

Democracy Realized
The Progressive Alternative



ROBERTO MANGABEIRA UNGER

1998

Zhiyuan Cui



VERSO

London • New York

II
A MANIFESTO

THE CONSTITUTIONAL ORGANIZATION OF GOVERNMENT AND THE LEGAL FRAMEWORK OF ELECTORAL POLITICS

No one genre of thinking, talking, and writing enjoys the privilege best to represent today a progressive, programmatic imagination. We can think discursively, prophetically, or poetically; systematically or by fragment and parable; with a particular context in mind or on a worldwide scale; linked to particular parties and movements or disconnected from them; extending actual experience or anticipating possible experience; for the here and now of immediate feasible changes or for the remote and speculative future of unborn humanity; with a wealth of empirical detail and justificatory argument or with nothing but the suggestive and dogmatic invocations of a manifesto. These forms have different uses. They complement one another. It is a mistake, for example, to oppose short-term and context-oriented proposals to the tentative exploration of long-term alternative futures, or moderation to radicalism, in programmatic thought. Any trajectory of cumulative structural change can be considered at points close to present social reality or distant from it. The direction matters more than the distance.

What counts is to populate our imaginative world with more such practices, and to free ourselves from the superstitious inhibitions that prevent us from doing so. The following theses

amount to one such experiment in discourse. Although placed at an extreme limit of the repertory of programmatic genres, they address directly the problems that have been central in this book.

First thesis: On the history of democratic institutions

The dominant constitutional tradition in the West draws today upon two sets of arrangements and ideas. The first set consists of a preference for constitutional forms that fragment power, favor deadlock, and establish a rough equivalence between the transformative reach of a political program and the severity of the legal-constitutional and practical-political obstacles set up in the course of its execution. Both the system of "checks and balances" in American-style presidential regimes and the need to base political power upon broad consensus within the political class in parliamentary regimes exemplify this inhibiting preference. The second set of arrangements and ideas in the dominant tradition is the adoption of rules and practices maintaining society at a relatively low level of political mobilization. These practices gradually replaced the institutional devices of protodemocratic liberalism – the limits to the suffrage and the recourse to multiple levels of representation – that secured property against populism. Progressives must reject and replace both parts of this tradition.

Second thesis: On the constitutional arrangements of government

A constitutional style designed to accelerate politics and to favor the repeated and frequent practice of basic reform should combine a strong plebiscitarian element with a broad range of channels for the political representation of society. Example: A strong parlia-

ment coexists with a directly elected president with substantial powers of political initiative. But the standard hybrid form of presidential and parliamentary regimes (as in the constitution of the Fifth Republic) is replaced by a system that avoids weak government and the perpetuation of deadlock. It does so according to the following principles. First, reform programs enjoy priority over ordinary, episodic legislation: they must be agreed to, rejected, or negotiated quickly. Second, when, under such a system, president and parliament disagree on a reform program, they may agree to plebiscites or referenda. Third, if the political branches of government are unable to agree about the realization or the terms of popular consultation, or if the result of the consultation is indecisive, either the parliament or the president may call anticipated elections, but the elections must be simultaneous for both branches of government. The general principle is rapid resolution of impasse through direct involvement of the general electorate. The aim is to quicken democratic experimentalism by facilitating the repeated practice of radical reform: change in the formative institutions and practices of society as well as in the beliefs sustaining them. In many countries, with strong political parties and informed electorates, the reform of a parliamentary system of government can produce similar results.

Third thesis: On the reorganization of electoral politics

A sustained heightening of the level of political mobilization is required for the acceleration of democratic experimentalism in all fields of social life. The level of political mobilization is not a natural fact about a society or a culture; it is, to a large extent, an artifact, responsive to changes in the rules and instruments of politics. Among such changes are: public financing of political campaigns; expanded free access to the means of mass communication for political parties and social movements; multiplication

of the forms of ownership of the means of communication; rules of mandatory voting; and changes in the electoral regime. Although a system of closed lists and proportional representation is usually most effective in strengthening political parties as the agents of structural proposals, the temporary adoption of majority elections may in certain countries help shake up a rigidified party system and reveal underlying progressive and conservative coalitions. A politics of repeated structural change is necessarily a high-energy politics. For the high energy to persist beyond interludes of collective enthusiasm it must find sustenance in arrangements friendly to the rise of popular political engagement. For the high energy to exercise a lasting productive effect it must leave its work inscribed in the institutional and imaginative order of the society.

