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The Realities and Illusions of the XXIst Century Social Contract

STRUCTURED ABSTRACT:

Purpose – The paper aims to clarify the relationship between the rise of the sovereign debt in the G20 and the relative underpayment of labor versus capital.

Design/methodology/approach – The historic analysis of successes and failures of demand management in the leading market economies. Provide data to support and illustrate the claims made in the paper.

Findings – The argument presented in the paper is that the root cause of the rapidly rising sovereign debt lies in the demand deficiency originating in the cumulative effect of lagging labor compensation relative to productivity gains. Developed market democracies desperately need policies to mend the failing social contract between labor and capital. The real solution of the debt is to address demand deficiency, increase labor participation and wages, or basically, introduce a new social contract between labor and capital.

Research limitations/implications – The detailed analysis of demand management policies would have to be country specific which goes beyond the scope of the paper.

Practical implications – The paper implies that G20 policies go into a wrong direction and increase the risk of chain debt defaults in the leading market economies.

Originality/value – This paper fulfils an identified need to study the root cause of the demand deficiency syndrome and the need to introduce long term policies needed to restore growth in the market economies.

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Key words: debt, wages and productivity, social contract, demand deficiency

Article Type: General view

Introduction

The principal high-income economies – the US, the Eurozone, Japan and the UK – have been suffering from chronic demand deficiency syndrome. More precisely, their private sectors and consumers have failed to spend enough to bring output anywhere close to a potential GDP. Their governments had to put in place ultra-aggressive monetary policies, large fiscal deficits, or both, to remedy their invalid social contract.

The management of the demand shortage has always been an essential problem of democratic capitalism. To procure more demand governments resorted to broad interventionism which included various forms of social distribution, budget deficits, immigration, market expansion, induced inflation and currency devaluation. In the last 7 years, however, governments more and more often turn for rescue to sovereign debt market [Wolf 2014].

The argument presented here is that the root cause of the rapidly rising sovereign debt lies in the demand deficiency originating in the cumulative effect of lagging labor compensation relative to productivity gains. Since the 2008 financial crisis, the lag between wage increases and productivity accounted for at least 75 percent of the \$25 trillion new government debt in the OECD countries. The public and household debt in Japan reached 400 percent of GDP, in France 280 percent, in Spain 313, in Greece 317 percent of GDP, and in the USA 233 percent of GDP [McKinsey 2015]. The new debt cannot be only credited to fiscally irresponsible governments or misconceived public institutions as suggested by the institutional economics literature produced under the auspices of, among others, the World Bank and the IMF [Stefania, Ashoka 2006, von Hagen 1996, 2010]. Governments had to step up borrowing not only because of the long recession cycle but also to replace the missing demand of labor. Developed market democracies desperately need policies to mend the failing social contract between labor and capital. The solutions to the demand deficiency and the debt need to start with resolving the deepening relative underpayment of labor.

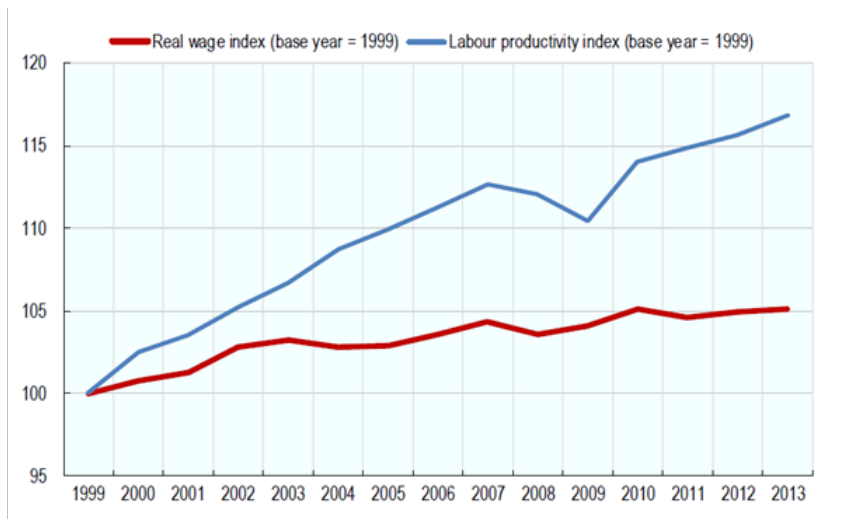
Capitalism's Achilles Heel

Democratic capitalism intended to resolve conflict between capital profits and wages through, labor contracts, minimum wage and collective bargaining. Every time when technology increased productivity, the labor would lose jobs and wages and capital would raise its profits. Macroeconomic stability required workable wage policies to support demand. That is why democratic capitalism promised some degree of distributional fairness at least between scourges of unpredictable recessions. This model does not hold anymore according to the

