Sustainability thoughts 108: Can we approach socially friendly capitalism through social externality management? If yes, how can this be done?

By

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Abstract

The fall of red socialism in 1991 due to its failure to transition towards an economy friendly red socialism and its flip back to pure capitalism after the fall perhaps can give us a good opportunity to think about a different way to achieve Karl Marx's dream, a world without social sustainability gaps. If businesses see that they are at a point where they can make more money if they produce socially friendly products, they will stay in the local market. In addition, if their products are competitive internationally, they can make extra money. The way to create such a world may be through social externality management in an capitalist environment accustomed to ongoing government intervention first as tolerance of ongoing intervention is needed to create the market climate in which the private sector can accept the transfer of critical areas or priority areas of social responsibility. The discussion above raises the questions; can we approach socially friendly capitalism through social externality management? If yes, how can this be done? Among the goals of this paper is to provide an answer to those questions.

Key words

Red socialism market, red market, traditional market, externality management, social externality management, economic externality management, paradigm shift, sustainability, social sustainability gap, economic sustainability gap, market illusion.

Introduction

It can be said that the dream of Karl Marx was development model superior to pure capitalism, a model without social sustainability gaps, and perhaps red socialism was the first step in the long haul transition from pure capitalism to socially friendly capitalism(Muñoz 2019a). His deep understanding of how capitalism operates suggest that red socialism in his mind was a transitional stage towards socially friendly capitalism model as he could have seen that in the long haul the red socialism stage is not sustainable as you cannot live piling up economic deficits forever. To understand the missed opportunities and the new opportunities to fulfill Karl Marx dream, below there is a general and simple overview of red socialism, its fall, the flip back to capitalism, and the new challenge facing the newest capitalist countries as well as of the new options available to move forward towards Karl Marx's dream.

a) The world of red socialism

As the world of red socialism(KM) puts society first, and therefore, it reflects only social cost of production; and related economic externalities[E(B)] associated with social production do not matter, its model can be summarized as in Figure 1 below:

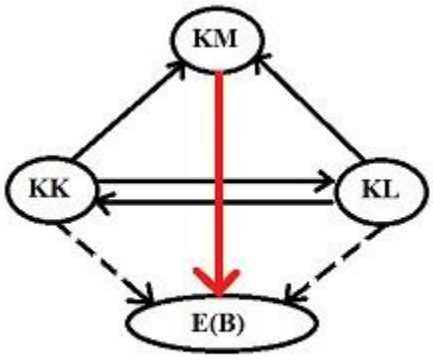

Figure 1 The structure of the red socialism market(KM)

Figure 1 above describes the heart of the red socialism market(KM): i) red socialism producers(KK) and red socialism consumers(KL) are bound together in the red socialism market(KM) producing and consuming at social cost(KMP = SM), which is indicated by the continuous black arrows from KK to KL and from KK and KL to KM; and ii) while social production take place economic externalities are not relevant and therefore they are externalized as indicated by the red arrow going from KM to E(B).

Figure 1 also summarizes the red socialism market illusion that social development(A) can take place without generating production and consumption economic externalities[E(B) = 0] as indicated by the broken black arrows from KK and KL to E(B).

b) The economic externality problem affecting red socialism

The economic externality problem affecting red socialism(KM) appears when face the reality that economic externalities do matter; and when you face that reality, then you see that there is a disconnection between the pricing mechanism of the red socialism model(KM) and the economic externalities[E(B)] as indicated in Figure 2 below:

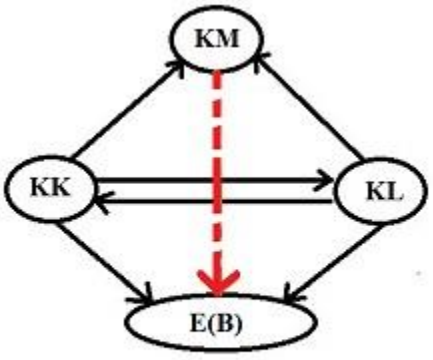

Figure 2 The externality problem affecint the red socialism market model(KM)

Figure 2 about tells us that there is a disconnect between red socialism(KM) and economic externalities[E(B)] as indicated by the broken red arrow from KM to E(B).