THE ORGANIZATION OF CIVIL SOCIETY AND THE PROTECTION OF RIGHTS

Fourth thesis: On the conception of fundamental rights

Progressives should reinterpret rather than reject the idea of fundamental rights. There is a dialectical relation between the protection of individuals in a haven of vital interests and the capacity of individuals to flourish in the midst of a quickened experimentalism. The role of the rights is to assure people of the political, economic, and cultural equipment they need in order to stand up, go forward, and connect. Such rights must safeguard them against the insecurities that might tempt them to abandon

their freedom. We must take the definition and assignment of this equipment out of the agenda of short-term politics so that we can broaden this agenda effectively. Thus, the relation of fundamental rights to the generalized tinkering of a deepened democracy is like the relation between the love children receive from their parents and the capacity of children to make and remake themselves through moral adventure.

People should inherit from society rather than from their parents: they should have a social-endowment account. Inheritance upon death or through gift should be limited to the patrimony required by a conventionally set standard of modest independence. The social-endowment account should include both a fixed and variable part. The variable part should increase by one measure according to a principle of compensation for special need, for physical, social, or cognitive disadvantage, and by another, countervailing principle according to a criterion of reward for special capability, through competition among individuals for increments to their accounts.

Education, continuing through a lifetime, rescuing people as children from the imaginative hold of their families, their class, their country, and their time, and giving them as adults access to a repertory of generic practical and conceptual capacities, is the most important enabler of individual and collective freedom. It is therefore the principal object of the social-endowment account.

In keeping with the experimentalist impulse, we should try out and compare different ways of composing the accounts and of restricting their use. Thus, some part may be received as cash grants from the government, and some part held as tradeable but not cashable stakes in productive assets. Some part may need to be spent in predetermined ways according to fixed rules, and some part may be available for choice among alternative uses and alternative providers. Moreover, if these inheritance-replacing arrangements impose a cost upon output and prosperity, let us

find out what the cost is, and let us decide how much of it we want to bear for the sake of a form of life better equipping and connecting us. Let us redefine as social choice what would otherwise remain institutional fate.

Fifth thesis: On the protection of fundamental rights

Rights, especially social and economic rights, should not be viewed simply as resource-dependent schemes of social welfare and social insurance. Claims of right enter into conflict with particular social organizations or areas of social practice when (a) a structure of inequality or exclusion emerges in particular organizations or practices, threatening the effective enjoyment of rights and (b) the individual cannot readily challenge this citadel of privilege by the normal forms of economic and political activity available to him. We need a type of corrective intervention and reorganization that is both (a) structural and rights-defining and (b) episodic and localized. Examples: Intervention in a school system to correct the disfavoring of children with certain skills or disabilities; intervention in a factory to reorganize a system of work imposing extreme forms of hierarchy in the interest of control and surveillance rather than as a requirement of technical coordination and efficiency. None of the existing branches of government are entirely well suited, by reason of political legitimacy or practical capacity, to serve as the agents of such intervention. A new branch of government must be designed, elected or co-chosen by the elected branches. It should have budgetary and technical resources appropriate to its reconstructive responsibilities.

Sixth thesis: On the legal organization of civil society

A vigilant and organized civil society is indispensable to the advancement of democratic experimentalism. A disorganized society cannot generate alternative futures or act upon them. Disorganization is surrender to accident, to drift, to fate.

It is not enough to call for an intensification of voluntary association without reimagining and remaking the institutional context in which voluntary association takes place. We can call the spirits, but they may not come. There are two paths of institutional reform that can strengthen the capacity of civil society for independent self-organization. Call them private law plus one and public law minus one. Far from being mutually exclusive, they can complement each other.

