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Capitalism is a subtle co-existence of apparently inconsistent values. Capitalists are stewards of their assets even while they restlessly pursue profit. They rely on a vigorous public realm that nurtures science, education and infrastructure even while they are go-getting individualists. They need flexible adaptable workforces; but they also need committed, loyal and trained workforces.

Bad capitalism got us into our current economic mess – good capitalism, which recognises social and public values, will get us out. For Labour this means a transition to a party that is the custodian of the Enlightenment tradition, with a model of capitalism founded on two interrelated building blocks: fairness understood as receiving one's proportional deserts for the contribution that has been made; and the co-dependence of public and private, individual and society.

The justification for capitalism is that it is the best way devised so far of organising our economy and society so that most people can live lives they have reason to value. Properly structured and founded on the values of fairness, plurality and openness, good capitalism can unleash great wealth and opportunity. But in 2012 the system, breaking down for the previous thirty years as it became ever more dominated by bad finance, has begun openly to disintegrate. The particular capitalist model that had developed up to 2008 – overextended banks fuelling a debt financed consumption boom, as inequality rose and companies became ever more short-termist and cynical about their customers, workers and core business purpose – had come to an end. Bad capitalism had reached its nemesis – and unreformed it is proving incapable of sustaining economic recovery. Thus we are living through the longest depression since the nineteenth century.

Even thirty years ago the conventional left response would have been to diagnose the crisis as a crisis of capitalism for which some form of state-led socialisation was the answer. Not today. Ed Miliband has been careful to dub this a crisis of a particular kind of capitalism, and his solution is more subtle: to build an argument – and the beginnings of a coalition – making the case for a different kind of capitalism. It is a much smarter position, even if he has some way to go in fleshing out what it means.

In the run-up to 2008, the social and public values that are paradoxically essential to a strong capitalism, were systematically torched. This does not mean that capitalism is in imminent danger of collapse. But it does mean, as even a growing number of businesspeople and capitalists themselves recognise, that the system needs substantial reform and rediscovery of those values if it is to mount a sustainable recovery. That is not going to come from the right – leaving the field wide open to the left. It also implies a very different conception of what it means to be on the left; not an enemy of capitalism but one of the instruments that holds it to account, reforms it and insists that it embodies public and social values. For Labour this means a transition from an anti-capitalist party to a party that is the custodian of the Enlightenment tradition in whatever economic and social context – a much more promising and potentially majoritarian position.

Capitalism has twin roots – in the individualistic Protestantism of the Reformation but also the assertion of the public realm in the Enlightenment. Over the last thirty years American neo-conservatives in well financed US think tanks have systematically denied the role of the Enlightenment in capitalism and focused solely on individualism. It is individual effort and individual risk taking that have been placed as the alleged heart of western business; short-term profit has become the only yardstick of success. The concept of 'rational economic man' evolved out of this intellectual, quasi-ideological approach: it has become the organising dogma of western corporate life. This allows for no recognition of interdependence between business and society, or the role of the social, meaning and purpose within business itself. Yet never forget the first recognisable companies – the East India Company, for example – were afforded the privilege of incorporation as a quid pro quo for delivering identifiable public benefit; they were incorporated for a purpose from which they set out to make profits.

Enlightenment philosophers enlarged this tradition by arguing that it is social interconnectedness and communal relations that give our secular lives meaning. For Rousseau for example, this was embodied in a social contract which enabled individuals to express mutuality, achieve solidarity and share the risk of life's hazards. Adam Smith wrote *The Wealth of Nations*. But he also wrote *The Theory of Moral Sentiments:* the two works were to be read as a whole. Capitalism could not be divorced from meaning or morality.

The Enlightenment was also the creator of the public realm; the arena where ideas and government were held to account. The great branches of government – the executive, legislature and judiciary – were to be separate. Accountability to argument and via the rule of law became the organising principle of nation states; science and reason triumphed over superstition, myth and the divine right of kings. Public companies reproduced these principles in their organisations; shareholders held managements to account. The company became an Enlightenment institution.

But religion contributed its fuel to the western capitalist fire. Protestantism and Catholicism alike insisted that there were rewards in the afterlife for good behaviour in the present, while Protestantism contained the ingredient, fundamental in early capitalism, that work, saving and investing brought reward in the hereafter. Crucially work conferred meaning, social obligation and was placed in a moral context. When religion declined, the early great sociologists – Weber, Durkheim and even Marx in these terms – all saw that the human condition was profoundly changing: now meaning needed to reside in the rise of capitalist organisations. Catholic social doctrine, drawing on this tradition, also draws a distinction between human labour – unfulfilling and alienating – and work – rewarding, and for Catholics, expressing the Holy Spirit.

The doctrines that have dominated today's corporate discourse do not recognise the importance of such distinctions or values. Instead they stress the rationality of economic individualism as a moral proposition in its own right – but with no wider social context. Everybody, rich and poor, alike must stand on their own two feet, take responsibility for their lives and face the consequence if they do not. Such propositions have enormous moral force because prima facie they are true.

Yet this is only half the story. There is the social: economic and social risk cannot only be handled by individuals, individual banks or individual companies. This reliance on individualism has been the route to economic breakdown. Worse, once companies and institutions deny any larger purpose, the vacuum is filled with incantations to efficiency, flexibility and the rationality of economic men and women – so creating alienation, disconnection and anxiety.