3) The economic sustainability gap embedded in the circular red socialism market

The disconnect between the red socialism market(KM) and economic externalities[E(B)] leads to a broken circular red socialism market structure, as shown in Figure 3 below:

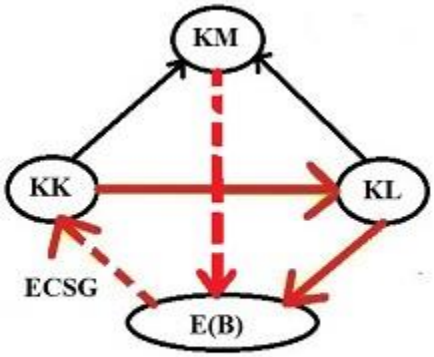

Figure 3 The economic sustainability gap (ECSG) embedded in the ciruclar red socialism market(KM).

Figure 3 above shows that there is an economic sustainability gap(ECSG) between KK and E(B) that breaks the circular red socialism market structure(KM) affecting the sustainability of red socialism(KM).

4) The missed opportunity to move towards economy friendly red socialism through economic externality management

If red socialism(KM) was a transition state towards the world of Karl Marx without social sustainability gaps or economy friendly red socialism, then once social production was stable, steps should have been taken to transition fast towards socially friendly capitalism if the government have the resources or to transition slowly if the government did not have the resources to go fast. It has been pointed out that the making of red socialism economy friendly leads to a higher responsibility model(Muñoz 2017). According to Figure 3 above there were two ways to transition and proceed to close the economic sustainability gap: a) the fast way was a shift from red socialism(KM) to red markets(RM) or socially friendly capitalism induced by internalizing the economic cost of production in the pricing mechanism of the red market(KM); and b) the slow way was to use economic externality management to put in place the basic capitalism blocks to orderly transfer economic responsibility to economy friendly red socialist producers and consumers later on. The structure of these two tools is shared below in Figure 4:

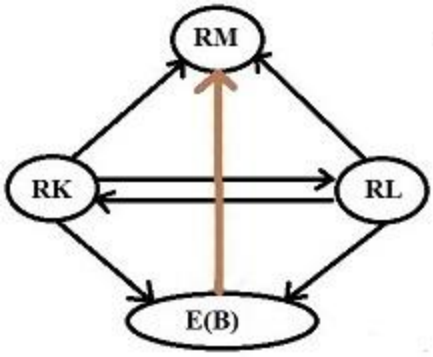

Figure 4A Internalizing the economic externality [E(B)] shifts the red socialism market (KM) to the red market or economy friendly red socialism(RM).

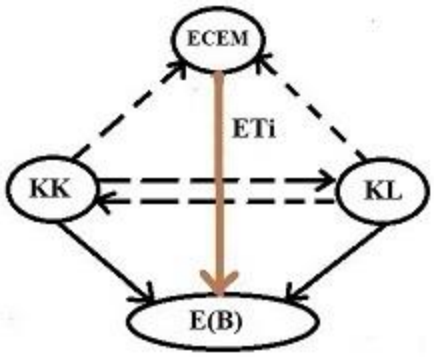

Figure 4B Managing relevant economic externalities[E(B)] through economic management tools like ETi brings us to the world of economic externality management market(ECEM).

Figure 4A above simply says that if we internalize the economic externality[E(B)] in the pricing mechanism of the red socialism market(KM) we shifts it to red markets(RM) and red market prices(RMP) as indicated by the continuous brown arrow going from E(B) to RM. You can also see in Figure 4A that red markets(RM) are driven by the interaction of red producers(RK) and red consumers(RL). How socially friendly markets would be expected to behave under perfect red market competition was not long ago detailed(Muñoz 2019b)

Figure 4A above indicates that if red socialism markets(RM) would have gone the way of economic externality management markets(ECEM) they need to set an economic tax schedule ETi to be used first to put together the first capitalism bricks so later the process of transferring economic responsibility slowly to the new private sector can be started, pushing down an economic trickledown effect, and approach that way socially friendly capitalism.

The author believes that no transitioning orderly towards economy friendly red socialist either by shift to red markets or by economic externality management when the social production model was stable in red socialism countries was a missed opportunity to complete Karl Marx's goals and avoid the fall of red socialism. Socially friendly capitalism in red socialism countries would have come out from inside out in the form of economy friendly red socialism if the transition had taken place.