Private law plus one accepts the conventional body of contract and corporate law as the basic framework for the self-organization of civil society. However, it supplements this framework by establishing a branch of government responsible for localized intervention in organizations or practices corrupted by entrenched forms of social exclusion or subjugation. The evil to be redressed by such corrective intervention is a social disadvantage people are unable to escape by the normal forms of political and economic action. Left unchallenged, such disadvantage prevents its victims from effectively exercising many of their other political and economic rights.

The work of the reconstructive branch of government is neither to promulgate general laws like a legislature nor to settle rights disputes among individual litigants like a traditional judiciary. Its work is to repair a localized obstacle to capable economic or political agency. To this end, the intervening branch may have to run the offending organization for a while, placing it in a kind of social receivership, the better to lift it past the threshold of acceptability. The new part of government may need to investi-

gate, invest, and reform – but always with a focused scope and for a limited time. Thus, it must enjoy the political legitimacy that comes from being elected by the people or co-elected by political branches of government, and the practical capacity that results from having financial and investigative resources at its disposal.

Public law minus one means a public-law framework for the organization of civil society outside the state, around jobs, neighborhoods or shared special concerns (like health care or education). There would be a right to opt out of this framework and fashion alternative arrangements under certain conditions. These readymade public-law provisions should help establish a bias toward inclusive organization in civil society. However, they should remain free from any taint of governmental control or tutelage.

For example, the contractualist labor-law principle of complete freedom of the unions from the government may be combined with the corporatist principle of automatic unionization of everyone. Automatic unionization may sound coercive until you realize that the choice may be between unequal organization, reinforcing the advantages of the advantaged, and inclusive but democratic organization, creating a structure over which everyone can fight on relatively equal terms. There is internal democracy in such a unitary and all-inclusive labor-union system: different labor movements, whether or not affiliated to political parties, compete for position in this union system just as political parties compete for position in government. The same idea can be reproduced on territorial principles: a system of neighborhood associations, outside the structure of local government and parallel to that structure. In yet a third domain the principle can take a functional direction: the organization of civil society around certain shared concerns, such as education or health services. Associational depth and diversity are conditions of cooperative competition in production and of deliberative capacity in politics. They diminish

the terrors of innovation by sustaining trust and containing risk. To promote them is the proper object of a body of social law expanding and shaping the space between private initiative and public policy.

People should be able to exit this public-law system of social organization and create alternative arrangements so long as two basic conditions are satisfied. The first condition is that those who withdraw be in a situation of rough equality relative to one another. The second condition is that they not use their power of exiting the framework to establish another little citadel of entrenched subordination.

THE ORGANIZATION OF PUBLIC FINANCE AND OF THE ECONOMY

Seventh thesis: On public finance and the tax system

Some significant element of indirect taxation has been shown to be necessary in most contemporary societies to guarantee substantial tax revenues and thus to ensure a high level of public investment in people. The least regressive of the indirect taxes, and the one least likely to distort and disrupt economic activities, is a comprehensive flat-rate value-added tax. On the secure basis of the revenue collected by this tax there should be two principal direct taxes. The first is a Kaldor-style consumption tax, taxing the difference between income and savings-investments, with a large exemption for a basic level of consumption and a steeply progressive scale. The second is a wealth tax, of which the most important part is heavy taxation of family gifts and inheritance.

In this way, we distinguish clearly the two targets of standard-of-living (for the consumption tax) and economic power (for the wealth tax) and address them directly rather than accepting the relatively confused and ineffective machinery of the income tax. The organizations of civil society described in the sixth thesis should be engaged in the allocation and supervision of public spending. At a later moment in the deepening of democracy, when, according to the ninth thesis, traditional unified property rights have given way to a system of fragmentary, joint, and residual rights in productive resources, taxation may cease to be the mainstay of public finance. Instead of taxing, the government may impose differential rates of return for the use of the productive resources of society. The semi-independent organizations responsible for broadening the decentralized allocation of social capital (ninth thesis) would pay such charges, recovering them from the firms and work teams who would be the ultimate resource users.

