Pegasus

A newsletter for the Caux Round Table Network
looking at business above the clutter and confetti

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Moral Capitalism At Work

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INTRODUCTION

In this issue of *Pegasus*, we include two articles. First are some reflections on how the distinction between public goods and private goods can be constructively used to bridge the gap in ethical thinking between the abstract reasoning of what is right, advocated by Immanuel Kant, and the consequentialist calculation of a greater good, proposed by Utilitarians.

The argument made is that there is something of a false dichotomy associated with these two approaches to doing what is right. While the different approaches, in some cases, can lead to very different decisions, there are many cases – especially where capitalist and business endeavors are front and center – where a good or a service can be seen as being both self-regarding and of community benefit at one and the same time.

The economist's consideration of externalities can be put into play here. A private good or service – i.e. food, education or health care – can have positive or negative externalities. It can be a good in a limited sense – for one consumer or for the producer who sells it - and it can be a public good in another sense in that it can contribute to the betterment of a wider set of interests, such as the community's standard of living or the environment.

The approach of looking for public goods (or bads) in and around private goods is a consequentialist, utilitarian approach that, nonetheless, opens the door to abstract standards of right and good, as Kant would have us attempt.

Any private good which takes upon itself public good characteristics becomes more universal in its goodness and less personal. It moves away from selfishness and dresses itself in more communal standards of right and wrong.

The second article consists of excerpts from a report from the Center for American Progress on "inclusive" prosperity. This is a setting forth of a social philosophy for economies that seeks to provide guidelines for the evolving welfare state, especially in the U.S. and U.K.

The principals leading the study group which drafted the report, Larry Summers and Ed Balls, are leading economic policy thinkers for the Democratic Party in the United States and the Labor Party in Great Britain.

The obvious intent of the argument is to provide a public good wrap around for the private goods that are the ends of modern capitalism. The goal of such a private enterprise system also being "inclusive" is to blend private satisfactions with a public good in promoting wide access to the private goods produced by the system.

The attempt, as I see it, is to find a path towards a more moral capitalism.

My disappointment in the report lies in its recommendations, not in its aspirations. Inclusivity and promotion of better lives for more people cannot be dismissed as wrong or foolish by any good person. But the few specific policies advocated strike me as superficial and rely on government intervention to shift the tilt of the table of enterprise in certain directions, rather than on setting incentives within the capitalist enterprise to take better care of more stakeholders than owners and senior managers of firms.

The report, however, is important for our global policy debate over the future of capitalism for it puts forward the thinking of two important Western political parties which may win election to government office in two leading countries.

Stephen B. Young
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USING OUR MINDS TO FIND A COMMON ETHIC FOR **"RIGHT-MINDED" DECISION MAKING**

Stephen B. Young
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How do we know what to do with any given decision? Many easily say "Just do the right thing?" But the "right" thing according to whom or to what?

Decisions, while they are often informed by our past experiences, always point towards the future, which, as former U.S. Secretary of Defense Donald Rumsfeld said, is filled with "unknown unknowns." Any decision, then, is filled with guesses and gambles about the future.

American baseball legend, Yogi Berra, reminded us that "It's tough to make predictions, especially about the future." He also advised: "When you come to a fork in the road, take it."

Having good intentions, we also know, is not enough to make the "right" decision. Common wisdom is that "The road to hell is paved with good intentions." And we all know about the "law of unintended consequences."

A former tutor of mine, longtime U.S. Congressman Barney Frank, once told me that his job in politics was "to get people to do the right thing for good, bad or indifferent reasons." His criteria for what was right did not depend on the motivations or the reasoning of others. Barney, in this regard, was a bit cynical perhaps and no doubt took a stance open to being devious and manipulative of others, but nonetheless sound when we consider the necessity of bringing diverse people together into a common cause.

Decision making implicates the future and forces us to consider what might be as opposed to what is. The immediate consideration, then, is how far and wide into the future should we look when making decisions? Should we focus narrowly, broadly or both simultaneously?

I would like to suggest here that a difference in possible focal lengths explains the tension between two dominant approaches to ethics. On the one hand, deontology grounds ethical decision making on abstract reasons to do the right thing. In particular, the very famous Immanuel Kant argued that ethics demands forswearing all self-interest as it would be too subjective and too far from truth. He concluded that ethical decisions had to be made on the most general and universal grounds possible. The justification for an ethical decision should be correct for all people in similar circumstances. This is taking the widest possible view of the future impacts of our decisions.

Kant's categorical imperative as the criteria of an ethical decision denotes an absolute, unconditional requirement that must be obeyed in all circumstances and is justified as an end in itself. It is best known in this formulation:

> *"Act only according to that maxim whereby you can, at the same time, will that it should become a universal law."*

The categorical imperative seeks to turn us into a sort of deity responsible for all space and time and in so doing, taking a sweeping view of the future, as well as learning from the past.

In Kant's view, a person cannot decide whether conduct is "right" or moral through empirical means. Such judgments must be reached *a priori*, using pure practical reason.

Deontologists are most opposed to a rival school of decision making called utilitarianism, which is an empirical calculation of costs and benefits. Utilitarian thinking, we might say, is more narrowly focused. Under utilitarianism, for right decision making, it is often sufficient to consider only the consequences for ourselves in making a decision and to sacrifice the rights and interests of others or put aside what might happen in a vague and inscrutable future.

Similarly, utilitarianism can take the collective good of a group as valuable and use that narrowly to justify excluding the concerns of individuals who will be negatively affected by promoting the majoritarian interest.
The critique of utilitarian ethics is the possibility that the good for some can be used to justify imposing harsh and degrading consequences on others deemed less valuable.

Utilitarianism is often associated with selfishness and deontology with altruism and selflessness.

Business is organized to seek profits – a utilitarian consideration. The fault of business decision making is nearly universally decried as being short-sighted, short-term and positing cash profits as the only worthy goal of enterprise, leaving out consideration of externalities, both positive and negative. This kind of business decision making is focused on the business as self. It is solipsistic and ego-centric.

In financial and economic theory about private property and free markets, the utilitarian basis for decision making is justified by rational choice theory and belief in the "agency problem," which argues that all of us are self-seeking and will be unreliable until we can "purchase" the agreement of those around us to do right by us according to our utility curves.

Thus, deontologists find themselves in tension with most business decision making. To remedy its defects, they have constructed the field of business ethics as a corrective to financial analysis.

