General Introduction

This book builds on the M(arx)–K(eynes)–S(chumpeter) approach to the understanding and further evolution of capitalism, the foundations of which we have laid in Flaschel and Greiner (2011a). It does so in a self-contained way by now focusing on current approaches to the study of macrodynamical systems in the tradition of the classical, the neoclassical and the Keynesian interpretation of the working of modern capitalist economies and the societies that are built on them. Instead of trying to combine important elements of the theories of Marx (1954), Keynes (1936) and Schumpeter (1942) into a coherent whole we now focus on different paradigms of economic theorizing in their applicability to an understanding of primarily labor market problems and their cure in the context of growing economies. These approaches have their formal point of departure in the tradition of Goodwin (1967) type models of classical growth, Solow (1956) type models of neoclassical growth and Harrod (1939)–Domar (1946) type models of Keynesian growth.

In the first tradition we study (in Part II) forms of the Marxian reserve army mechanism, the creation of mass unemployment when the profitability of capitalist economies is endangered by a profit squeeze. We do this first against the background of the Ricardian theory of capital accumulation, by showing the limitations of this approach as compared to the classical growth cycle model of Richard Goodwin (1967). On this basis we then develop a distributive cycle approach with recurrent phases of mass unemployment, basic elements of social security, minimum wages as well as basic income guarantees, where the employment decision of the firms is characterized by complete flexibility in the sense of free hiring and firing of employees. We then study in this context the occurrence of low income work (atypical employment) and, thus, situations of segmented labor markets and their consequences for the well-being of the workers at the lower end of the labor market hierarchy when there is no protection by means of minimum wages for them.

In a next step such minimum wages as well as basic income guarantees are again introduced and shown to be beneficial for the working of the economy after some temporary adjustment processes. This situation is extended by allowing for a neoclassical production function with smooth factor substitution – in place of the so far used fixed proportions in production – and shown to be valid also in such a case, where neoclassical economists would claim that factor substitution would work to the disadvantage of the low income workers and their employment situation in the case of minimum wages.

In sum, our classical approach in Part II of the book demonstrates that classical supply side dynamics need not bring about the economic consequences asserted by most academic writers and politicians in the public discussion of a general minimum wage legislation. The future of capitalism is not endangered by these basic changes in the social structure of accumulation, but – as this part shows – in fact improved by it, both from the economic as well as from the social point of view.

With respect to the second tradition, in Part III we analyze neoclassical models of endogenous growth where particular attention is paid to unemployment and welfare issues of public policies. To do so we consider three different prototype models of endogenous growth where we allow for unemployment. In the first model, we assume that ongoing growth results from positive externalities of investment that prevent the marginal product of capital from declining as capital grows. We first study the structure of this model, and then analyze how taxation and different degrees of flexibility on the labor market affect the economy.

In the second model, sustained growth results from investment in human capital where we allow for heterogenous agents with one type of individuals acquiring skills through higher education whereas the second type of individuals remains low-skilled. Both types of individuals may be subject to unemployment and receive unemployment benefits in case they lose their jobs. Higher education is financed by the government that hires teachers and uses additional spending for the education of students. Growth and welfare effects of different fiscal policies are analyzed for that model type and we derive effects of different degrees of labor market flexibility.

The last model, finally, posits that investment in a public capital stock generates endogenous growth where the government may finance its expenditures by taxes or by issuing government bonds. Again, labor may become unemployed and the government pays unemployment subsidies. The analysis studies different policy rules where special

attention is paid to debt policy. In particular the outcome of a balanced budget scenario is compared to that where the government runs permanent deficits.

Finally, working in the third (Keynesian) tradition in fact means that both the classical as well as the neoclassical perspective on economic growth and the business fluctuations which are surrounding it are or can be augmented in an important way, simply by introducing the Keynesian concept of effective goods demand into their supply side orientation and also by embedding into the demand side extension the working of financial markets in the form of a Tobin (1982) portfolio approach as the necessary extension of the Keynesian theory of liquidity preference. The Keynesian approach is therefore in its nature more an (important) extension of the other ones than an alternative to them in line with what is claimed in the title of Keynes's (1936) book.