Eighth thesis: On the reform of the production system and of its relation to the state

The reformation of production along more experimentalist lines need not have democratizing consequences, but it offers democratizing opportunities. The most promising path to the realization of such opportunities lies in a growth strategy combining the following attributes: (a) within firms, the practice of production as learning and the softening of rigid contrasts between task-defining and task-executing activities; (b) among firms, cooperative competition – small and medium-sized firms, or decentralized divisions of large firms, simultaneously compete and cooperate, pooling financial, commercial, and technological resources; (c) between firms and governments, a wide range of forms of partnership, with decentralized, pluralistic, and socially inclusive

forms of strategic coordination between government and business. To prevent such partnership from degenerating into collusion between bureaucratic and entrepreneurial elites and from falling victim to rent-seeking and dogmatism we need to diversify the cast of economic agents and to screen governments from particular firms while affirming, in novel form, the idea of association between public power and private enterprise.

Democratizing the partnership between government and business requires the development of a level of organization standing in between the state and the firms: competitive social funds and support centers. Enjoying broad independence, and subject to competitive pressure and financial responsibility, such funds would operate with the resources of an original endowment, supplemented by their own gains. Their task would be to associate private initiative and public power in a decentralized form, calculated to minimize bureaucratic prejudice and economic privilege while promoting experimental innovation in the institutional forms of market activity.

From the outset some of these organizations would be charged with taking a view beyond the short term, in the fashion of a public venture-capital business. A characteristic concern of theirs would be to invest in a productive vanguard capable of producing, in customized fashion, the materials and machinery the productive rearguard of the economy needs. They would also work to lift up this rearguard, helping it identify and assimilate better practices and more advanced technologies.

Ninth thesis: On property rights

The decentralized and democratized partnership between governments and firms described in the eighth thesis can in turn advance through the dismemberment of traditional property rights. The powers now brought together under the label “property” would

be torn apart, step by step, and vested in different tiers of rightholders: governments, intermediate organizations, and firms. Democratic governmental institutions may mark the outer limits to inequality of benefit or position in the workplace, shape the alternative means for the decentralized allocation of capital, and set the basic underlying charge for the use of capital. The intermediate organizations – social funds and support centers – would coordinate access to productive resources under different legal regimes.

Under some such regimes the funds would have an arm's-length relation to their client firms: assigning resources, in exchange for debt and equity, to those with the best prospect of assuring over longer or shorter periods the highest rate of return. Under other regimes the firms would develop a more intimate relation to their client firms, as centerpieces of little confederations of cooperative-competitive businesses. The ultimate capital-takers and users – the client firms or the teams of professionals or workers moving in and out of the firms – would share with the intermediate organizations and with local governments or community associations joint residual rights in the businesses they established.

Thus, we qualify property rights to make them proliferate. We achieve more decentralization of economic opportunity as well as more diversity in the legal forms of the market at the cost of weakening the absoluteness of the command rightholders enjoy over the resources at their disposal. Different systems of contract and property law, amounting to alternative methods for the decentralized allocation of capital, come to coexist within the same economy. An active, informed society can then evaluate their respective merits for each sector of economic activity, their economic benefits and social costs.

We diminish the tension between private initiative and public control by changing their institutional vehicles. Moreover, we diminish it simultaneously in many different ways, the better to

see and to judge the practical consequences of each way. By such devices we turn into recognized and replaceable artifice what had been mistaken for practical or conceptual necessity in the institutional design of a market economy. The result is neither “capitalism” nor “socialism” but the market economy made more inclusive, more pluralistic, and more experimental.