recent evidence from the G20. Between 1979 and 1990, in 34 leading market economies data published by the OECD productivity rose annually by an average of 1.4%, while compensation averaged increases by only 0.5%. The 1990s were better: Productivity gains accelerated to 2.1% yearly, and compensation to 1.5%. But because compensation grew at less than three-quarters the rate of productivity, the gap continued to widen. Since 2000, annual productivity gains have actually increased to 2.3%, compensation rose by only 0.9%, and the gap widened still more. In 2012 (the latest year for which data have been released), labor received only 58% of total output, the lowest by far in the entire postwar period [OECD 2012, Galston 2014]. In addition, recent studies by Oxfam and Thomas Picketty point out to the truly alarming capital and wealth concentration [Oxfam 2015, Picketty 2014]. The populist voter backlash in Greece, rising debts in Southern flank of Eurozone, Japan, France and Ireland should be convincing enough that unless developed democracies address the issue of wages and public sector spending they will enter the phase of remarkably slow rates of growth, debt defaults and social malady.

In all OECD G20 countries, workers have lost both income, as well as purchasing and political power to claim a larger share of the pie at the expense of capital. At the same time capital enjoyed higher returns as well as gains in political influence to protect itself against higher taxes. Since wages are stagnant in real terms, internal demand must increasingly rely on debt policies to restore lagging aggregate demand.

Picture 1. REAL WAGE AND PRODUCTIVITY INDEX IN THE G20



Source: OECD, G20 labor markets: outlook, key challenges and policy responses International Labor 2014, Report prepared for the G20 Labor and Employment Ministerial Meeting Melbourne, Australia, 10-11 September 2014.

For some 40 years the lagging demand initiated many rounds of anti-deflationary policies and currency devaluations as long as such option was available. The European demand management also included expansion of the welfare state, immigration and enlargement to post-communist Eastern Europe. In the 1980's and 1990's U.S both the neo-Keynesians and neoliberals tried to procure new demand by various incarnations of debt policies: deficit spending and public debt but also, financial deregulation and private debt [Foley 2014].

Before 2008 neoliberals strongly argued for financial deregulation and a constant interest rate calibration towards a “normal rate of unemployment”. The ensuing crisis exposed not only the risks of deregulation but also by the fallibility of the “zero lower bound” and “pushing on the string” approaches. First, it was impossible to pay people to borrow more as the cost of money approached zero and, second, since the interest rate impact is asymmetric, it could stop expansion but definitely it could not stop severe contraction. Instead of using labor income policies the central banks resorted to quantitative easing which Milton Friedman compared to tossing money from the helicopter because of its undefined target.

Rising OECD G20 debt is proof of the losing battle to find the right policy mix to face widening gap between wage and productivity, decreasing consumption demand and aging population. In the last two decades corporations besides investing in labor-saving robots also gained full freedom to offshore and use cheaper foreign labor leaving much of the domestic consumption at the mercy of demand-side interventionism. To sustain 70 percent of GDP the U.S. policymakers resorted to induced inflation, public debt, private debt, as well as an assortment of redistributive fixes. However, it should be noted, the success of this policy depended in the U.S. in 40 percent on foreign savings, otherwise the interests rates or higher taxes would have prohibited any growth. What was a good solution for the U.S. does not have to be an optimal solution for other G20 countries. The global debt market is different than a decade ago. Too many G20 governments decided to imitate the U.S. quantitative easing as well as selling their sovereign debt as a default solution. Japan is holding the debt level of a developing country. The European Central Bank (ECB) instead of developing a viable plan to deleverage Southern Europe insists on austerity measures deepening the debt crisis. The ECB has no plan or resources to face chain defaults which may jeopardize the Euro 18. The EU is left with few good policy ideas to restore growth and deleverage.