In business, the approaches to decision making proposed by CSR and sustainability require taking into account the future costs and benefits to different categories of interests. Deciding on what is right balances independent and sometimes conflicting interests and claims for the firm's open-minded and solicitous consideration. Corporate Social Responsibility and sustainability decision making are prone to compromise and gradualism as opposed to a fixed, absolute, bright line, which may never be crossed.

These practical decisions taken within a market place of stakeholders who bring value to the firm often stand on utilitarian calculations. But that does not, in my view, necessarily make them less worthy or unappealing.

A third and marginalized approach to ethical decision making goes by the name of virtue ethics. Virtue is character-based. It does not depend on abstract reason, but works through intuition and standards of conduct like honor and honesty. Virtue is practical and circumstantial and can be justified on utilitarian grounds. It sets forth general principles and standards for good character as criteria for how we should act towards others. Aristotle and Confucius advocated approaches to virtue ethics.

Buddhism, too, supports a virtue ethics, the ability to follow the eight fold path of mindfulness in decision making, of looking beyond self to the consequences we can set in motion with our thoughts, words and actions.

One might even suggest that the second commandment proposed by Jesus to love thy neighbor as thyself is a standard of virtue ethics. It is applied by individuals through their self-mastery and inner volition and demands we take a broad view of ourselves as in relationship with others. But it is, at the same time, universalizable as a categorical imperative should be.

From this perspective, along with others presented to us by the books of the New Testament, the Catholic Church has articulated social teachings guiding how we should decide to live by standards of respect for human dignity, subsidiarity, solidarity and the common good as attached to all the things we can own.

Some harmony and consistency, I think, among these approaches to ethical decision making can be found which will ease our way towards a better future for all.

We could apply to deontology, utilitarianism and virtue ethics an unusual framework of how to categorize the goods that we seek. We could place the different approaches on the continuum conceptualized by economists running from public to private goods.

Public goods – those available in some general way to all – have characteristics akin to universals. Just as universals are available to all and the use of them by one does not restrict similar use by another, so public goods are open to simultaneous use by many. The air with which we breathe, along with justice and public security provided by the state, are classic examples of public goods. They can't be owned under exclusive personal dominion as a monopoly of private exploitation. Public goods attract free riders without concern.

Private goods are at the other end of the ownership continuum. They are subject to monopoly possession and exploitation. Private goods reject the possibility of being subject to use by free riders.

Public goods exist broadly and openly. They are common goods having wide impacts across society, culture, politics and the environment. Private goods are very circumscribed and narrowly focused as to who can benefit from them. When the deontological categorical imperative is applied to the use of private goods, they are given new scope in our understanding. Our minds must re-categorize them and add public good characteristics to them. A decision about my private good must, under this deontological approach, look broadly at the future implications of my actions. My decision, to be the right one, must come up with a course of action which would make sense in all times and all places – thus, for all people and other realities implicated in the proposed use of the good or service.

Just as in the case of public goods, no one should be excluded from consideration. The impacts of the decision should not be viewed restrictively limited to my own self-centered interests and perspectives on life. Deontology, I suggest, would move us away from exclusivity towards inclusivity, converting us from acting only as private principals to serving more broadly as public trustees.

Deontology would have us willingly put others in the position of being free riders on the results of our decisions. They would benefit or avoid harm without paying us anything for the advantage. This would reflect a kind of altruism, I suppose.

Now, from the utilitarian perspective, we would adopt the opposite perspective: public good considerations would not be allowed to gobble up, like a cancer, what otherwise would be private goods. The potential for excess in the utilitarian approach – that a calculus of what is good for free riders would lead to impositions on my freedoms so that I would have to carry those fellow souls on the back of my efforts and my money – would be corrected by giving some privilege to private goods.

A categorical imperative, if you will, would be imposed on utilitarian calculations that some degree of private dominion over goods should be available in all times and all places.

Thus, both public and private goods would each have a claim to universality under the right circumstances. Private goods would not be always exclusive and imperious (upholding the universal claim of public goods), while the public good would not always prevent the use and exploitation of private goods (upholding the universal claim of private goods).

From the perspective of virtue ethics then, we come to the same result: a continuum of public and private goods open to all. A virtuous person in contemplating his or her private goods and advantages would seek not to harm others and perhaps to be honorable, to provide the office of a friend, to be charitable, etc., so that they would work a positive benefit to others, their community and the environment. In so acting, we would applaud their good character as judgmental bystanders.

The description of a good or service as public or private does not fix the essence of that good or that service. It merely denotes how we think of them from some perspective. A good or a service is not fully one or fully the other. We can assign different characteristics depending on our point of view. What is short compared to a longer referent can be long when compared to a shorter referent. Six inches is short compared to twelve inches, but long compared to one inch.

Thus, a good or service can be described as having public characteristics to some degree and private attributes in other ways without changing the essence of the good or the service in actuality. We merely ascribe different attributes and dimensions to something we contemplate in reality.

However, we can argue among ourselves as to the proper description and which attributes to ascribe. That is the arena of our discourses within ethics and politics, I suppose.

A discourse that adds public good attributes to private goods and also adds private sanctity to offset the claim that what we own and control must be subservient to claims of public access and right would provide dynamic balance between individual liberty and the common good.

I think Adam Smith was inferring something like this in his famous, or to some, infamous, observation about an "invisible hand" at work when private self-interests interact in markets to reciprocally bestow advantages, but without intending to do so, also benefitting the commonweal by creating new wealth and economic growth. Smith can be understood as saying that some transactions can be described from one perspective as merely the application of private goods, but also, at the same time, from a social perspective as an instance of a public good that brings indirect benefits to many as an instance of a system of wealth creation at work.

The social teachings of the Catholic Church provide us with another example of multiplicity in the characterization of goods and services. The Church talks about the "universal destination of goods." It holds that "God gave the earth to the whole human race for the sustenance of all its members, without excluding or favoring anyone." From this premise, the teachings of the Church conclude that while private rights are absolutely indispensable if individuals are to attain the highest purpose to which they are called, at the same time, those private rights may not trump and overcome a public good in using private rights for promoting the well-being of all people and for preventing their exclusion and exploitation.

It is as if our private goods are subject to some lien in favor of a public good so that our use of what is "ours" is restricted in some ways from time to time. There is a paradox here, or perhaps a conundrum for our further contemplation, in that what is "ours" is also "theirs" at one and the same time. Private goods have a public aspect, while public goods – the claims of universal considerations about the future – are limited in the extent they can command our private decision making.

