-interested agents to the public sphere gave neoliberalism a view of public choice in which governments and other collective actors, such as trade unions, or environmental groups were simply special interest groups using up scarce resources in order to get a larger slice of a smaller pie. In this model, the limits on government that were advocated on ethical grounds were also necessary for a well-functioning economy.

Table 2. The normative foundations, economic model, emblematic policies and economic vernacular of four paradigms.

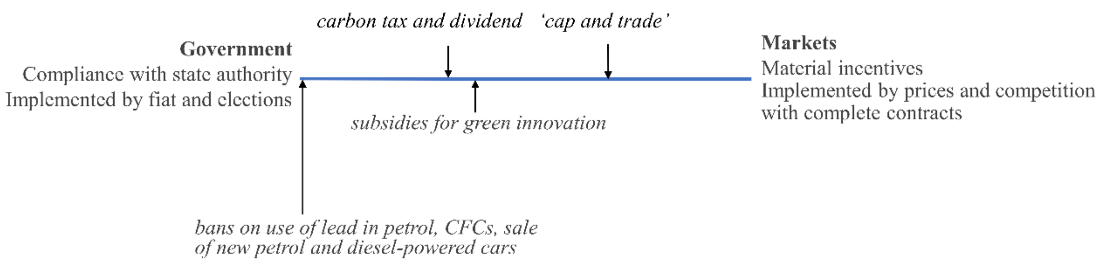
	Normative foundations	**Economic model**	**Emblematic policies**	**Economic vernacular**
Classical liberal	Order, rule utilitarianism, individual autonomy from traditional hierarchies and paternalism, equal dignity	Division of labour, specialization, competitive markets, comparative advantage, precursors of mechanism design; cardinal utility	Anti-tariff, anti-monopoly, complementarity of state-provided infrastructure and private investment	"It is not from the benevolence of the butcher, the brewer, the baker that we expect our dinner, but from their regard to their own interest. … Nobody but a beggar chooses to depend on the benevolence of his fellow citizens" Smith. Additivity of "moral sentiments" and material interests
Keynesian-social democratic	Security, fairness, shared affluence	Aggregate demand, paradox of thrift, solidarity wages, theory of the second best	Demand management, tax, transfer and public goods redistribution, unemployment insurance, egalitarian supply-side policies	Well-paid workers sustain demand. Saving is prudent for a family but not for a government when the economy is in recession. "Same boat" solidarity
Neo-liberal	Negative (formal) freedom, procedural justice	Self-interest (individuals & government officials) and competitive markets. No interpersonal comparisons of utility. Pareto criterion.	School vouchers, "negative income tax" "Buy your own council house" Privatize telecoms and utilities. Reduce barriers to international movements of goods and capital.	"The government that governs best, governs least." Labour unions are special interest groups. "There is no such thing as "society". You get what you pay for. "Choice" "Exit" Individual responsibility.
New paradigm	Social relations free from domination, equal dignity and voice, community, sustainability	Power in principal agent models; identity economics; increasing returns and multiple equilibria; Schumpeterian growth. Cardinal utility. Complementarity of "moral sentiments" and material interests. Intrinsic motivation and cooperation as essential to a high-performance economy.	Significant inheritance taxation with a partial civil society opt out; home price insurance to reduce risk exposure and democratize innovation; workplace rights and voice; substantial reform of IPR; competition *for* markets via corporate governance reform; unconditional basic income grant.	"Real freedom for all", "The cooperative species", Good morals is good economics, "Voice", "Libertarians fail at inequality, statists fail at innovation" "Shrinking capitalism" , Difference without domination.

The values and the model were brought together in emblematic policies additional to school vouchers such as a negative income tax in the US (replacing anti-poverty programs with direct cash payments, and thereby reducing the need for privacy-invading information gathering by governments), the sale of council houses to renters in the UK and of shares in formerly state-owned utilities to consumers in Australia and New Zealand. A new vernacular took up memes such as "The government that governs best governs least" and "welfare Cadillac" (to indict alleged government profligacy in aiding the poor) and the famous 'Tell Sid' advertising campaign for gas privatization in the UK (to brand share ownership as something for 'the man on the street').