DEMOCRACY AND THE LEFT

Tenth thesis: On what it means to be progressive today

To be progressive today is to insist upon crossing the boundaries of the established institutional settlement in a democratizing direction. Anyone who accepts the established institutional framework as the horizon within which interests and ideals – including egalitarian ideals – must be pursued is not a progressive. The European social-democratic parties are not progressive. A pessimistic, socially concerned but institutionally conservative reformism is not progressive. The error lies in believing that the alternative to resignation is the total substitution of one “system” by another. Revolutionary reform – the part-by-part substitution of formative institutional structures and ideas – is the exemplary mode of transformative politics. The idea of revolutionary change has, by its impracticality, become a pretext for its opposite. The first nine theses give examples of revolutionary reforms crossing the frontiers of the established institutional settlement.

**Eleventh thesis: On the interpretation
of the democratic cause**

The democratic cause is the effort to identify and to realize arrangements exploiting the area of potential overlap between the conditions of material progress and the conditions of individual emancipation. Thus, it moves toward the generalization of experimentalism in social life. It subjects the institutional forms of representative democracy and of the regulated market economy to this same experimentalism. It is not antiliberal; it realizes liberal hopes by changing liberal forms. It refuses to sacrifice the plurality of human interests to a single-minded egalitarianism. It wants us to be less unequal and less disconnected from one another in ways that also make us bigger, energizing and empowering.

**Twelfth thesis: On the social base
of the progressive parties**

The progressive parties cannot accept the choice between clinging to the favored representation of organized workers in mass-production industry and redefining themselves as middle-class "quality-of-life" parties. By choosing the first path they sink into the defense of ever narrower factional interests. By choosing the second path they betray their transformative and democratizing mission. They must find in a program of structural reconstruction both the focus and the basis for an enlarged popular alliance. What makes this effort possible is (a) the internal or dialectical relation between the redefinition of interests and ideals and the remaking of institutions or practices and (b) the asymmetrical relation between social alliances and political alliances. Social alliances are built through the transforming work of political

alliances and sustained by structural reforms that turn tactical convergences into lasting combinations of group interests and identities. However, political alliances do not take social alliances for granted; they have the development of social alliances as a task.

**Thirteenth thesis: On the focus of institutional innovation
and ideological conflict in the world**

The democratic project advances through conflict: the inherited ideological divisions lose their living connection to real concerns and possible alternatives. They must then be reinvented. The conflict between statism and privatism is dying and being replaced by a contest among the alternative institutional forms of political, social, and economic pluralism. Representative democracy, free civil society, and the market economy can all take forms different from those they now assume in the North Atlantic world. The choice among such alternatives is fateful because it represents a preference not just for certain arrangements but also for the possibilities of individual and collective experience these arrangements sustain. The involuntary institutional experimentalism of the poor countries (that invent when imitation fails to work) sheds light on the suppressed opportunities for transformation in the rich countries. The albatross of state socialism has been lifted from the neck of the left. However, the attempt by institutionally conservative social democrats to reduce progressive politics to the reconciliation of social protection with market flexibility leaves democracy unrealized and fails in its own objective. The time for progressives to reinvent themselves by driving democratic experimentalism forward is now.

AN APPENDIX ON SAVING AND INVESTMENT

by Zhiyuan Cui

The possibility and desirability of alternative institutional arrangements linking saving and productive investment is the central issue of democratic experimentalism in the area of finance. However, contemporary mainstream economics has helped obscure this problem rather than illuminate it. Two flaws of the existing economic literature – both “neoclassical” and Keynesian – contribute to this obscurity.

The first defect lies in the accounting identity between saving and investment. The second defect concerns the view of the causal relation between saving and investment. The first flaw prevents us from addressing the second. Opening up any macroeconomics textbook (e.g. Dornbusch and Fischer, p. 44), you will find that saving and investment are equal within a country by definition. This idea has its origin in Keynes’s *General Theory of 1936*.¹

¹ Keynes remarks as follows: “Provided it is agreed that income is equal to the value of current output, that current investment is equal to the value of that part of current output which is not consumed, and that saving is equal to the excess of income over consumption – all of which is conformable both to common sense and to the traditional usage of the great majority of economists – the equality of saving and investment necessarily follows. In short:

This accounting identity is a useful tool for the National Income Account,² but it prevents economists from considering alternative institutional arrangements linking saving and productive investment. Only in the earlier period of industrial revolution, when saving and investment were usually done by one and the same individuals, did it make sense to follow Adam Smith: "What is annually saved is as regularly consumed as what is annually spent, and nearly in the same time too" (Smith, 1776, vol. I, pp. 337–8). However, with the development of the sophisticated financial institutions of the modern market, economy, saving and investment are usually done by different people, Keynes's accounting identity between saving and investment has become counterintuitive. Recognizing this counterintuitive nature of his definition, Keynes offers a substantive justification that is worth citing in some detail:

The prevalence of the idea that saving and investment, taken in their straightforward sense, can differ from one another, is to be explained, I think, by an optical illusion due to regarding an individual depositor's relation to his bank as being a one-sided transaction, instead of seeing it as the two-sided transaction which it actually is. . . . But no one can save without acquiring an asset, whether it be cash or a debt or capital-goods; and no one can acquire an asset which he did not previously possess, unless *either* an asset of equal value is newly produced *or* someone else parts with an asset of that value which he previously had. In the first alternative there

Income = value of output = consumption + investment

Saving = income – consumption

Therefore saving = investment." (p. 63)

² Keynes was directly involved with the preparation of the first National Income Account for England (by James Meade and Richard Stone), which became the basis for the United Nations' recommendations for every country in 1948.

is a corresponding new investment: in the second alternative someone else must be dis-saving an equal sum. (pp. 81–2)

...

Thus the old-fashioned view that saving always involves investment, though incomplete and misleading, is formally sounder than the new-fangled view that there can be saving without investment or investment without "genuine" saving. (p. 83)

...

The reconciliation of the identity between saving and investment with the apparent "free-will" of the individual to save what he chooses irrespective of what he or others may be investing, essentially depends on saving being, like spending, a two-sided affair. (p. 84)

It is clear from this citation that, by the time the *General Theory* was published in 1936, Keynes had completely changed the view expounded in his 1930 *Treatise on Money* – that is, that saving and investment are not equal by definition. This change is more than a matter of definition for national income accounting,³ for its consequence is to obscure the alternative institutional links between saving and productive investment. If our purpose is to understand institutional arrangements in capital markets, it is more useful not to define saving as equal to investment. As Gunnar Myrdal pointed out with regard to Wicksell's monetary theory (which Keynes was still to uphold in *A Treatise on Money*): "the idea underlying his [Wicksell's] whole analysis of the capital market is that investment and saving are not identical but that

³ As a matter of definition, the identity between saving and investment can be accepted for limited purposes, such as constructing National Income Accounts. James Tobin once said that "respect for identities is the first piece of wisdom that distinguishes economists from others who expatiate on economics" (p. 300). However, we must go beyond this identity to explore institutional mechanisms linking saving and investment.

they can be compared. They can then in a given situation be found equal or unequal.” (p. 88)

The point here is not to object to the saving-investment identity for national income accounting, but to argue that we should not be blinded by this identity from looking for better institutional alternatives for mobilizing saving for productive investment. Let me illustrate this point by discussing what Keynes calls the “dilemma of liquidity.” On the one hand, initial public offerings of corporate stocks are useful for mobilizing saving for productive investment; on the other, secondary stock-market trading breeds wasteful, casino-like speculation. The dilemma arises because we cannot enjoy the first effect without suffering the second. In Keynes’s own words:

Of the maxims of orthodox finance none, surely, is more anti-social than the fetish of liquidity, the doctrine that it is a positive virtue on the part of investment institutions to concentrate their resources upon the holding of “liquid” securities. It forgets that there is no such thing as liquidity of investment for the community as a whole. (p. 155)

...