The End of the most effective EU Demand-side interventionism

Since the late 1980's the EU found missing demand in single market, single currency and enlargement. The admissions of Greece, Spain and Portugal were fundamental to the creation of unlimited access to lesser developed Europe's southern flank. The demand boost lasted as long as Spain, Greece, Italy, and Portugal were net receivers of the cohesion and structural funds from Brussels.

Germany, France, Great Britain were all the largest net payers to the EU budget as well as the net exporters and financiers in the region. Besides subsidies from Brussels, Greece and Spain could sell more debt to Northern Europe's sovereign funds and corporate investors. The Socialist governments in Greece and Spain used sovereign debt to pay for the public sector welfare state, expand administration, subsidize state sector and delay privatization of transportation and utilities.

In 2004 the EU, in the middle of recession, opened the door to Eastern Europe. The EU Single Market was expected to extend the famous German export-focused demand model. At home the German Social Democrats (SPD) promoted cost lowering and scaling down of the welfare-state. The SPD Agenda 2010 reforms made it easier to create low-wage jobs and reduced pension benefits. Its focus was on restraint in higher-paid jobs and weakening of the traditionally strong German union's collective bargaining. In addition, many German manufacturers relocated their production to lower labor cost Hungary, Poland and the Czech Republic. But squeezing wages as a growth strategy was short lived at best from the demand point of view. Lower wages put a pressure on consumption. The resulting gap was met by a combination of investment, social policies, government spending, and especially rise of net exports. Germany prospered because it undertook the tough reforms needed to ensure competitiveness. However, assuming that low productivity Greece, Spain, Italy and Portugal could manage internal demand by the combination of export, labor migration and austerity measures was overly optimistic. Deficit spending and by sovereign debt became a default solution for Spain, Italy and Greece.

The EU broke its "rule-based" debt policies by the Maastricht Treaty exceptionalism. In 1989 Bonn impatriated the former German Democratic Republic into the homeland but also into the EU membership. Overnight, East Germany, a 16.6 million people country, became EU member skipping all formalities of the EU admission process. Over the next 10 years German government spent \$2.6 trillion which came both from ECB low cost funding and public debt at home. Since Germany's public debt reached 70 percent of the GDP and exceed the Maastricht Treaty's 60 percent debt limit, the Greek and Spanish governments felt that they also could violate the debt to GDP rule. The EU Commission also looked the other way when Portugal, Ireland, Italy but also France 3 percent budget deficit convergence criteria. The Greek government has perfected the skill of dodging the Maastricht Treaty convergence rules by reaching 317 percent total household and public debt in 2014.

The admission to the EU of 9 Eastern European states to the EU in 2004 was very timely in pulling the Eurozone out of recession. The EU businesses gained zero tariff access to 93 million new buyers. Western European producers could hire millions of qualified non-union workers at 50 percent discount compared to home and spend a fraction of the transport cost from the Chinese plants. Germans and

the French sold their old cars to Eastern Europeans making space for new cleaner engine brands at home. Western construction business joined forces to build new transport infrastructure, apartments and utilities using generous EU net funding of \$400 billion in two budget cycles. Department store chains Tesco, Praktiker, and Carrefour took over large segments first time mass consumer markets. German, French, Italian, Spanish and Dutch banks sold dozens of millions of credit cards, loans and insurance policies, swiftly taking over between 68 percent in Poland and 91 percent in Croatia of banking sector (Dainkov, 2015). Enlargement to the East was one the world's most effective demand-side interventionisms. 2004 enlargement doubled the EU growth from 1.5 percent in 2003 to 3.2 percent in 2006. In the last 11 years Eastern European GDP per capita tripled and reached from \$13,000 to \$19,000. However, as in the case of previous enlargements, rising income phased out EU structural and cohesion funding ending demand-side impulse coming from the new markets. For now, admission of Ukraine and Turkey to the EU is unpredictable. The EU has few other options to boost demand other than more immigration and more debt.