5. The one-dimensional approach to options for policy and institutions.

A changing mix of motivations and allocation mechanisms associated with market and state characterizes the previous two paradigm shifts, illustrated in Figure 1. Take the policies "carbon tax and dividend" (in which the government sets a price on carbon emissions) and "cap and trade" (in which the government sets limits on emissions and lets the market determine the price). Each uses a different combination of state capacity and market mechanism (one more neo-liberal closer to the market pole; the other closer to the government pole) to deliver lower carbon emissions (lower panel).

Figure 1. The one-dimensional "government versus markets" policy and institutions space



But Figure 1 depicts a restricted one-dimensional continuum of policy options, one that appears anachronistic in light of two important developments in economics. The first, thanks to the "information revolution", is the recognition that the information available to both governments and private economic actors alike is local and limited. The result is to curtail the ability of either private contract or governmental fiat to address many problems. The consequences go beyond market and state failures (respectively). Limited information is also the reason why many economic interactions take the form not of market exchanges – like the purchase of bread or steel – but instead principal-agent relationships in which one party to the exchange – the employer or, for example, the lender – exercises a form of private power over the other – the worker or the borrower.

The second development, due to behavioural economics, is that people have other-regarding preferences and ethical commitments going beyond the amoral and self-interested economic man. The one-dimensional paradigm and its policy levers thus overlooks the opportunities for solutions drawing on the social character of people, our intrinsic motivations to help others and to do a good job, our desire to construct a dignified identity and the power of social norms, such as greener consumption preferences.

These social preferences may constitute not only an opportunity for better societal governance missed in the one-dimensional paradigm, but also when ignored, a cause of ineffective, even counterproductive policy. There is some evidence, for example, that paying for blood donations reduces the supply (at least among men). And during the 2020-2021 COVID-19 pandemic in Germany, "control-averse" citizens enthusiastically supported vaccination if it were to be voluntary but much less so if it was required by the government.

The limitations of the one-dimensional depiction of the policy-institution space are illustrated by returning to the challenge of environmental sustainability shown in Figure 1. Where do we locate policies that cultivate and mobilize green values and social pressures from neighbours and friends to alter one's lifestyle so as reduce one's own carbon footprint?

Dismissed by some as a fringe concern, the impact of values' changes can be substantial. A recent empirical study of "green" and "dirty" patents in the automobile manufacturing sector around the world found that a greening of values (of a magnitude observed over the past two decades) along with increased competition would account for a greening of innovation of the same magnitude as would have resulted from a (politically explosive) forty percent increase in fuel prices.

6. The synergy simplex: State, market and civil society as complements not substitutes.

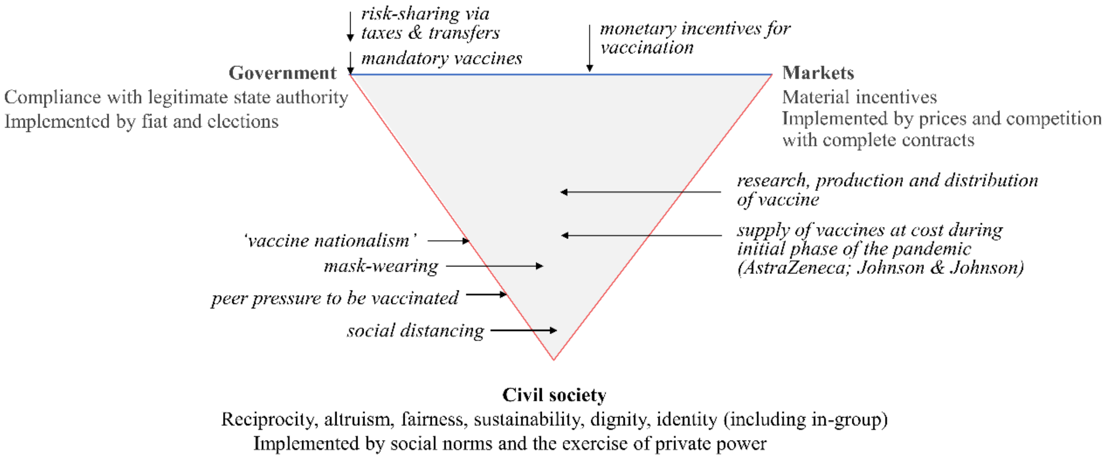
New developments in economics have extended our thinking to a new set of motivations – a commitment to justice, reciprocity and a concern for others, the demand for dignity and voice and new allocation mechanisms – social norms and the exercise of private power, including that wielded in the form of collective punishment by peers. As a result a new space is opened up for policies and also for new critiques of the status quo. The third pole in Figure 2 is labelled 'Civil society' and any point in the interior of the triangle represents a particular configuration of policies or institutions that combine motivation and implementation mechanisms from all three poles working together. Thus, entries represent organizations or policies with differing combinations of rules of the game and motivations characterized by the three vertices.