How, then, to make the best decisions?

May I suggest taking a clue from Buddhism and also the Confucian text *The Doctrine of the Mean* (Aristotle also uses a similar approach of moderation)? There is no single rule – deontological or utilitarian – which can guide us all the time. There are no easy answers. We need to be mindful of alternatives and possibilities and to seek a "mean" between the extremes of too much private hoarding of goods and services and too much public suppression of our private goods.

Another way of putting this conclusion is to put forth the virtue of living as a steward, as a fiduciary for a better future, whereby we can take care of ourselves, but modestly and with due care for the betterment of others out of a duty of loyalty to the better angels of our natures.

Center for American Progress

Report of the Commission on Inclusive Prosperity

Co-Chaired by Lawrence H. Summers and Ed Balls

Convened by the Center for American Progress January 2015

WWW.AMERICANPROGRESS.ORG

Introduction

At the heart of the commission's work is a simple premise: Nations need to ensure both that economic growth takes place and that it is broadly shared. Nations succeed when their middle class is secure in the expectation that those willing to work are able to work and that standards of living will increase. Without that expectation, citizens lose confidence in institutions, social cohesion and international cooperation suffers, and confidence in the future erodes.

In recent decades and particularly in recent years, developed countries have experienced a toxic combination of too little growth and rising inequality. To extents that vary across countries, people are no longer confident in the expectation that hard work will be well rewarded or that their children will live better than they did. Most families find it harder to raise their living standards than they did a generation ago, and there are grounds for concern about stagnation in living standards. Those in work are working longer for less, and those out of work experience lengthy, destructive periods of unemployment. Higher incomes for working families will help avert this stagnation. In the short run, higher incomes will lead to higher demand, which will in turn increase growth. And in the longer run, a high-wage, high-productivity economy is the only route to sustained growth and opportunity for all. Indeed, shared prosperity is the challenge for our time.

Economies transformed

In the decades following World War II, the advanced industrial economies experienced rapid growth and brought an increasing share of households into prosperity. With these changes came a revolution in living standards. Hundreds of millions of people across developed countries were able to work and gain economic security through higher salaries and a series of benefits provided either directly through employers or through government social security systems. Most households came to believe that hard work and careful planning would deliver heightened levels of security for themselves and opportunity for their children, year after year. It was possible for ordinary families to enjoy better housing, and health care, and a secure retirement, and to provide their children with higher education and the prospect of economic opportunity as incomes rose broadly as the economy grew.

By the end of the 1970s, inflation and unemployment seemed out of control. In the 1980s, conservative leaders such as Ronald Reagan and Margaret Thatcher came to power with an anti-government agenda of market fundamentalism and individualism. Measures of inequality, which had been stable or declining, began to increase.

With the return of center-left governments in the 1990s, politicians such as Bill Clinton and Tony Blair sought to marry economic efficiency with social justice through their policies of the "third way." They recognized that the collapse of communism was bringing new countries into the global economy while developments in information and communications technology were bringing the world closer together. But they also foresaw that trade and technology were combining to place a premium on higher-level skills and qualifications and to reduce the number of low-skilled jobs, which could be done more cheaply by robots or workers in poorer countries.

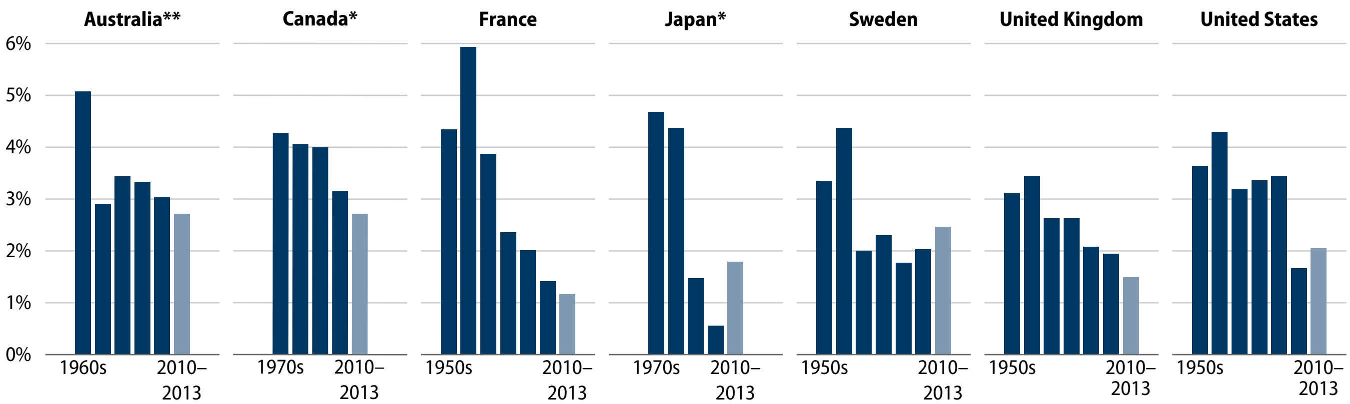
Their policy response was to put people first, emphasizing measures to develop skills and to support work because of a recognition that in a world of increased international competition and a greater and greater ability for capital and innovation to flow across international borders, the most important investments a nation could make were in what was most distinctively national—its people. Along with an emphasis on education and skill development, and greater efforts to support work through tax policy came support for a more open, globally integrated, and managed global economy.

Challenges facing developed countries

Today, developed economies face new challenges for new times. The principles of putting people first need to be updated. Global forces are operating to create new pressures on middle-class incomes and wages at the middle and bottom, and in many countries, institutions that had previously worked to mediate rising levels of inequality have been weakened, leaving families to weather these trends on their own. Therefore, even before the financial crisis and subsequent recession, some countries, such as the United States, experienced the stagnation of average wages and a decline of median household incomes, all while the real costs of important elements of most people's lives have grown more rapidly. Across the advanced economies, the underlying rates of growth have slowed. (see Figure 1.1) The income that has been generated has been distributed increasingly unequally. (see Figure 1.2)