Immigration as a Demand-side booster

One of the main causes of European slow growth is the weak demand of a shrinking and aging population. Europe has tried to resolve its demographic disadvantage through immigration. Unlike a massive American illegal immigration, the EU's immigration is well controlled, orderly and very costly to government budgets. In France, the Netherlands, Benelux, Switzerland and the Nordic states, immigrants are provided quite generous state-funded welfare, job and language training. First generation immigrants get easily accustomed to monthly welfare paychecks and have ever increasing expectations of the providing state. When the support programs end many of them are unprepared to undertake a normal life and are angry at being abandoned by the system. They come from North African Muslim countries seeking a better life, anticipating an escape from poverty, oppression, and hopelessness. In Europe, if they are lucky, they find low-skill jobs, raise children and grandchildren. They have the right to an education and health care but they grow up in the ghettos that ring Europe's major cities, surrounded by families like theirs, literally on the margins of society. Unable to integrate fully, they have few opportunities for real economic advancement. They are consumers, add to the labor force, become examples of the generous multiculturalism which in reality means ghettoization, re-islamization and radicalization within western secular society. Europe is trying to replenish its low end job market without building a socially inclusive society. The results can become tragic as evidenced recently in the Paris attack.

By comparison Japan, unlike the EU, as an island and practically self-isolated in Asia, had no option of creating a Single Market or a Monetary Union with

its neighbors. In the early 1990's government deficit spending steroids proved ineffective as an antidote for imported US deflation. Until then, the Japanese liberal democratic government authorized spending trillions of yens to keep their workers on the job when the US technology imports did not materialize. The Bank of Japan, fully controlled by the Ministry of Finance and the Ministry of Economy, Trade and Industry, allowed the Keiretsu banks to ignore nonperforming loans, pay wages to underemployed workers on lifetime employment contracts, and maintain cartel pricing. The liberal government failed to see the need for competition therapy. Japanese cultural isolation, which preserved their national identity, also prevented them from adapting to rising low cost technology manufacturing at their doorstep in South Korea, China, Singapore, and Malaysia. Asia enjoyed a massive demographic advantage plus access to global capital and technology including Japan's. Instead of reforming the labor markets and forcing more competition, Japan let the government and household debt reach 519 percent of the GDP, protected labor markets from unemployment at the cost of deflation, allowed real estate prices to collapse, subsidized inefficient Keiretsu using government-controlled pension funds and dug the economy into a liquidity trap for two and a half decades. Japan became a case study of wrong policies at time of flagging aggregate demand. It is a warning scenario for all reform-averse democracies. Interventionism is as valuable as the ideas which drive them. After a 25 year stalemate the Japanese government started the debt reduction, immigration reform, competition policy reform and defense spending to stop the decline.

The successes and failures of the demand management models happened in liberal democracies, which, in principle, have representative mechanisms to address fundamental long-term challenges. Ideally, the voters, assuming their collective interest, should be able to resolve the causes of the missing demand. Specifically, they should be able to defend employment and wages not necessarily through labor protectionism but through easing the worker adaptation to the changing market environment. It did not happen.

The Post-Keynesian U.S. Demand-side Policies

Until the 1970's, growth in the U.S. was fostered by post-war reconstruction, rising education levels, higher workforce participation rates, restored global trade, increasing investment, and the diffusion of new technologies. In the late 1970s the government understood that it was unable to deliver on their promises of the Great Society such as union pension hikes and old-age health-care for public-sector workers. To meet their obligations, governments needed growth and debt. Owing to the 1970s oil price shocks and inflation, the Reagan era was marked by tax cuts and interest rate hikes which appreciated the dollar, opening the gate to cheap imports and a pressure to raise nominal wages. Public debt turned out to be a convenient substitute for inflation. It enabled the government satisfy demands for social distribution. In the absence of domestic savings the Treasury had to resort

to a massive bond selloff to foreign investors, sovereign wealth funds. During the second Clinton administration (1996–2000) the debt relief came from the dotcom revolution. The Republican Congress introduced austerity measures to cut public spending which rose income inequality. This prompted the Clinton administration to deregulate the financial sector [Steeck 2011].