We call it the synergy simplex because we are not posing the question as governments *versus* markets or state *versus* civil society. Instead, well-designed organizations and rules of the game allow its vertices – governments, markets, and civil society – to work in complementary ways rather than as substitutes.

Consistent with a new paradigm, the simplex also provides a way of conceptualizing the sources of growth, not in material output but in the subjective well-being of people. A revival of economic dynamism is essential for addressing the climate and biodiversity crises. And, modelled by the new Schumpeterian growth theory – will depend on mobilizing the complementary strengths of creative destruction among capitalist firms (markets) motivated in part by green social norms (civil society), as well as the ability of the state to direct innovation and enforce competition and regulation, along with new policies to democratize access to innovation.

Figure 2 introduces the simplex by locating responses to the COVID-19 pandemic crisis in the new institutional/policy space.

Figure 2. The synergy simplex: Using an expanded space for policy to map responses to COVID-19



Such policies fall at various points inside the triangle. A successful policy placed toward the centre would use a mixture of all three mechanisms such as in the research, production, distribution, and population coverage of a vaccine for COVID-19. Other policies are closer to one or the other of the vertices, for example social distancing, which when it occurs, is largely a matter of individual values and social pressures that characterize the civil society pole, whilst the massive fiscal and monetary policy action lies at the state pole.

The pandemic has brought to the fore employers' exercise of power over their employees: as when workers in meat packing plants and other hot spots were required to come to work. An economic model recognizing this exercise of power – and therefore able to incorporate its abuse by employers – gives policymakers a framework for addressing the plight of low-paid essential workers forced to choose between their family's livelihood and their health during the pandemic. Policy initiatives in this area range from expanding workers' individual rights on the job to support for those who stay home so as to minimize the epidemic spread.

7. Elements of a new paradigm

Ethics and economics.

Returning to Tables 1 and 2, the normative foundations of the paradigm – stressing equal dignity and voice, freedom from domination and solidarity among members of a community – have been articulated in the works of Robert Dahl, Amartya Sen, Philip Pettit, Philippe Van Parijs, and Elizabeth Anderson, and others. Many of the themes of which can be traced to the early contributions of Machiavelli's *Discourses* (c. 1517) and James Harrington's *Oceana* (1656).

The associated economic model has roots in the work of Marx and Coase on the nature of the firm and the exercise of power by employers over employees, Schumpeter on creative destruction, Hayek on the creativity of market competition, Robert Akerlof and Rachel Kranton on identity, and Eleanor Ostrom on community-based ways of addressing environmental and other social problems. It rests on the advances over the past several decades in behavioural, information and identity economics and in the understanding of Schumpeterian growth.

The economic model component of the paradigm is based on an expanded concept of uncompensated external effects of an actor on the wellbeing of others, which provides a critique of status quo institutions – and also reveals alternatives. These external effects include not only the familiar market failures arising from our interaction with the biosphere and increasing returns but also the central markets in a modern capitalist economy, those for labour, credit, and information.

In the labour market, for example, of great concern to both employees and employers is how hard and carefully a worker works. How is this to be motivated? We set aside piece rate compensation – pay for work done – because outside of the gig economy it is of very limited importance. Think about a more typical case: work done by a worker who is paid a fixed wage, which the employer sets to be in excess of the worker's next best alternative, namely unemployment insurance and job search. Her fear of job loss contributes to the motivation for exerting effort. She chooses how hard to work in light of these carrots and sticks; but were she to work a little harder she would confer an uncompensated benefit on the owner. There is no way to compensate for this effect, or to by some other means to enforce or even to specify additional effort in a contract.

In the credit market the promise to repay a loan is part of the contract but is often not enforceable (e.g. if the debtor is bankrupt). Another uncompensated external effect of increasing relevance: Personal data on individuals that is harvested by Facebook, Google, Amazon and other firms is treated as free for the taking, no different from an animal in the wild that is owned by the hunter who kills it. These data are used to extract behavioural patterns reflecting individual preferences that are sold to firms who use it to manipulate and monetize the information shown to consumers.