FIGURE 1.1

Average annual GDP growth rate in select advanced economies by decade



* OECD data not available before 1970

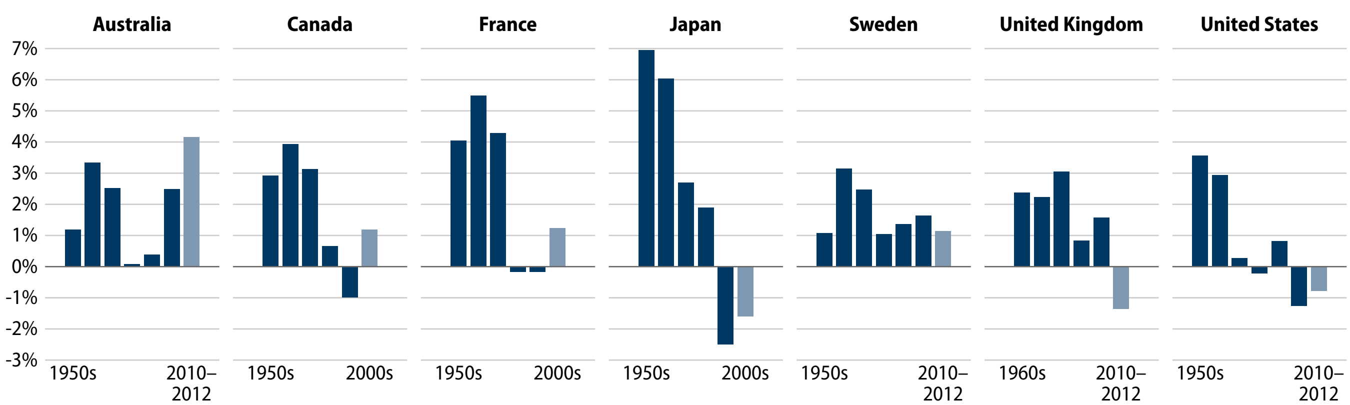
** OECD data not available before 1960

Note: Lighter shading indicates that significantly less than a full decade of data are available.

Source: Organisation for Economic Co-operation and Development, "Stat Extracts: Gross domestic product (GDP)," available at http://stats.oecd.org/index.aspx?queryid=61429# (last accessed December 2014). U.S. data from Federal Reserve Bank of Saint Louis, "Real Gross Domestic Product, Billions of Chained 2009 Dollars, Annual, Not Seasonally Adjusted," available at http://research.stlouisfed.org/fred2/series/GDPC1 (last accessed January 2015).

FIGURE 1.2

Bottom 90 percent average annual income growth rate in select advanced economies by decade



Note: Lighter shading indicates that significantly less than a full decade of data are available. Due to sporadic data availability, appropriate decades range from 9–11 years, and endpoints of decades may differ by 1–2 years.

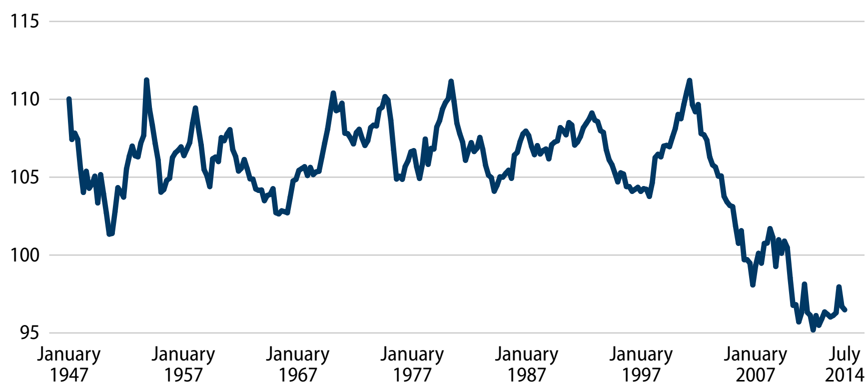
Source: Facundo Alvaredo and others, "The World Top Incomes Database," available at http://topincomes.g-mond.parisschoolofeconomics.eu (last accessed December 2014).

Middle- and low-income families across the developed world face downward pressure on wages and incomes. As growth has slowed, most economies have seen a bifurcation between growth in productivity and growth in income from labor. For example, in the United States over the past several years, firms have been profitable, but their success increasingly translates into income for shareholders and top management, not for employees. (see Figure 1.3) This was far less true 50 years ago. Dividend payments and stock-price increases are skewed to increase, not decrease, inequality. It is, therefore, entirely understandable that middle-class families feel that something is amiss when companies are profitable but wages are stagnant.

FIGURE 1.3

U.S. workers' share of income has been shrinking

Nonfinancial corporations sector: Labor share, series indexed to 2009=100, 1947–2014



Source: Bureau of Labor Statistics, "Major Sector Productivity and Costs," available at http://www.bls.gov/lpc (last accessed December 2014).

In many countries, the worst effects of the crash were exacerbated by austerity programs as premature tax increases and spending cuts sucked demand out of the economy. Countries such as the United Kingdom have seen little of the hoped-for rebalancing, with growth focused heavily on the housing market. The United Kingdom and United States are at least growing again, but wages are stagnant in both countries; the eurozone is suffering from chronically weak growth; and there is a slowdown in some emerging markets, including China, Latin America, and the Middle East. While tax-and-transfer systems—which provide income support and aid for housing, education, and health care costs, supported by government revenues—have mitigated some of these market outcomes, they have not done so everywhere.

The changing economic environment

While the immediate predicament facing most advanced economies is in large measure a result of the financial crisis and the subsequent policy response, other economic forces have played an important role in creating the challenge they confront—particularly four changes that have fundamentally reshaped the world.

First, the global economy has fundamentally changed over the past 40 years. As communism collapsed and countries gradually liberalized their economies, rapid reductions in poverty and increases in living standards have taken place in Asia and especially China, in South America, and in Eastern Europe, with growth increasingly taking off in Africa. As a result of all these changes, global trade is greater than ever before with new market opportunities opening up in many rapidly growing countries. Many goods are cheaper than ever before, giving consumers in the developed world significant increases in their living standards.

But increasing global economic integration has also meant increased competition for many workers who produce tradable goods and services. As the productive capacity of low-wage countries has increased, the level of import competition has also increased. And as Internet and computer technology has made cross-border business organization less costly and more efficient, it has become easier for businesses to outsource or relocate all or part of their operations to countries where wages, labor, and environmental standards are low.

Second, the profound technological changes that brought down the cost of many goods and services are also replacing traditional middle-income jobs. In addition to unskilled labor—which has, in some cases, been squeezed by globalization and offshoring—advances in robotics and artificial intelligence have put intermediate-skill jobs at risk in what economists call a hollowing out of the labor market. This has been common to most developed countries. Sophisticated machine tools and software are already reducing the need for routine jobs on production lines and in offices. This trend is set to continue with 3-D printers, Google's driverless cars, and Amazon's drones. This is creating an even greater premium on higher levels of skills and qualifications, making the returns from ideas, capital, and top-class qualifications greater and greater.