The 2000's were marked by a policy switch to “privatized Keynesianism” which, in effect, meant replacement of public with private debt (Colin Crouch, 2009). This time rather than the government borrowing money to fund social programs such as cheap housing and education, it was now individual citizens who, under a relaxed borrowing regime were allowed to take out loans at their own risk. The budget had a basic surplus; the top earners were spared higher taxes. The relaxed regulatory regime allowed financial services to promote itself to U.S.'s prime industry with many times higher profits than manufacturing. The burdens and the risks of demand adjustment were shifted from the government to borrowers. The problem was, however, that many of the borrowers lost jobs as some 16,000 enterprises closed nationwide in early 2000's due to “offshoring” and “outsourcing”.

Privatized Keynesianism marked a big demand policy turnaround. Financial liberalization replaced social policy, private debt replaced public debt, real estate appreciation replaced wage increases, and the financial sector replaced domestic manufacturing. The bailout of the financial sector and households which followed subprime mortgage crisis, in fact, was billed back to the U.S. government and world savings. While selling one trillion dollars debt to the Chinese and oil exporters represented a moderate risk for the U.S. or the dollar, adding 25 trillion to the world debt in the last 7 years makes a significant difference. The real issue is whether the world debt markets have already approached its maximum capacity and acceptable risk.

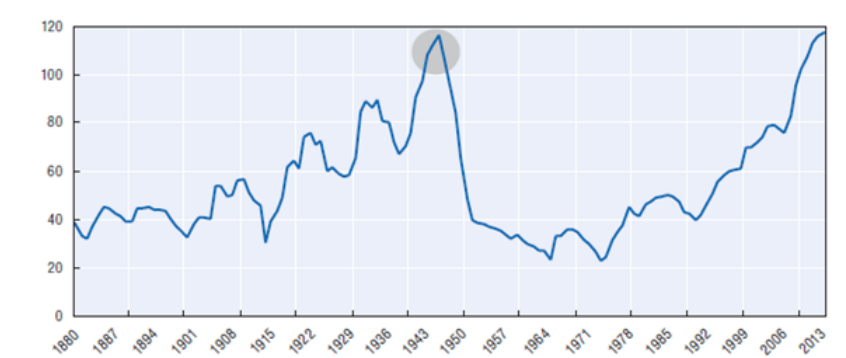
The Peace Time War Debt

In 2014 the average world debt reached 286 percent of the global GDP (McKinsey). For selected economies: Australia, Canada, France, Germany, Italy, Japan, Korea, Spain, United Kingdom and the United States, the GDP ppp-weighted average government debt ratio reached around 116 percent of GDP in 2013, the same level as in the 1940's. (Table 2). The G7 central government marketable debt-to-GDP ratio reached 90 percent in 2013, for the Euro area the ratio in 2014 has been 67.4 percent [OECD 2014]. The acceptable external debt limits are not known. According to an IMF study over the last 60 years there were 633 cases of sovereign debt restructuring in 95 countries [Udaipur, Papaioannou, Trebesch 2012]. The total of 447 the restructurings were in the framework of the Paris Club, while only 186 cases were with private creditors. Restructurings are not uncommon, however, because of the size of the debt, extreme reductions in interest rates, weak bank capital controls, currency devaluations the probability of orderly restructuring is increasingly doubtful [Feibelman 2015].

The standard remedies for public-sector deleveraging proposed some 40 years ago such as interest rates hikes and capital controls do not apply today [Belke, Koesters, Leschke, Polleit 2004]. Since 97% of debt is issued in the five largest “global” currencies—the U.S. dollar, the euro, the British pound, the yen, and the Swiss franc, currency volatility raises the risk of currency mismatch [Galina B. Hale, Jones, Spiegel 2014]. It occurs when borrowers suffer balance sheet deterioration if the exchange rate of their home currency falls in relation to the issuing currency. Since 2014 the yen has fallen by 11 percent against the dollar and 17 percent against the euro. The euro has fallen by 20 percent against the dollar. Foreign exchange markets are a zero sum game and a country with a rising currency will be tempted to seek depreciation of its own, for fear of importing deflation that others try to reduce. That’s why competitive devaluations in the low interest environment are very likely.