5) The flip back to pure capitalism

Since at no point after social production was stable steps were taken to either shift to red markets or go the economic externality management way to economy friendly red socialism, when the red socialism model fell in 1991 they simply flipped back to pure capitalism. The structure of socially friendly markets or red markets that would have resulted from a paradigm shift from red socialism to red markets if they had internalized economic externalities, a shift the never took place, has been recently pointed out(Muñoz 2019c). In other words, capitalism came from outside in. As the world of capitalist market(TM) in new capitalist countries puts economy first, and therefore, it reflects only economic cost of production; and related social externalities[E(A)] associated with economic production do not matter, its model can be stated as in Figure 5 below:

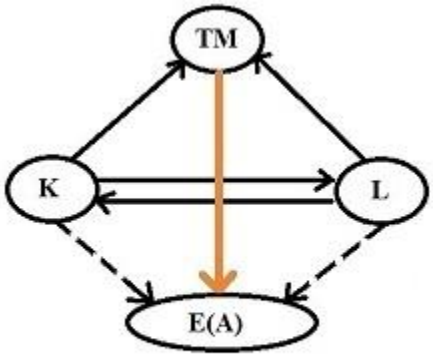

Figure 5 The flip back to pure capitalism or economy only traditional market

Figure 5 above highlights the heart of the capitalism market(TM) in new capitalist countries: i) traditional producers(K) and traditional consumers(L) are bound together in the new traditional market(TM) producing and consuming at economic costs cost(TMP = P), which is indicated by the continuous black arrows from K to L and from K and L to TM; and ii) while economic production takes place social externalities are not relevant; and therefore, they are externalized as indicated by the brown arrow going from TM to E(A).

Figure 5 also summarizes the traditional market illusion under which new capitalist countries are operating that economic development(B) can take place without generating production and consumption social externalities[E(A) = 0] as indicated by the broken black arrows from K and L to E(A).

6) The social externality problem now affecting the market of new capitalist countries

The social externality problem affecting the new traditional market(TM) in new capitalist countries appears when face the reality that social externalities do matter; and when you face that reality, then you see that there is a disconnection between the pricing mechanism of the new capitalist market(TM) and the social externalities[E(A)] as indicated in Figure 6 below:

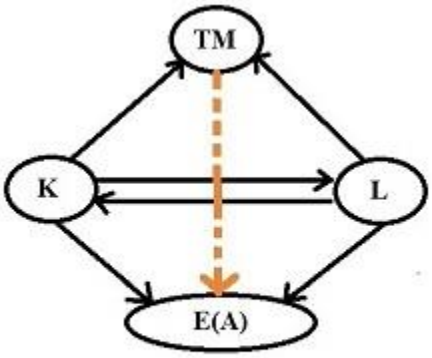

Figure 6 The externality problem affecting the traditional market model(TM) in new capitalist countries.

Figure 6 about tells us that there is a disconnect between the new traditional market(TM) in new capitalist countries and social externalities[E(A)] as indicated by the broken brown arrow from TM to E(A).

7) The social sustainability gap now embedded in the circular economy of new capitalist countries

The disconnect between the new traditional market(TM) and social externalities[E(A)] leads to a broken circular traditional market structure in new capitalist countries, as shown in Figure 7 below:

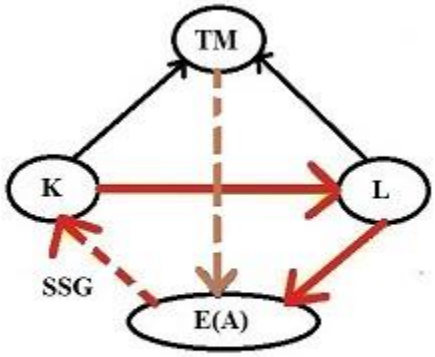

Figure 7 The social sustainability gap(SSG) embedded in the circular traditional market(TM) in new capitalist countries.

Figure 7 above shows that there is a social sustainability gap(SSG) between K and E(A) that breaks the circular traditional market structure(TM) in new capitalist countries affecting the sustainability of the economies(TM) in these countries.

8) The need to address the social sustainability gap in new capitalist countries

Leaving the social sustainability gap(SSG) untouched is a risky option for new capitalist countries in terms of system sustainability as if untouched as the new capitalist market works it will accumulate social sustainability deficits; and just as the accumulation of economic deficits brought down red socialism, the accumulation of social deficits should be expected in the long term to bring down new capitalism markets as they would put upward pressures on income inequality. It has been pointed out that the unsustainability created by the economic sustainability gap embedded in the red socialism model led to the fall of Karl Marx's world in 1991(Muñoz 2016a; Muñoz 2016b); and it is known that from 2015 to 2018 the gini coefficient in China grew from 0.462 to 0.468(CEIC 2019), which may indicate increasing pressures on social sustainability gap in China and therefore, increasing relevance with respect to the social sustainability issue in China. Figure 7 above indicates there are two ways of closing the social sustainability gap and move towards socially friendly capitalism, a fast way and a slow way. As new capitalist countries are still adjusting to the 1991 paradigm flip from red socialism to pure