Third, the structure of labor markets has changed. In many advanced economies, such as the United States and the United Kingdom, employment is less likely to be stable or long term. Increasing numbers of workers find themselves in contractual relationships that do not guarantee hours worked or provide benefits such as paid vacation, sick days, or pension benefits. In the United States, unions represent a small fraction of workers, and therefore, many workers have little power to create upward pressure on wages. Major corporations have opted to use subcontracting to perform basic functions, and many workers are now classified as independent contractors, eroding basic labor-law protections.

Fourth, corporations have come to function much less effectively as providers of large-scale opportunity. Increasingly, their dominant focus has been the maximization of share prices and the compensation of their top employees. In a world where mobility is always a possibility, they have become less committed to their workforces and their communities. And their managements' attention has shifted to financial engineering, particularly with the goal of minimizing tax payments. This sea change has been facilitated by technology that has loosened the connections between top management and ordinary workers.

In summary, declining growth, the effects of the financial crisis, and increasing inequality have combined to put substantial economic stress on middle- and low-income families across the developed world. Poor policy choices have only made matters worse. These challenges are formidable, but they must be met.

Chapter 2 outlines these challenges in more detail.

Creating a better economic model

So how do we create a stronger, fairer, and more sustainable economic model in which the many and not just the few benefit from rising prosperity now and into the future? This is not just a question for governments but for companies and citizens as well.

While some on the left seek to turn away from globalization and technology, that is not a realistic option. No country can prosper in isolation. And firms that stand still and do not adapt to new technology inevitably lose out in global competition. Without successful entrepreneurs and wealth creation that finances investment, there is no possibility for progress. But if successful businesses are necessary for economic success, they are far from sufficient.

Those on the right who argue for a return to laissez-faire, trickle-down economics—cutting taxes at the top, stripping out regulation, and making deep cuts to public services—do not provide a viable alternative. Developed countries cannot succeed through a race to the bottom in which companies simply compete on cost as workers see their job security erode and their living standards decline.

A race to the top is the only route to inclusive prosperity.

How to achieve inclusive prosperity

This report analyzes the economic condition of the middle class across the developed world. The challenges outlined above are not unique to one country; indeed, globalization and technology stop at no border. Across advanced economies, middle-class households have experienced a wide range of outcomes: Some countries, such as Australia and Canada, have experienced continuing middle-income growth, while for many it has halted. Therefore, there is nothing predetermined about a country's abilities to navigate these trends and ensure shared prosperity for its people. Rather than fully embracing isolationism or laissez-faire policies, we must show—as progressives have traditionally done—that a dynamic market economy and a fair society can go hand in hand.

Creating a more-inclusive prosperity with good jobs, decent salaries, and a sustainable future is possible but requires a concerted effort and a major shift in policy across a number of areas. Powerful forces of globalization and technological change must be navigated or inequalities will continue to widen, and for many, precarious low-skill work will increasingly become the norm. The consequence is that growth will stall.

We recognize that we call for bold action at a time when institutions on all levels are deeply mistrusted by the public. However, part of that mistrust has developed precisely because both government and business have failed to offer broadly shared prosperity.

At the same time, the pace and scale of change has grown. Institutions—including governments—must respond more quickly and perhaps be more flexible and adaptive. And for those tasks they do take on, whether delivery of services or regulation, government must treat citizens like participants, customers, and clients. To build greater resilience will require reforming old laws to work in a modern era. For example, in the United States, the architecture of labor laws was created to address the industrial age; today, with the rise of technology, the structure of work has dramatically altered, but U.S. labor law, for the most part, has not.

We must focus on open, efficient government committed to addressing the concerns of its citizens. Confidence in government is at an all-time low, and consequently, the public resists intervention by a government it views as incapable of solving its problems. This forces families that could benefit from public support to face the challenges of the evolving economy on their own. It is a vicious cycle—and a cycle we can and must break by renewing confidence through a government that works effectively and efficiently for its citizens.

There are five key policy areas that need to be developed to deliver inclusive prosperity.

Raising wages: Full employment in an economy where work pays

First, we need to return to wage growth for everyone in a full-employment economy. There are still too many people who are unemployed. In the United States, for example, 16 percent of working-age men are out of work.[1] Furthermore, in the sectors in which job growth is taking place, good jobs with clear career progression must be developed. Developed countries have varying levels of institutional support for workers. In most countries in Europe, collective bargaining agreements cover many workers. However, in the United States, coverage is at a low level and middle incomes are stagnant. In the United States, we need to support the growth of unions and collective bargaining so workers can capture their share of productivity increases.

In many countries, minimum wages have lost their real value. The increase in part-time work across developed countries is associated with salaries that are often less than the living wage and with a lack of access to health care and other employment benefits. To help raise living standards and increase family incomes, there is a need to remove barriers to women's labor-force participation, such as inflexible work environments and high-cost child care. In addition, there is an important role for pro-work tax credits, but they must be used in conjunction with a strong minimum wage and substantial employment benefits to ensure that these credits are an added reward for hard work rather than a subsidy for low pay.

Finally, workers must benefit from increased productivity rather than seeing returns accrue primarily to shareholders. Profit-sharing and share-ownership schemes provide a direct way to ensure that employees have an incentive to help their company to succeed.

Educational opportunity for all

Second, in a world where technological change is increasing productivity and mechanizing jobs simultaneously in so many sectors, raising skills levels is critical to increasing growth in the long term. Focusing on early childhood education, increasing the quality of our schools, eliminating financial barriers to higher education, and providing support for apprenticeship programs are all critical to driving higher skill levels across economies in both tradable and nontradable sectors. Increasingly, a college education is similar to the high school education of the past—necessary for a prosperous life.

Different countries have approached these challenges in different ways. Countries with a more harmonious and less adversarial partnership between workers and trade associations have tended to have better on-the-job training. In some countries, there is a market failure in the provision of on-the-job training as firms fear that training will be wasted if a competitor poaches their member of staff. New institutions are therefore needed to ensure that adequate levels of work-based training take place and to bring together businesses and education providers to ensure that vocational qualifications are what employers need.