The simplest solution to begin debt deleveraging would be to start with the reduction of the fiscal deficits and the public debt. Here, unfortunately there is no clear cut agreement among economists. Professor Paul Krugman offers a typical neoliberal position. He thinks that the debts represent the money borrowed from current adult taxpayers and that they may be let grow indefinitely with the growing GDP [Krugman 2012]. While it is statistically true, it does not explain the real cost of the debt to the borrower. The debt service money happens to be outside the home country economic multiplier and the risk thresholds raise the cost of present and future debts for the country. Media economics is good politics but bad explanation for indebted economics.

Picture 2. Gross public debt of selected countries 1880-2013*



OECD Sovereign Borrowing Outlook 2014, March 28, 2014

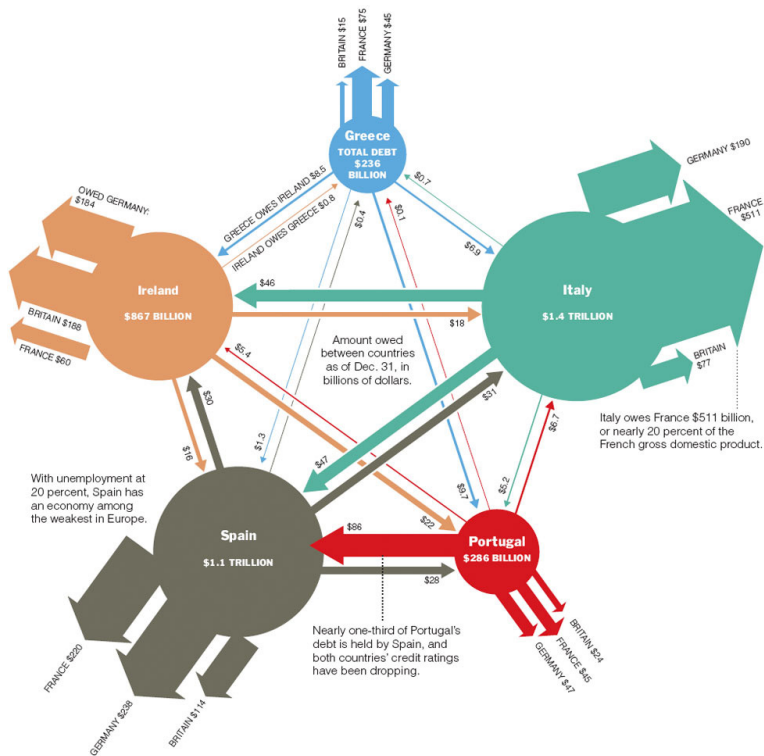
Notes: Historical debt levels, GDP-weighted average.

*Includes Australia, Canada, France, Germany, Italy, Japan, Korea, Spain, United Kingdom and United States.

Source: IMF Historical Public Debt Database; OECD Economic Outlook 94 Database; and OECD staff calculations. <http://dx.doi.org/10.1787/888932993617>

The macroeconomic arguments for fiscal consolidation in Europe and Japan are compelling. In 2014 the debt in elite OECD countries has reached the war time debt level. With populations growing older the challenge of making good on open-ended promises of health and pension support the OECD countries continue to run up debt to very risky levels. As they do so, sovereign bond holdings are sold to domestic investors. The resulting rise in borrowing costs for banks is passed on to corporate and household borrowers. Meanwhile, the sovereign's backing for the banking system loses its credibility in the marketplace. The OECD governments face rapid increase in sovereign risk, as well as euro area-induced contagion effects. Growing concerns among investors have resulted already in the offloading of significant holdings of European debt. The mismanagement of the Greek bailout will without doubt cause chain sovereign defaults [Belke 2013] (Picture 3).

Table 3. The Possibility of the Contagion effect in case of the Greek default



Source: BIS, 2012.