In these interactions, the exchange is governed in part by some combination of the contract, social norms (such as a work ethic on the part of the employee or truth telling by the borrower), and the private exercise of power by the employer (in the labour market), by the lender (in the credit market), and by big tech firms (in the market for information).

A second arena of the exercise of unaccountable power is expanding with the privatization of previously public spaces, a rerun of the 18th century enclosure movement in Great Britain that deprived commoners of access to previously shared spaces. Included are the privatization of entire residential communities that now take the form of gated communities, marketplaces that now are shopping malls, and social communication that now takes place on privately owned and regulated platforms. Owners of gated communities, shopping malls and social media platforms now exercise extraordinary private rights of exclusion and limitations on speech.

The comparative advantage of the three modes of governance.

Our proposed paradigm re-combines the vertices of the synergy simplex in a new way based on comparative advantages of the three modes of governance – state, market, and civil society. Even where there are substantial conflicts of interest among economic actors, markets can often allocate resources reasonably well as long as the nature of the inputs and outputs of economic activity are readily measured and so can be written into contracts that are enforceable at low cost. Similarly, as demonstrated in the pandemic, competent governments are able to use their legitimate authority to solve a range of coordination problems. The comparative advantage of states is rule-making, enforcement and risk mitigation.

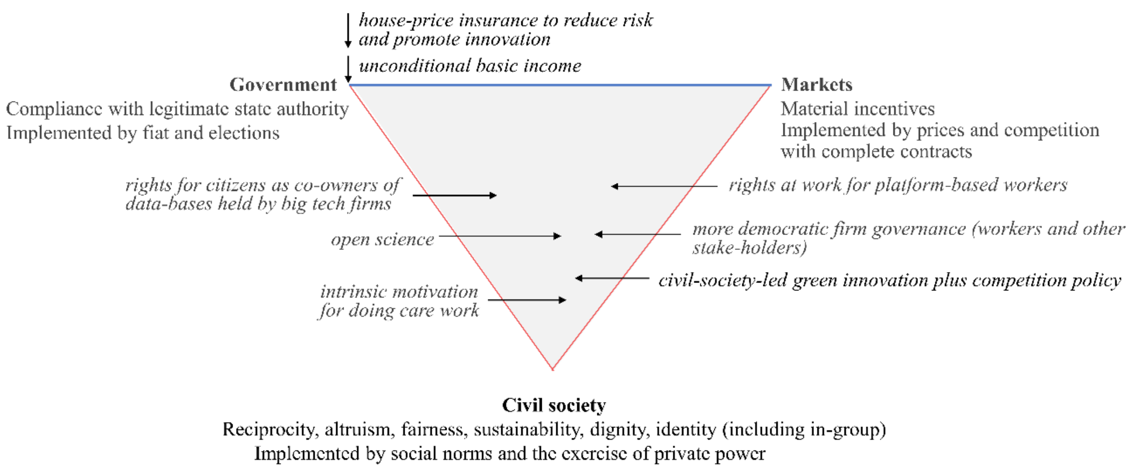
The comparative advantage of civil society is based on the fact that the members of communities making up civil society often have information not available to economic actors in markets (lenders, or employers, for example). As a result can they interact in mutually beneficial ways, with contracts being substantially replaced by informal peer enforcement motivated by reciprocity, mutual concern or other shared values. But these social preference underpinnings of the successful workings of communities do not flourish under conditions of elevated conflicts of interest due to extreme inequality of reward or hierarchical organization.

The three modes of governance differ fundamentally in their scope, from global to local. Markets encompass the entire planet, effectively ignoring national boundaries in the absence of market-restricting policies. By contrast state capacities beyond national (or more local) boundaries are limited. Civil society is often local – based on neighbourhood or workplace interactions – but it can also extend to global dimensions as with the growing economic and political impact of green preferences.

8. Emblematic policies of a new paradigm.

Continuing with the framework of Table 2, some of the emblematic policies and institutional forms of a new paradigm are suggested in Figure 3. Key to the success of these illustrative policies and organizations will be policies to redistribute wealth, mitigate risk exposure, and enhance our capacity to produce and use new knowledge, expanding the "creative" and limiting the "destructive" effects of Schumpeter's depiction of innovation. We will discuss just two of these emblematic policies.