Measures to support innovation and regional clusters

Third, ensuring that workers are well skilled and able to participate in the labor market is insufficient unless developed countries remain at the technological frontier. The financial crisis continues to reverberate across advanced economies in an era of weak productivity growth. Innovation drives productivity growth and economic growth. The most innovative cities and regions tend to have higher social mobility and higher wages in lower-skilled service sectors, so there are positive consequences for most people.

It is increasingly recognized that agglomeration effects tend to cluster industries and people with similar skills in particular locations. It is, therefore, critical that cities and regions are given the tools to make their own local decisions to help drive growth.

Greater long-termism

Fourth, it is essential that markets work in the public interest and for the long term rather than focusing only on short-term returns. Corporate governance issues, therefore, remain critical. In the United States, company profits have been high relative to GDP, but this has not produced a corresponding increase in business investment in the post-recession period. There is a need to better align the incentives of corporate executives with the goals of fostering productive capital investment and long-term profitability.

Crucially, a further element of long-termism is the fulfillment of environmental commitments. Developed countries must ensure that they are sticking to their own carbon commitments in order to secure a sustainable future. That means sending clear and unequivocal signals to clean energy companies about their intentions to decarbonize the power sector and to tackle the inefficiency of the existing building stock. If we get this right and take a leadership role in international negotiations around climate change, we will help consumers and businesses reduce their own energy costs and reap the benefits of the new markets that will be created around the world.

Infrastructure investment can increase wages by creating jobs—thus tightening the labor market—and enhancing productivity. Infrastructure investments provide strong and well-paid jobs and productive assets that serve as the foundation for long-term economic competitiveness, increased prosperity, and a high quality of life. In comparison, failing to invest leads to deteriorating facilities, unpredictable service disruptions, congestion, and higher costs to businesses and households.

International cooperation on global demand, trade, financial stability, and corporate tax avoidance

Finally, we need a tougher international response to the trends outlined above—what might be called hardheaded internationalism. All countries and regions must come together in forums such as the G-20 to encourage macroeconomic coordination for sustainable global growth. While showing that they understand and can respond to voters' concerns about financial instability, immigration, and tax avoidance, governments in developed countries must stay open to the world, seek new trade deals and regional partnerships, and continue their commitment to a dynamic market economy.

On financial regulation and corporate taxation, new impetus is needed to move forward stalling efforts toward reform. On business taxation, greater international cooperation is needed to strike a fairer deal for the future and ensure that governments have a stable source of revenue to provide for a stronger, smarter, and fairer society.

Restoring the integrity of corporate taxation will require more than a simple reversal of the policies of the past 30 years. It will require governments to develop a taxation system that can withstand the pressures of a globalized economy, promote long-term investment, and provide a stable, fair, and predictable policy framework for businesses.

Chapter 3 outlines these policy responses in more detail.

Conclusion

Around the world, advanced economies are facing similar challenges as they grapple with the new realities of the global economy, technological change, and the long-term effects of a changing balance of economic power away from domestic workers and toward mobile, international corporations.

Left to their own devices, unfettered markets and trickle-down economics will lead to increasing levels of inequality, stagnating wages, and a hollowing out of decent, middle-income jobs. This outcome is morally wrong, economically myopic, and at fundamental odds with a democracy in which everyone quite reasonably asks for an equal chance to succeed.

The enduring response of progressives has been to find ways to share the gains of market dynamism broadly. To ensure that all of society's citizens have a stake in its prosperity, and therefore all of its citizens have a stake in its future. Absent a strong and effective progressive response, it is of little surprise that some countries are turning toward populism and insularity. But a better future is possible, one that combines openness with solidarity, dynamism with security, and innovation with equity.

The remainder of this report outlines these challenges and risks in more detail and sets out policy responses to secure sustainable growth by reforming our economies for the long-term, and thereby generating inclusive prosperity.

Policy

The central challenge of economic policy in the industrial world

The central challenge for economic policy in advanced-market economies is renewing the growth of living standards for everyone. As market incomes have stagnated or declined, the prospects for many households have dimmed. Tax-and-transfer systems have mitigated some of these market effects, but they have not counteracted all of them. To change this dynamic, policies must be directed toward reviving growth rates, increasing productivity, and ensuring that middle- and lower-income households are the substantial beneficiaries of the subsequent economic progress.

Increased economic growth depends on both aggregate demand and supply. At the moment, many advanced economies are operating below capacity because of shortfalls in aggregate demand. There is an immediate need to increase demand to get these economies back to full employment and higher wages. In the longer term, increased growth will depend on increasing the overall productive capacity of the advanced economies.

Delivering high-employment, high-productivity economies, with rising employment and rising wages, will also help bring budget deficits down and put national debt on a downward path. As the experience of the United Kingdom has shown, low productivity and the stagnation of wages leads to lower income tax and national insurance receipts, as well as higher spending on social programs. The result has been that targets to reduce the United Kingdom's deficit have been missed by a substantial margin. Higher productivity and wages are essential to putting public finances on a robust and sustainable footing without deep and damaging cuts to public spending and investment.

Restoring demand

In response to the downturn initiated by the financial crisis of 2008, many advanced economies have responded by quickly embracing fiscal austerity. Government expenditures were reduced rapidly in the belief that immediate attempts to bring budgets into balance would somehow serve to increase demand and restore output and employment. This has not happened, and as International Monetary Fund, or IMF, chief economist Olivier Blanchard and IMF economist Daniel Leigh have recognized, the negative output effects have been significant.[1] A better approach to the current situation is to recognize that many advanced economies find themselves in a liquidity trap. That is, in some countries, even when central banks manage to push the short-term interest rates to zero or close to it, the effects on aggregate demand are insufficient to bring those economies to full employment. This was a major problem in the United Kingdom in 2011 and 2012, and it seems clear that the economies of Japan and most of the eurozone are in such a trap—and that the United States was at least in this trap. Where these countries' fiscal positions allow and where demand is weak, governments should consider making investments in their people, stimulating demand and addressing the challenge of stagnant wages. Domestic policy will of course be most effective if there is adequate global demand, and with so many of the world's large economies in similar positions, international coordination on demand management becomes of paramount importance.

Increasing supply

A return to an economy growing at full potential will produce substantial benefits for middle- and lower-income households. Increasing growth where it is currently not occurring will increase employment. Lower levels of unemployment and underemployment in labor markets, combined with increased productivity, will deliver rising real wages. The increase in potential output and productivity will improve not only long-term economic welfare but also the ability of government finances to fund necessary expenditures.