There are several significant consequences of internationalization of debt policies:

First, in the aftermath of the financial crisis the output has been below the growth trajectory predicted several years ago. As a result, government revenues are lower and expenditures higher. High debt levels increase the need to refinance regularly. Ten countries have fiscal and household debt ratios of more than 300 percent of GDP [McKinsey 2015]. If the average maturity of debt is five years, then 60% of GDP must be refinanced every year. If creditors lose confidence in debtors' ability or willingness to repay, a crisis can occur very quickly [Belke, Verheyen 2014]. Fiscal problems confronting industrial economies are larger than suggested by official debt figures. The possibility of a new global financial crisis rises from the fact that governments are lulled into complacency by the ease with which they have financed their deficits in the low interest environment created by quantitative easing.

Second, voter reaction has strong financial consequences. The recent Greek and soon the upcoming Spanish vote have already led to a sharp rise in risk premium on long-term bonds issued by several industrial countries. These votes suggest that markets no longer consider sovereign debt low-risk. The risk premium moves up with debt levels and down with the revenue share of GDP as well as the availability of private savings. Countries with a relatively weak fiscal system and a high degree of dependence on foreign investors to finance their deficits will face larger spreads on their debts. The good scenario is that high levels of public debt will drive down capital accumulation, productivity growth and long-term potential growth. The bad scenario is that governments which hold large sovereign debt with weak fiscal systems will plunge into a chain of defaults in the next 3-5 years.

A New Social Contract as a Debt Crisis Solution

Since the debt cycle is unstoppable and deleveraging not in sight, the probability a G20 sovereign debt crisis is very likely. The real solution of the debt is to address demand deficiency, increase labor participation and wages, or basically, introduce a new social contract between labor and capital. The position of the New Left is that the social contract completely broke up years ago and with it the hope to reform the political system. Western capitalism, they claim, favors owners of capital and exploits workers [Steck 2011]. The mainstream studies by the Economic Policy Institute blame governments for not siding with the labor in collective bargaining [Bivens, Gould, Mishel, Shierholz 2014]. The theoretical models of social contract argue that the ongoing global diffusion of technology "exports inequality" across borders and makes it difficult for nations to maintain distinct institutions and social structures [Benabou 2012].

This brings us to a fundamental question whether there is, a theoretical or a practical, alternative scheme of social distribution which could deliver both growth to the economy and social justice to the workers. Has, for example, Chinese

state capitalism created such a system as some economists claim? [Moyo 2011]. After all, pragmatic communist autocrats in China have succeeded in moving 300 million peasants out of poverty and until last year achieving stellar growth rates of the economy. Social science with all its limitations may, if it does its work well, provide some facts and plausible interpretations. The conclusion of Chinese middle income trap studies is clear: cheap labor reserves are exhausted, demand of western consumers is slacking and so does the capital inflow. The economy is heading towards 7 percent rates and debt-to-GDP ratio is already reaching 300 percent mark. [McKinsey 2015].

Adam Smith some 240 years ago as well as contemporary experimental behavioral economists argues that animal spirit and greed are the most reliable foundations of human behavior. A rising number of billionaires among Central Committee of Chinese Communist Party members suggest a deep gap between an ideological narrative and reality (Pei, 2006). Since China is lacking mechanisms to mitigate the social costs of growth as well as independent labor representation it can hardly meet the requirements of an optimal participatory model of social distribution. According to Fukuyama, China does not operate under the constitutional “Rule of Law” but “Law of the Rules” arbitrarily imposed by autocrats whose ultimate objective is to stay in power. Such system does not guarantee either fair social contract or even the social order in the long run (Fukuyama, 2011). Thus a question if there is a better alternative to democratic capitalism remains open.

The bottom line is that democratic capitalism produces both competent and very incompetent governments which all promise better social contracts, repayment of debts and elimination of austerity measures. The hard fact is that populism is not a good solution to negotiate a fair payment for labor in the XXIst century. Here are some of the parameters of the contemporary labor – capital relations:

First, a truly fair social contract is hardly possible in a framework of the nation-state and even less so in a global economy. Once the world became open to free capital movement such contracts become invalid. There is always somebody somewhere who is going to work for less than at home. For all practical reasons labor is local and capital is global. Capital is far more mobile than labor and that's why marginal productivity of capital will always be higher than that of labor.