For the fact that each individual investor flatters himself that his commitment is “liquid” (though this cannot be true for all investors collectively) calms his nerves and makes him much more willing to run a risk. If individual purchases of investments were rendered illiquid, this might seriously impede new investment, so long as alternative ways in which to hold his savings are available to the individual. This is the dilemma. (p. 160)

Here, it is important to realize that if we were to take the accounting identity between saving and investment literally, the dilemma of liquidity would not exist at all. There is simply no waste in the financial casino, because nothing prevents successful

speculators from reinvesting their gains in productive projects. At the end of the day, saving and investment are still equal by definition without saving having been diluted and wasted in financial casinos. However, in reality, relatively little real investment in the expansion of production and productivity is financed directly through stock markets. Corporations in all major Western countries fund almost all their capital expenditures – investment in plant, machinery, and inventories – internally, through retained earnings, in other words through profits and depreciation.⁴ Since 1952, retained earnings have covered ninety-five per cent of capital expenditures. Since the early 1980s, through mergers and acquisitions, buybacks, and dividends distribution, more stock has been retrieved from stock markets than has been issued. As a result, new equity as a net source of finance is negative!⁵

By going beyond the accounting identity between saving and investment and looking into the flow of loanable funds, we see that the potential for productive investment has indeed been reduced by the financial casinos. The accounting identity should not be understood to imply that all potential uses of loanable funds are equally productive. To justify such an implication, we would need to add two other crucial links to the chain of reasoning: that the established arrangements channeling saving into production approach the ideal of a market system that

⁴ From the accounting perspective, retained earnings can be viewed simply as “corporate savings.” So the dominance of retained earnings as the main source of finance does not change the accounting identity between saving and investment. However, if we really want to know how well stock markets mobilize public savings for corporate investment, the dominance of retained earnings is revealing: the mobilizing job is not well done! Moreover, the reliance upon retained earnings tends to perpetuate the existing economic divisions and hierarchies in the market, to the disadvantage of small and start-up firms.

⁵ There is much statistical evidence, all based on official flow-of-account analysis, on the dominance of retained internal earnings as the net source of finance in all Western countries. See, for example, Colin Mayer (1997).

allocates resources to their most "efficient" uses and that there is no major, market-friendly alternative to these arrangements. These are empirical, not analytical claims. This book has argued that they are false.

Hence, Keynes's "dilemma of liquidity" is a real one. Our task as democratic experimentalists is to search for alternative institutional arrangements to reduce the detrimental consequence of this dilemma.

The equation of saving with investment obscures a problem of great practical interest: the way in which particular institutional arrangements can either squander or tap the productive potential of saving. One way of squandering this potential is so to centralize access to finance that a myriad of small or would-be businesses are denied the practical resources with which to begin and to expand. One means of tapping this potential is to create alternative devices for the commitment of retained earnings to productive projects. Yet another strategy is to popularize the business of venture capital: the long-term investment of funds in start-up firms, typically in exchange for an equity stake.

Contemporary experience offers suggestive although limited examples of both approaches. Remember, as an example of the alternative routing of retained earnings, the Meidner Plan of wage-earners' funds in Sweden. As described by John Stephens, these funds work in the following way. "Companies with more than 100 employees, which account for two thirds of all private employment, would have to transfer a portion (10–30 per cent) of their profits in the form of newly issued shares of stock to 'wage earner' or 'employee investment' funds administered by the unions. The transferred portion of profit would be new equity capital and would remain in the firm for investment. The voting rights of the stocks would go to the unions with the first 40 per cent split between the national and the local union." (Stephens, p. 189)

As an example of the popularization of venture capital, consider

an experiment that has been underway in Canada for more than a decade. Starting from the first labor-sponsored venture capital project in 1984 – the Québec Solidarity Fund – labor-led venture capital funds now account for more than one third of venture capital in Canada. Established with tax credits and public seed money, the funds channel the savings of Canadian workers into small and medium-sized companies. The funds are independently managed and dedicated to ensure their investors high returns and diversified risks. Studies have suggested that the value of the tax incentives – worth some forty per cent of the funds invested – is paid back to the government in about three years, thanks to effects such as the increase of payroll taxes, as well as the diminishing of welfare payments, associated with the new jobs created.