capitalism, then the fast way, the shift towards red markets induced by internalizing social externalities in the pricing mechanism of the new capitalist market is not sustainable in the short term. But the use of social externality management markets can be a slow, sustainable long term solution to transition from pure capitalism to socially friendly capitalism and to the ultimate goal of Karl Marx by creating an environment where the basic bricks for social stability can be placed and strengthen first and later transfer some social responsibility to the new private sector by making it possible for them to make more money by providing socially friendly goods and services in exchange of lower or no social tax. If businesses see that they are at a point where they can make more money if they produce socially friendly products, they will stay in the market. If this were to take place, we would be in a world where socially friendly capitalism competes with pure capitalism. The discussion above raises the questions; can we approach socially friendly capitalism through social externality management? If yes, how can this be done? Among the goals of this paper is to provide an answer to those questions.

Goals

i) To highlight the structure of the social externality management market that results from governments choose that development route; ii) To link social externality management with the embedded social sustainability gap that needs to be addressed to approach socially friendly capitalism that way; and iii) To stress a plan that can be followed to close the social sustainability gap to a point where social responsibility can be orderly transferred incrementally to the new private sector.

Methodology

a) The terminology used in this paper is shared; b) The operational concepts and externalization rules are introduced; c) The social externality management framework is highlighted; d) The circular social externality management frame work linked to the social sustainability gap is stressed; e) The implementation of the social externality management framework is described step by step both analytically and graphically; and f) Some food for thoughts and relevant conclusions listed.

Terminology

A = active social system	a = passive social system
B = active economic system	b = passive economic system
C = active environmental system	c = passive environmental system
TM = traditional market	RM = red market

T = traditional producers/supply T = traditional consumers/demand

RK = red producers/supply RL = red consumers/demand

KM = red socialism market KK = red socialism producers/supply

KL = red socialism consumers/demand E(T) = externalization of T

I(t) = internalization of t E(A) = externalization of A

E(AC) = externalization of A and C I(ac) = internalization of a and c

ECEM = economic externality management E(B) = externalization of B

SEM = social externality management STi = social tax "i"

SEMIi = social externality impact "i" ST* = social tax at transition

SEMI* = social externality impact at transition I(a) = internalization of a

RSSG = remaining social sustainability gap I(b) = internalization of b

SSG = social sustainability gap ECSG = economic sustainability gap

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Operational concepts and externalization and internalization rules

i) Operational concepts

1) Red socialism market, *the society only market.*

2) Red socialism market price, *the price that reflects only the social cost of production.*

3) The traditional market, *the economy only market.*

4) The traditional market price, the *general market economic only price or the price that covers the cost of production at profit(TMP = ECM + i = P) or zero profit(TMP = ECM = P).*

5) The red market, *the society and economy only market.*

6) The red market price, *the price that reflects the social and economic costs of production.*

7) The economic margin, *to cover the economic cost of production.*

8) The social margin, *to cover the extra cost of making business socially friendly.*

9) Full costing, *all costs are reflected in the pricing mechanism of the market.*

10) Partial costing, *not all costs are reflected in the pricing mechanism of the market.*

11) No costing, *all costs are not reflected in the pricing mechanism of the market.*

12) Full responsibility, *when a market uses full costing.*

13) Partial responsibility, *when a market uses partial costing.*

14) Full irresponsibility, *when a market uses no costing.*

15) Circular market illusion, *the idea that production activity can take place without producing relevant externalities.*

16) Circular traditional economy illusion, *the idea that production activity can take place without producing relevant social and/or environmental externalities.*

17) Circular red socialism market illusion, *the idea that social production activity can take place without producing relevant economic externalities.*

18) Circular dwarf red economy, *the idea that market prices can be manipulated externally to generate revenue to cover the cost of dealing with the externality they create to close the non-free market cycle production-consumption-social externality if coming the capitalism route or to close the non-free market cycle production-consumption-economic externality if coming the red socialism route.*

19) Circular red economy, *the idea that market prices reflect the cost of making business socially friendly in order to cover the cost of dealing with the social externalities they create to close the free market cycle production-consumption-social externality.*

20) Circular social externality management based market illusion, *the idea that you can solve a social sustainability problem by dealing ongoing with the consequences of that problem, not the cause.*