Second, the payment of the full value of labor in a classic sense is not possible. It would mean that all profits and productivity gains would be going to the worker. The whole logic of this argument does not hold in an economy that uses robotics in services and manufacturing. Since capital enables technological progress but does not create it, all profit should go not to investors but to inventors, software programmers and sophisticated machine operators. This argument does not withstand the test of economic logic or fairness. Investors and capital owners would not get the return for the risk at all.

Third, if we assume that profit is the compensation for risk rather than human labor, all those who live by selling daily their labor would be left out of the demand equation and thus cause gaps in aggregate demand, slow growth or a new budget debt or both. The nature of the modern economy is such that it gives premium to quickly implementable ideas. It's a long time since perspiration gave way to inspiration, and the instant wealth which it leads to is commonplace and socially acceptable. Since societies are made of large number of labor sellers this conflict must be resolved or the developed market economies will continue to fight overproduction and deflation with rising external debt until the collapse of the sovereign debt market.

Fourth, all debt-based policies developed after WWII have postponed but not eliminated conflict between return to labor and capital, social distribution and profit maximization. At the current stage the conflict has left national boundaries and become a global tug of war: rich nations consuming the savings of the poorer Chinese, overspending nations try to renegotiate their sovereign debt to other rich nations. This is not the failure of global financial equilibrium credit to monopoly capitalism as the New Left theorists purport but a dynamic factor price equalization predicted by the Heckscher-Ohlin model [Leamer 1995, Roubini 2011, Mitran, Ipate, Dragos 2014].

Fifth, the proliferation of quantitative easing also necessary to jump-start growth is destabilizing the sovereign debt market because they are applied at the same time by many countries. Broad use of quantitative easing will eventually debase leading world currencies and raise sovereign default rates. The flood of low cost money creates an effect similar to competitive devaluations. In the past competitive devaluations shut down international trade; competitive monetary easing may shut down the sovereign debt market with unpredictable consequences for world economy.

In conclusion, financial consolidation in democratic capitalism besides available technical solutions to lower the risk of borrowing and orderly deleveraging must include activist governments promoting better compensation for productive and efficient labor and taxes on capital.

What can policy makers do? The solutions are country specific. For the U.S., for example, it could be a serious long-term infrastructure program to raise productivity and economic efficiency of labor. It could involve better access to education, reduction of high-school dropout rate, high-quality technical training, expanding basic research to create new products and industries. Generally, the G20 average households must be allowed to have a share in the benefits of growth through various contractual algorithms linking wages and productivity. The new economic policies must bring about not only new minimum wage standards but also formulas of profit sharing between better educated labor and capital. Treating labor as an easily disposable factor of production does not commensurate with need to maintain a macroeconomic stability which, in turn, defines capital profits.

Whatever philosophical, economic or moral arguments the developed Western societies are going to endorse they need to understand that capital is an enabler, not the inheritable right to economic and political power. Taxes on capital profits are not penalties and should commensurate for the opportunities that the society creates for the entrepreneurs such as rule of law, education, safety, venture capital. It is discouraging that such common truths have to be restated in developed societies which lose their common sense and lessons of history. Excessive wealth concentration is socially disruptive and without exception leads to socio-political conflict. On the other hand taxation of wealth should be predictable, especially high inheritance tax. Such principle is consistent with the finality of human life and expectation of what we are going to contribute to the quality of life of future generations rather than only passing the opportunity to narrow, self-perpetuating oligarchy. There has been lot of confusion created in the last decades in the minds of business people, politicians and educators. The neoliberal narrative about the disincentive of taxes on capital to produce entrepreneurship, growth, competition is worth as much the communist propaganda about its ability to create an egalitarian society. Capitalist entrepreneurs must be energized and motivated by profits and wealth but at one point they also need to understand that they actually do owe something to other members of the society. Democracies which only breed and boast of rising number of myopic rich have a tendency to stagnate but they do not have to. The doomsday theorists on the Right as well as the New Left cannot offer a better solution besides talking about capitalism's self-destruction. Markets do work. Democracy, like capital, is an enabler, not a guarantor of the perfect vote investment every time. The birth of sharing economy, artificial money such as bitcoins, crowdfunding, crowdsourcing, is a symbol of the wage earners actually trying to get out of the confinement of the dependence on labor – capital relation. It is obvious that the political institutions of democratic capitalism need grassroots reforms.

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