In the longer term, however, once advanced economies have thoroughly recovered, expanding potential output will require more progress on the supply side. Advanced economies need to increase the productive capacity of their workforce, make much needed investments in the public goods that support business growth, adopt family-friendly policies that will increase the number of workers, and take steps to aid innovation.

Raising wages: Full employment in an economy where work pays

…

It is also important that minimum wages adjust to keep up with pay at the middle and top. However, as crucial as minimum wages are to raising living standards for low-wage workers, strong minimum wages are not a cure-all. There are trade-offs in relying on minimum wages to raise living standards, and we must not lose sight of the fact that we need a mix of policies that deliver fairness and productivity growth. A labor market that works for everyone includes a healthy minimum wage that the vast majority of workers out earn.

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Raising take-home pay for low-wage workers

Expanding labor-market participation is critical but must go hand in hand with efforts to raise wages. When large portions of the workforce are earning low wages, their welfare is affected and their consumption is limited, which weakens aggregate demand. Comparative empirical work on the share of low-wage work in advanced economies suggests that the most important determinant of the observed differences across economies is the degree of "inclusiveness" of labor-market institutions.[20]

For lower-wage workers, a principal mechanism to generate inclusiveness is a minimum wage that provides sufficient income and is tied to the median wage of all employed people. The available evidence strongly suggests that this is one good way to reduce the share of workers who are trapped in low-wage work.

…

Family-friendly labor-market policies to increase female labor-force participation and income

Families in all advanced economies have changed dramatically over the past half-century. Gone are the days when most children had a full-time, stay-at-home caregiver. Today, mothers work in record numbers in most advanced economies—though the United States is an outlier, with working-age women's participation in the labor market falling fairly steadily since about 2000.[13] In some countries, there are large potential gains in labor supply to be had if policies that help working families manage the dual responsibilities of earning wages and caring for family members can be improved. A recent analysis by Cornell University economists Francine Blau and Lawrence Kahn suggests that had family-friendly policies in the United States expanded in line with those of European economies, U.S. women's labor-force participation rates would have been 7 percentage points higher in 2010.[14] Addressing the issues facing working families can help fight income inequality by boosting labor-force participation, increasing wages for working caregivers, and reducing temporary separations from the labor force by supporting continuous employment.

In particular, paid parental leave—which increases labor-force participation for mothers in the years after giving birth—should be encouraged where it is not currently adequate.[15] Paid caregiving leave, paid sick days, paid vacation, protections for part-time workers, and workplace flexibility are all important to increase the inclusiveness of advanced-market economies. These policies are especially important in diverse nations, where many community traditions call on family members to shoulder a large share of the caregiving burden.

…

Other inclusive capitalism practices range from employee stock-ownership plans and worker cooperatives—which allow workers an ownership stake in a company—to cash-based profit- and gain-sharing programs, which pay workers a portion of the capital-related income they helped generate but do not grant ownership. The connection between these schemes is that they compensate a broad base of workers—not just top executives—on the basis of group performance rather than individual performance.

For workers, inclusive capitalism is often associated with higher pay, expanded benefits and greater job security, participation in decision making, trust in the company and management, and better labor-management relations. For businesses, inclusive capitalism is often associated with increased productivity and profitability and a greater likelihood of corporate survival. In addition, companies often benefit from greater worker loyalty and effort, lower turnover rates, and an increased willingness on the part of workers to suggest innovations.
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Protecting workers who are underemployed

The unraveling of the traditional employer-employee relationship has made it more difficult to provide basic labor-law protections to workers. As corporations have shed employees, through devices such as subcontracting or hiring independent contractors, they also have shed traditional responsibilities as employers.

This has long been an issue in the U.S. construction industry, where firms use subcontractors and create subsidiaries to avoid employer responsibilities. Currently, many workers at franchises of large corporations are nominally employees of the franchisee but have much of their workplace lives determined by the franchising corporation. Hospital, retail, and other workers are treated as just-in-time workers, required to report to work on demand, with no guarantee of minimum hours. In the United Kingdom, many workers employed on zero-hours contracts are in a similar position. Some companies are employing up to 85 percent of their workforces on contracts of this kind.[21] This form of employment makes weekly household budgeting almost impossible and reduces employers' commitments to their workforces.

To address these problems, basic legal protections for employees need to apply when an employment relationship exists, and these protections should not be negated by legal form.[22] Firms that are in reality employers should be made responsible for basic protections such as overtime pay, workers' compensation, and unemployment compensation, as well as for following other protections provided by labor law. In some countries, certain rights are quite rightly bestowed on individuals after a continued period of employment by the same organization. Legal distance from employees should not shield the employer from fulfilling basic responsibilities.
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Educational opportunity for all

The analysis in Chapter 2 shows that advanced economies are increasingly rewarding those with high skills. It is therefore essential that education systems ensure that there are clear routes to high skill levels through both academic and vocational paths.
…

This is where the strategy of inclusive prosperity is so important. For a country to be most effective in realizing its economic potential, opportunities to build human capital must be broadly available in the population. However, as income inequality has risen and as economic mobility has tightened across many advanced-economy countries, the opportunities for quality early learning and education are becoming scarcer.

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The richness of this early life environment is also, of course, highly correlated with parental socioeconomic status. Rice University economist Flávio Cunha and University of Chicago economist James Heckman summarized the evidence: “The best documented market failure in the life cycle of skill formation in contemporary American society is the inability of children to buy their parents or the lifetime resources that parents provide.”[34] Economists measure the extent to which these privileges bestow competitive benefits upon offspring as the intergenerational elasticity of income—or, in other words, the part of the child’s income that is not explained by their individual ability or characteristics.

…

Finally, world-class schools can only be achieved through a close relationship with local and national employers. This relationship must be a two-way process that allows businesses to have input into the development of the education system but also creates incentives for businesses to invest in training.

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Support for apprenticeships to increase productivity and employment

Apprenticeships are also an effective public investment. In an analysis of workforce-training programs in the U.S. state of Washington, researchers found that the return on investment for apprenticeships is $23 for every public dollar invested—substantially higher than for any other workforce-training program, including community colleges, which were found to have a return on investment of $3 for every public dollar invested. Apprenticeships in Washington, as in the rest of the United States, have a low public cost because employers and labor unions pay the bulk of the expenses. In the United Kingdom, the Department for Business, Innovation and Skills and the National Audit Office determined that for every pound spent by the government to support apprenticeship, the country gets a return of between 18 pounds and 28 pounds.