In Part IV of the book we are laying the foundations for the ideal Keynesian approach to flexi(ble-sec)urity capitalism. We present and analyze the baseline model of a supply-driven flexicurity economy against the background of a Goodwin Kalecki welfare economy (and its breakdown after the prosperity phase following World War II). We show the stability and the sustainability of such an institutional framework, with first and second (but not segmented) labor markets, by including pension fund accumulation as well as credit supply out of such funds. This situation is then extended towards the treatment of neoclassical smooth factor substitution implying that the possibility to substitute labor through capital does not change this framework very much. In place of the segmented labor markets of Part II of the book we also study here the interrelationships between labor markets for skilled and high-skilled employees and the educational system on which such a distinction is based.

The first three chapters of Part IV consider from various outlooks the problems caused by Keynesian demand rationing, yet do so in a way that does not fully integrate the financial markets of a general Keynesian approach as we have investigated it in the introductory Chapter 1, in order to provide a baseline model of unleashed capitalism and its various destabilizing feedback chains within and between the real and the financial markets. It is the task of the final chapter of the book to integrate the approach to a flexicurity system of Part IV into such a framework in order to provide a full employment scenario also in a fully-fledged model of Keynesian real financial market interactions. In this chapter we therefore add significant labor market reforms to the welfare measures of Part II and to the reformulations of monetary and

fiscal policy measures of Chapter 1, which are also further discussed in this final chapter.

In this book the Keynesian approach is therefore used on two levels. In Part I of the book we use it to study the basic stabilizing and destabilizing forces of the current form of an unleashed capitalism as well as basic possibilities of fiscal, monetary and labor market policies appropriate to tame the in general dominant destabilizing features of this unleashed form of capitalism. In the final chapter of the book we then go on from this discussion to the implementation of the far-reaching labor market reforms we have been suggesting and analyzed in the first three chapters of Part IV.

The final chapter, therefore, shows that the construction of a full-employment economy by suitable labor market reforms is a viable strategy in the context of a complete Keynesian model of the real financial market interaction and can make such an economy not only a stable one (also by suitably chosen monetary and fiscal policy rules), but also one where the distributive cycle that we have investigated in detail in Part II can be controlled through the establishment of a corporatist regime between capital and labor, founded on labor market institutions and employment decisions that are not only flexible, but also offer employment guarantees (not job guarantees) on the basis of the principle of an employer of first resort (EFR). While Part I may be describing the status quo of current capitalist economies, the final chapter is therefore providing the ideal of a full employment market economy with a full interaction of financial, goods and labor markets as described in Keynes's (1936) *General Theory* and in Chapter 1. Reform proposals for actual economies are then always a compromise between what we have studied in Chapter 1 and have proposed as alternatives in Chapter 11 of the book. Summing up, the book provides an important and new approach for the study of the future of capitalism, a topic that has never been more urgent than in the current times after World War II. The scope of the book is aimed at providing an alternative to the often very narrow discussions of current forms of capitalism which focus too much on the current status quo of such economies instead of providing an ideal scenario on the basis of which compromises between the status quo and the ideal can only be discussed in a meaningful way.

The book therefore represents a novel approach to the macroeconomics of capitalist societies, an approach which we believe is urgently needed in the present situation of a new classical/New Keynesian macroeconomic consensus theory that is exclusively focussed on representative economic agents in place of principal agent relationships,

market-clearing in place of the study of gradual adjustment processes to such equilibrium positions and, above all, purely forward-looking and extremely perfect ‘rational expectations’ in place of agents with different (heterogenous) expectations formation (also of the animal spirit type).

The modeling approaches chosen in this book are, on the one hand, certainly of an advanced type, which are fully usable at the post-graduate level of economic teaching, in particular when compared with the New Keynesian ones. The chapters of the book are fairly self-contained and therefore can by and large be used as teaching material and read independently of each other. They represent a unique approach to macrodynamic theorizing, rooted in the initially discussed MKS tradition of the understanding of the growth dynamics of capitalist economies. The material of the book is, on the other hand, not only clearly related to current macroeconomic research which goes beyond the New Consensus macroeconomics but can also be related to the discussion between practitioners and politicians on the reform of the financial as well as the labor markets. This holds true in particular within the European community where the future of capitalism is more clearly related to significant labor market reforms than is the case in the USA and the rest of the world.

A number of professional colleagues, too numerous to name here, have contributed to the present project through stimulating discussions on various aspects of the subject matter of this book as well as on related research projects. We are also grateful for comments and criticisms we have received from participants at presentations of aspects of the material of this book at numerous international conferences and research seminars. Of course, we alone are responsible for the remaining errors in this work. We also wish to thank Uwe Köller for his excellent editorial work. Finally we would like to thank Matthew Pitman of Edward Elgar for all he has done to make the publication process go as smoothly as it has.

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