Figure 3. State-market-civil society complementarities in a new paradigm.



Redistribution of endowments. Reduced wealth inequality would support less unequal standards of living, greater security and equality of dignity and voice, addressing unequal power not only at work but also in the polity. Wealth redistribution would also provide conditions favouring more collaborative and less hierarchical workplace organizations, including producer-owned co-operatives, expanding the social domains in which people are in a position to effectively voice their concerns. A member of a work team may feel some reciprocal obligation to do the best he can if differences in team members' pay or wealth are modest, but not otherwise. This means that a condition for sustaining the values and social norms critical to exploiting the problem-solving capacities of civil society is substantial equality of wealth.

A more equal distribution of endowments along with public policies to enhance the value the time we spend not at work would support a redefinition of how we conceive “the good life”, placing less emphasis on material consumption (with its negative impacts on the biosphere) and more on free time. Over the first three quarters of the 20th century dramatic increases in the free time enjoyed by manufacturing workers occurred in those countries and decades that saw a reduction in the income share of the richest one percent, apparently, because greater equality reduced the pressure to “keep up with the (rich) Jones”.

Endowments include more than physical assets. Policies redistributing wealth include an unconditional basic income (making citizenship an asset), a modification of intellectual property rights to facilitate access to public knowledge assets, and enhanced life-long learning opportunities, including the replacement of university level tuition fees by a tax on graduates' incomes (favouring greater educational opportunity for the less well off). A substantial inheritance tax with the option to devote a portion of the tax obligation to a civil society organization would underline the synergy between wealth redistribution and sustaining vibrant communities.

Consistent with a new paradigm, the policies to implement a less unequal distribution of wealth constitute a kind of insurance. Consider the basic income grant. It increases the fraction of one’s after-tax income that is certain (the grant itself) and reduces the extent that is subject to risk (one's earnings after taxes). The lesser risk exposure and greater wealth though these policies of the less well-off could contribute to a larger share of the population engaging in ordinary kinds of risky innovations such as investing in a new skill, switching occupation, or moving to a region with better job prospects.

Home price insurance. Broadening participation in innovation by reducing risk exposure would also be accomplished by a new insurance device that mitigates the risk from fluctuations in the value of the major asset held by most families, namely their home. House prices often reflect the nature of the dwelling for example its size, condition, location, and amenities. The owner can affect the price and therefore value of the house by maintaining it well and devoting time and energy to ensuring that the surrounding neighbourhood is a pleasant place to live, for example by seeking to improve the local schools. But independently of anything that the owner does, home prices can fluctuate dramatically with bubbles and crashes occurring from time to time.

When house prices crash, the wealth of a family can be cut in half. This exposes them to great uncertainty about how much wealth they will have in the future. The resulting insecurity deters risk-taking. In short, as a result of house price volatility, the economy is more unequal, more volatile, and less dynamic than it would be if families could be insulated at least partially from the fluctuations in the price of their homes.

But doing this is a challenge: if the homeowner receives an insurance pay-out when the price of her home falls, then she would be less motivated to maintain the house and neighbourhood in good condition. This moral hazard problem can be avoided: insure the owner against a price fall not of her own house, but of the average house price in the city or region. The insurance is based on a piece of information that is easily observed by both the homeowner and the insurer. Importantly it is not something that the home owner herself can influence (unlike the value of her own home). If the city experienced a house price boom, then she would pay more into the insurance fund; and this would finance the insurance pay-outs to homeowners in cities with depressed prices.

This plan would have the added benefit of dampening house price booms and busts. The reason is that if the owner's insurance costs increase when the house price rises, then the incentive to buy more housing when house prices rise – the mechanism that causes the bubble – would be less, or even entirely absent.

If home price insurance is such a good idea, why do we not have it? The answer seems to be that private insurers would be unable to insure on such a huge scale and would run the risk of their own bankruptcy were the entire housing market to be depressed for a year or so. Governments, however, could provide this insurance, and their insurance pay-outs during periods of depressed housing markets would contribute to the aggregate demand expansion that would most likely be an appropriate policy at those times.