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Supporting innovation clusters

Governments can encourage innovation through a mixture of tax policies such as research and development tax credits, grants for research into specific technologies or prizes for solutions to particular challenges, and support or incentives for patient capital that recognizes the long-term nature of returns from innovation. While there are divergent views on the role of government in cluster policy, it is broadly accepted that the role of government is not to cut new clusters out of whole cloth but rather to support and develop existing clusters. As Mark Muro and Bruce Katz of the Brookings Institution have written, “Clusters can’t be created out of nothing and cluster initiatives should only be attempted where clusters already exist.”[45]

Porter has argued that “government should reinforce and build on established and emerging clusters rather than attempt to create entirely new ones,”[46] seeing a role for government in “cluster upgrading,” which focuses on “removing obstacles, relaxing constraints, and eliminating inefficiencies.”[47] Enrico Moretti notes that it is “really hard to engineer an innovation cluster,”[48] instead advocating for the use of R&D and education policy to lay the groundwork for successful clusters.

…

Greater long-termism in the private and public sectors

To provide greater macroeconomic and financial stability and to raise productivity, it is essential that markets work in the public interest and for the long term rather than focusing only on short-term returns. Meanwhile, policies to improve the supply side of the economy or to address long-term risks such as climate change should be developed and implemented on a cooperative basis to create greater certainty.

…

Reforming corporate governance to encourage long-term investment

In the United Kingdom, economist John Kay carried out an independent review for the government that concluded that “short-termism is a problem in U.K. equity markets, and that the principal causes are the decline of trust and the misalignment of incentives throughout the equity investment chain.”[61] The review by Sir George Cox in “Overcoming Short-termism within British Business” also concluded that “the potential to deliver quick results to the potential detriment of the longer-term development of a company has become an entrenched feature of the U.K. business environment.”[62]

Reforms to corporate governance are therefore critical. There are a number of potential ideas that could be implemented, including making directors more independent of company staff, moving away from quarterly reporting, taking measures to reduce the ease with which hostile takeovers can take place, and promoting greater information disclosure from brokers and other market participants.

…

Investment in infrastructure

An economy can only grow as fast as its infrastructure systems can move information, people, and goods. Infrastructure investments provide strong jobs and productive assets that serve as the foundation for long-term economic competitiveness, increased prosperity, and a high quality of life. By comparison, failing to invest leads to deteriorating facilities, unpredictable service disruptions, congestion, and higher costs to businesses and households.

…

Shared efforts to raise global demand

Greater efforts are now needed to use international forums such as the G-20 and the International Monetary Fund to coordinate policies that increase global demand. Within the scope of individual countries' fiscal outlooks and policy approaches, there is a strong case for internationally coordinated, long-term public investment over other forms of public spending or tax cuts. In a period when many advanced economies are operating well below potential output and real interest rates are relatively low, there should be little concern that this would displace private investment.

…

Outro: Legitimacy and Inclusiveness

"Just because markets do not address value, goodness, justice, and morals does not mean that such concerns can be safely ignored."

-- Lovins, Lovins, and Hawken

There is a reformation going on in our economic system.

In order for capitalism to continue its reformation – moving from 'industrial capitalism' to 'moral capitalism' – there needs to be a continued effort to increase its legitimacy. What I see in this issue of *Pegasus* is a laying out of a new(-ish) way forward in the report from the Center for American Progress (CAP); a way forward that has increased legitimacy.

Malcolm Gladwell recently wrote in *David and Goliath* that legitimacy is based on three things:

> "*First of all, the people who are asked to obey authority have to feel like they have a voice- that if they speak up, they will be heard. Second, the law has to be predictable. There has to be a reasonable expectation that the rules tomorrow are going to be roughly the same as the rules today. And third, the authority has to be fair. It can't treat one group differently from another.*"

While Gladwell wasn't specifically writing about our economic system, the same types of rules apply. Of particular salience is the third 'rule' referencing fairness. Gladwell notes later in his book that if too many people are seen to be getting 'deals,' it has the ultimate effect of undermining the legitimacy of the entire system. An inclusive economy, as called for by the CAP report, relies upon a resilient and legitimate economic system. This inclusive economy would be more able to address the failures of our current system.

If we continue to live in a society where three-quarters of those receiving government assistance are in families headed by one or two workers (as is the case in the U.S.), we see a failure in the economic system.

If we continue to see stock prices go up, but real wages stagnate or, in fact, decrease, we see a failure in the economic system.

When we continue to see inequality increase year after year – failure in the economic system.

A recent article in Time Magazine notes that the OECD estimates that inequality has been rising for over 30 years and has reduced U.S. economic growth even more than the financial crash of 2008.

These are the externalities of our current economic system; the result of high income for some and the opportunity to do worse financially than your parents did for others. It is these types of externalities (among others) that need to start being incorporated into the actual price of goods. As Lovins, Lovins, and Hawken wrote in their book, *Natural Capitalism*, "People now know the price of everything but the true cost of nothing. Price is what the person pays. Cost is what society pays, here, now, elsewhere, and into the future." Those externalized costs become manifest in over-pollution, underemployment, and de-legitimization of an economic system.

These are the same type of externalities that Steve references in his article. Far fewer boats are rising with the tide and, in fact, it is quite possible that the current economic system is actually acting as an anchor for many. Moral capitalism and sustainability, the very things being recommended in many cases by the CAP report, are what is needed to reverse these dangerous trends. The Caux Round Table's Principles for Business, for Government, and for Responsible Globalization also address these concerns.

As with other large structural changes throughout history, there will be people who say that we cannot succeed in this endeavor. We *can't* remake the capitalist system into a more potent engine of growth, achievement, and prosperity through the application of morals and sustainability. What we should realize when people say this is that what they mean to say is they *won't*, they are simply too lazy to articulate their reasoning.

Again, going back to Gladwell, he notes that if a child from a middle class family asks for a pony for their birthday, the parents can easily say they "*can't*." However, if a child from a much wealthier family asks for the pony, the parents are much less able to say "*can't*" and have it be truthful. The modern global economy is much like that wealthy family. We are wealthy in diligence and creativity. We can speak to principles instead of talking about interests. We can make the necessary changes to create a legitimate, inclusive, sustainable, and moral version of capitalism. We can, and in fact, we must.

As always, I welcome your comments.

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