21) Circular social externality management based market principle, *the idea that you can transition from a social sustainability problem to a higher level market by managing the social externality until the point of social responsibility transfers to the private sector.*

22) Circular economic externality management based market principle, *the idea that you can transition from an economic sustainability problem to a higher level market by managing the economic externality until the point of economic responsibility transfers to the private sector.*

ii) Externalization rules

Let's assume we have a market with two relevant components, society(A) and environment(C), where A = active component, a = passive component, B = active component, and b = passive component, then the externalization rules(E) work as follows:

1) E(A) = a ---→ *relevant social costs(A) are assumed irrelevant*

2) E(B) = b ---→ *relevant economic costs(B) are assumed irrelevant*

3) E(AB) = ab ---→ *relevant social costs and economic costs(AB) are assumed irrelevant*

iii) Internalization rules

Let's assume we have a market with two relevant components, society(A) and environment(C), where A = active component, a = passive component, B = active component, and b = passive component, then the internalization rules(I) work as follows:

4) I(a) = A ----→ *irrelevant social costs(a) are now relevant*

5) I(b) = B ----→ *irrelevant economic costs(b) are now relevant*

6) I(ab) = AB ----→ *irrelevant social costs and economic costs(ab) are now relevant*

iv) Model structure and externalization rules

Let's assume we have the following three market structures M1 = ab, M2 = Ab and M3 = AB, then the following holds true:

7) M1 = ab = E(AB) = *a fully irresponsible market as all costs are externalized*

8) M2 = Ab = [I(a)][E(B)] = *a partially responsible market as social cost is internalized*

9) M3 = AB = [I(a)][I(b)] = *a fully responsible market as all costs are internalized.*

v) Reversing externalization rules

Let's assume we have a market with two relevant components, society(A) and environment(C), where A = active component, a = passive component, C = active component, and c = passive component, then the process of reversing externalization-internalization rules works as follows:

The case of internalizing the externality: if E(AC) = ac, the following holds true:

10) I[E(AC)] = I(ac) = AC, internalization-externalization forces cancel each other out

The case of externalizing the internality: if I(ac) = AC, the following holds true:

11) E[I(ac)] = E(AC) = ac, externalization-internalization forces cancel each other out

The social externality management framework

If the route towards socially friendly capitalism is chosen to be social externality management markets(SEM), then the structure of the social externality management framework can be indicated as done in Figure 8 below:

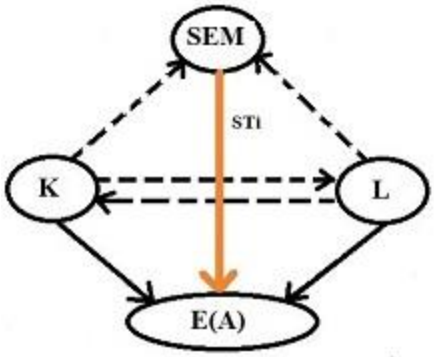

Figure 8 The structure of the social externality managment market(SEM) in new capitalist countries.

Figure 8 above indicates that relevant social externalities[E(A)] are being externalized as indicated by the continuous black arrows from K and L to E(A); and they are being managed at the social tax STi as indicated by the continuous brown arrow going from SEM to E(A). The broken arrows indicate that the social externality management market(SEM) is under ongoing government intervention.

The circular social externality management frame work

The social externality management market(SEM) can be linked with social sustainability impacts aimed at closing the social sustainability gap by means of the social externality management impact(SEMI) that the social tax STi has on the market as indicated in Figure 9 below:

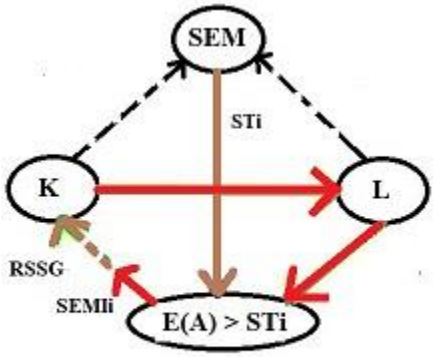

Figure 9 The circular social externality managment based market(SEM)

We can use Figure 9 above to point out the following: i) that the social externality management intervention(SEM) through the social tax STi has an impact SEMIi closing some of the social sustainability gap(SSG) as indicated by the small continuous red arrow between E(A) > STi and K; ii) that there is still a remaining portion of the social sustainability gap(RSSG) since the size of the externality E(A) > STi, which means that SSG – SEMIi = RSSG as indicated by the small broken green arrow between E(A) > STi and K; iii) that producers(K) take the

government set social tax STi and passes it to consumers(L); and iv) the government uses the social tax STi collected to address social stabilization programs/poverty.