9. A caveat: The dark side of civil society.

There is a dark side of civil society: other-regarding preferences are not confined to goodwill towards others but also include xenophobic nationalism, religious intolerance, racism and other repugnant us-versus-them distinctions. The governance of criminal gangs is located near the civil society vertex. In-group identity is a powerful motivation, which was evidenced during the Covid-19 pandemic in attitudes toward mask-wearing, public support for prohibiting the export of vaccines, other forms of "vaccine nationalism," and the surge in the US of attacks on Americans of East Asian origin.

Thus, there is a danger associated with our emphasis on civil society. Unless directly addressed, the greater reliance on community-based solutions such as worker owned cooperatives may make it more difficult to sustain a cosmopolitan and tolerant society. An endemic shortcoming of community based civil society organizations is the risk that they may provide greater scope for acting on the identity based us-versus-them sentiments that are the downside of other-regarding preferences. For example: a producer owned, and democratically managed cooperative is likely to be more homogeneous in personnel than a conventional firm.

To see why this might be, consider the fact that in the US, residential neighbourhoods are much more racially and ethnically segregated than workplaces. There are many factors contributing to the contrast between occupational and residential segregation but one of them, we suspect, is that families choose the neighbourhoods in which they wish to live and segregationist (or at least homophilic) preferences are common, while for the most part it is employers rather than workers who choose an employee's co-workers. The less segregated state of employment does not arise because employers are less in-group oriented about their own desired associates than workers: it is because employers are constrained by competition to place an important weight on other considerations in their hiring and assignment of workers to jobs.

10. Conclusion

We have made the following case.

First, a morally compelling and politically viable program will have to go beyond shared affluence and sustainability to include a more encompassing standard of justice based on equal dignity, equal voice and (borrowing Danielle Allen's phrase) difference without domination.

Second, a central feature of an economic model that is complementary to this ethical position is that it recognizes not only the private exercise of power in the modern capitalist economy but also the public nature and therefore the associated speech and other rights people have in the arenas in which this private power is exercised: for instance in workplaces, gated communities, and shopping malls.

Third, technical change (eliminating routine jobs) and the increasingly knowledge- and care-centred composition of our livelihoods is shrinking the share of work that can be effectively governed by hierarchically ordered and unequally rewarded positions, and increasingly requires intrinsic or social motivations and less unequal rewards to undergird a high-performance economy.

Fourth, egalitarian redistribution of wealth (broadly construed to include endowments of all kinds) is key not only to the objectives of equal dignity and voice but also to the democratization of innovation and to sustaining the trust, reciprocity, and other social preferences on which a high-performance modern economy depends.

Is a change of this magnitude utopian? We think not.

Changes in the economy and biosphere have placed us in a world in which the norms of sustainability and of equal dignity and voice are not just ethical values that are worth pursuing. Their advancement is now essential to getting the work done and finding solutions that can deliver concrete gains to citizens.

There is historical precedent for a paradigmatic shift of this magnitude. The demise of the classical liberal paradigm and its replacement by the post-war social democratic paradigm was made possible by an unusual concatenation of events: the immediate shared memory of massive unemployment and insecurity that could be addressed by new rules of the game that delivered immediate benefits to the electorate. Unemployment insurance, a larger role for government spending and, in many countries, trade union engagement in wage-setting and new technology all resonated with the analytics and the ethics of a new understanding of the economy.

Today's confluence of new problems and new economics resembles the aftermath of the Great Depression and the Second World War that saw the ascendency of the social democratic paradigm that was politically viable because its favoured policies enhanced the performance of the economy. We may be witnessing today a similar symbiosis between pressing economic and societal challenges and new ways of thinking about the economy and new policies and institutions to tackle climate change, the future of work and guard against future pandemics. This is a confluence that could propel a new paradigm in political economy to dominance.

A note on sources. We have drawn on our previous work Bowles and Carlin (2020a, b) and the works cited there. The expression difference without domination is from Allen (2020). The evidence about control aversion in Germany, blood donations, house prices, social democracy and innovation in the automobile industry are from Schmelz (2021), Mellstrom and Johannesson (2008), Duca, Muellbauer, and Murphy (2021), Benedetto, Hix, and Mastrorocco (2020) and Aghion et al. (2020), Aghion, Antonin, and Bunel (2021), respectively. The passages on personal data and big tech, and on home equity insurance draw, respectively, on Pistor (2020), and Shiller and Weiss (1999). The data on work hours and top income shares is from Oh, Park, and Bowles (2012).

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