A second way in which contemporary economics helps obscure the institutional issues in finance is its failure to resolve a conundrum about the causal direction between saving and investment. The neoclassicists hold that the causal direction goes from saving to investment; Keynesians, the other way around. As James Meade vividly put it, "Keynes's intellectual revolution was to shift economists from thinking normally in terms of a model of reality in which a dog called savings wagged his tail labelled investment to thinking in terms of a model in which a dog called investment, wagged his tail labelled savings." (p. 342)

According to the classicists before Keynes and the neoclassicists after him, high saving rates provide means for investment at low interest rates. Inversely, low saving rates make loanable funds more scarce, thereby raising interest rates and discouraging investment. In the long run, saving and investment are brought into equilibrium by interest-rate variation. That equilibrium interest rate is called the "natural rate of interest." Keynes's revolution in 1936 turned this classical saving-drive-investment theory upside down. For Keynes, investment decisions are made on the basis of future profit expectations. Investment spending,

through the mechanism of the multiplier, increases total income and, thereby, the level of saving. In this sense, investment is a revolving, self-liquidating fund for the society as a whole: it is not constrained by the prior saving level. However, this important insight did not prevent Keynes from running into a crucial theoretical problem. Before the completion of the investment multiplier, how can the initial investment be financed if not by prior saving?

Keynes's answer is that banks will accept a temporary decline in their liquidity the better to finance the initial investment before the multiplier completes its work. This is why he insists that his "most fundamental conclusion" is that the investment market "can never become congested through shortage of saving" (Keynes, 1930, p. 222). But ever since Keynes published his *General Theory*, the critics, from Robertson (1936) and Ohlin (1937) through to Asimakopulos (1983) have argued that banks would not accept the reduction of their liquidity without high interest-rate compensation. In turn, high interest rates will increase the cost of capital and thereby discourage investment. At this point in the causal chain, the critics claim, saving comes back into the picture again as a determinant of investment, since without a prior increase in saving, banks' demand for high interest rates compensating their liquidity loss cannot be resisted.⁶

These debates on the causal direction between saving and investment in economics have reached a dead end. For, having failed to bring institutional alternatives into discussion, the Keynesian revolution is at risk of being totally reversed. Only by overcoming the obscurity perpetuated by mainstream economics – through the accounting identity between saving and investment as well as through the conundrum about the causal direction between saving and investment – can we begin to explore alternative institutional arrangements linking saving and production.

⁶ Bridel (1987) and Dymski and Pollin (1997) are good surveys of the fascinating debates on the causal direction between saving and investment.

References

- Asimakopulos, A., "Kalečki and Keynes on Finance, Investment, and Saving," *Cambridge Journal of Economics*, vol. 7, 1983, pp. 221–33.
- Bridel, Pascal, *Cambridge Monetary Thought: Development of Saving-Investment Analysis from Marshall to Keynes*, St. Martin's Press, 1987.
- Dymski, Gary and Pollin, Robert, eds, *New Perspectives in Monetary Macroeconomics*, The University of Michigan Press, 1994.
- Keynes, John Maynard, *The General Theory of Employment, Interest, and Money*, Harcourt Brace Jovanovich, 1953 (originally published in 1936).
- Keynes, John Maynard, *A Treatise on Money*, Harcourt Brace, 1930.
- Keynes, John Maynard, *The Collected Writings of John Maynard Keynes*, vol. XIV, Macmillan, 1973.
- Mayer, Colin, "The City and Corporate Performance," *Cambridge Journal of Economics*, vol. 21, 1997, pp. 291–302.
- Meade, James, *The Collected Papers of James Meade*, vol.1, edited by Susan Howson, Unwin Hyman, 1988.
- Myrdal, Gunnar, *Monetary Equilibrium*, William Hodge, 1939.
- Ohlin, B., "Some Notes on the Stockholm Theory of Saving and Investment," *Economic Journal*, vol. 47, March and June 1937.
- Robertson, D.H., "Some Notes on Mr. Keynes's General Theory of Employment," *Quarterly Journal of Economics*, vol. 51, November 1936.
- Tobin, James, "Comments," in Robert Pollin, ed., *Macroeconomics of Saving, Finance and Investment*, University of Michigan Press, 1997.