The implementation of the social externality management framework

Based on an extension of the implications in Figure 9 above a step by step plan can be developed to use government intervention through social externality management markets(SEM) to set up a strong social foundation needed to later transfer some social responsibility to the new private sector through social tax reduction incentives and economic support. Those specific steps are summarized in Figure 10 below:

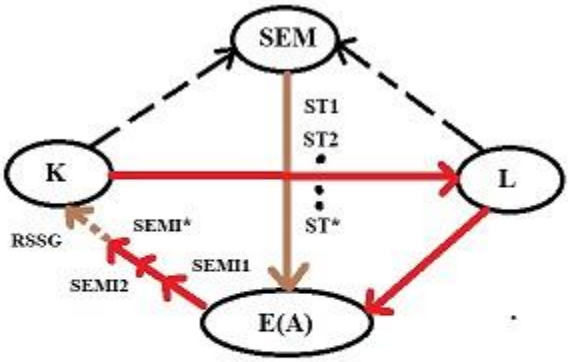

Figure 10 Implementing a social tax schedule STi = ST1, ST2...ST* before transfering some social responsibility to the private sector creating that way the environment under which a social trickle down effect can be pushed out of the private sector by making it profitable to provide socially friendly goods and services.

Figure 10 above highlights the following: i) that there is a social tax schedule set from the first one ST1(the lowest) to the last one ST*(the highest the market can bear) as indicated by the continuous brown arrow from SEM to E(A); and ii) that the social tax schedule is linked to the social externality management impact that it has on the market from SEMI1(the lowest) to SEMI*(the highest) as it closes portions of the social sustainability gap(SSG) leaving only the remaining social sustainability gap(RSSG).

In other words, Figure 10 summarizes the how a transition to socially friendly capitalism can be framed and executed, gradually, as detailed below:

a) Step 1 Short-term: stabilizing the social infrastructure and wellbeing

The first step should be to set a low social tax on economic production of ST1 to invest in stabilizing social infrastructure and wellbeing with focus on basic social needs.

b) Step 2 Medium term: Strengthening the social infrastructure and wellbeing

The second step is to gradually increase the social tax from ST1 until it reaches ST*, which is the highest social tax ST the new economy can tolerate and invest the proceeds in strengthening social infrastructure and wellbeing with focus on higher social needs.

c) Step 3 Long-term: Transferring social responsibility to the new private sector

When the social tax is at ST* and having a social externality management impact SEMI* the transferring of some social responsibility to the new private sector should start in exchange of lower or not social tax while the government takes responsibility for the remaining social sustainability gap(RSSG) and for the monitoring of the social responsibility transfer. Doing this will force a social trickledown effect that would not happen under free markets, and which would improve the stability of the socially friendly economic system. The government can set a list of basic and higher social priorities for the new private sector to invest in and which can be used to develop a social responsibility index that can be linked to social tax reduction programs. The more social responsibility a business takes the lower the social tax; and those businesses that go the extra mile in social responsibility pay no social tax and get access to other economic incentives.

d) Step 4: Very long term: Monitoring and enforcement

The government continues to take responsibility for the remaining social sustainability gap(RSSG) as well as the social transfer monitoring and enforcement function following a flexible approach that rewards more those businesses that increase their social responsibility not just with lower or no social tax, but also by even giving them access to other economic incentives.

Summary:

Social externality management markets(SEM) can be used to transition new capitalist economies into socially friendly capitalist economies, approaching socially friendly capitalism from the inside out, a world closer to Karl Marx's dream.

Implications:

Social trickle downs are possible under ongoing government intervention providing an indirect route towards socially friendly capitalism.

Food for thoughts

i) Can green capitalism exist without green markets? I think no, what do you think?; ii) Can externality management markets exist without ongoing government intervention? I think no, what do you think?; and iii) Is the drive to produce at the lowest cost possible in traditional markets behind its cost externalization problem? I think yes, what do you think?

Conclusions

First, the social externality management framework that results when governments decide to approach socially friendly capitalism that way was shared. Second, the circular social externality management framework that links the social tax based government intervention with

its impacts on closing the social sustainability gap was introduced. And finally, the step by step way of how a social externality management framework can be implemented, first to assure social cohesion, and later to transfer some social responsibility to the new private sector was detailed.

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