It is a moral hollowing out in which the aggressive pursuit of material well-being is all that is left to provide meaning.

Yet the events of the last decade have proven that there is a complex inter-relationship between state, society and business. Business is not above state and society: it is part of it – requiring state and society to share in risk and in reward. It is not a one way track in which profits are privatised and losses socialised. The re-legitimisation of capitalism requires more balanced and long-term decision-making on behalf of all its stakeholders, which in turn implies capping the power of finance and giving employees more voice.

Good capitalism

Good capitalism rests on two interrelated building blocks: fairness understood as receiving one's proportional deserts for the contribution that has been made; and the co-dependence of public and private, individual and society. A truly competitive market is one where entrepreneurs, capitalists, businesses and workers win rewards that are proportional to their contribution – no more, no less.

But there is a crucial second component to a good capitalism. No individual business or worker can shoulder risk alone; there need to be social and public systems of risk sharing and risk mitigation. For a firm this can be the entire ecosystem in which the firm does business – its banks, its investors, the flows of ideas it receives from research laboratories and the quality of those it hires - but it also may need the state to provide upfront grants or create institutional networks to support the uncertainties of innovation at the frontier. For an individual the ecosystem is a well-structured social contract. Good capitalism is founded on an acknowledgement of interdependency and an acceptance of due desert.

It is thus necessarily biased to the productive rather than unproductive. The system must be organised to permit the maximum amount of insurgency from new business start-ups, be ready to break up monopoly and relentlessly assault price rigging, cartels and market fixes. This necessarily requires tough competition authorities – a crucial role for the public realm and public institutions. It also requires a strong infrastructure supporting the public good of science and technological advance, the underpinning of the business models of the new insurgents. This will necessarily be tax financed and publicly provided.

Good capitalism is indissolubly linked to good ownership – the recognition that owners have obligations along with the right to direct property autonomously. Once again interdependence and mutuality enter the frame. If business assets are to be owned well, owners have to be committed and recognise that they are stewards and trustees of what they own; this has to be written into company law and codes of corporate governance, and stock markets, which trade ownership rights in shares, must be organised to respect this.

This has profound implications for the relationship between finance and business. The good capitalist firm cannot have financial performance as the sole metric that counts. Firms should incorporate to deliver business purpose that finance must serve – and the delivery of that purpose will require a commitment to innovate, to invest, to enlist employee engagement, to confer meaning at work and to be sensitive to consumer wants. If financial targets override those goals then the firm is reduced; it succumbs to commoditisation of relationships to serve finance.

Good capitalism rests on just workplaces. Reward is proportional to contribution. Workers have voice, and their views are respected. There is a commitment to performance and adaptability. Shirking is tackled. Trust is high. Leaders communicate the business purpose then live the values. What matters are outputs not inputs.

None of this will happen spontaneously. An enterprising, enabling state has watchfully to nudge, cajole, regulate, legislate and build the ecosystems in which good capitalism and the social contract can flourish. The state itself cannot be captured by the interests it must superintend; there needs to be careful division of powers, maximum transparency and openness. Democracy and the rule of law are thus indispensable buttresses to good capitalism.

The creation of good capitalism is thus quintessentially an Enlightenment project. It is predicated on a strong public realm, democracy, rationality, science and a commitment to equity. It creates an economy and society where risk is fairly distributed and opportunity maximised. It is a profound challenge to the conservative doctrine is that the market will handle existential risk best alone and unimpaired, and that beyond a minimum safety net there should be no social contract. But markets, individuals and business cannot deal by themselves, for example, with the systemic uncertainty of transformational new technologies, the obsolescence of skills or the aftermaths of credit crunches. They batten down the hatches and don't take risks. Instead they need a smart state to mitigate and socialise the risk. What creates a great and dynamic capitalism is the interplay between risk-taking entrepreneurs and companies, and a smart state creating the structures and processes that relieve them of risks that would otherwise crush them. There are three broad axes on which to proceed.

1. Towards a new fiscal, monetary and financial policy

The unwinding of the excessive private debt – British bank assets are five times our GDP – that has taken a generation to build is obviously going to take at least a decade, perhaps longer. Worse the task is superimposed on another calamitous mistake originating from the same mindset; namely that markets do not and cannot make mistakes. Britain had vastly over-invested in the business sectors that benefited from rocketing and unsustainable credit growth – retailing, catering, leisure, housing and housing improvements – and not in those that sold goods and services abroad. This had been made worse by the chronic overvaluation of sterling. Britain, with a large international financial sector but committed to allowing its exchange rate to float (rather than being pegged or in a single currency), had created an economic doomsday machine. The banks sucked in money from abroad, buoying up the unmanaged pound and so hollowing out the productive part of the economy while diverting resources to the unproductive.

Thus it has been blindingly obvious since the crisis broke that economic recovery from the deepest recession since the early 1930s was going to be exceptionally difficult. However, fortunately Britain's stock of public debt was modest which would give an intelligent government some valuable room for manoeuvre in timing how it lowered the deficit. Britain had a private debt crisis – but not a public debt crisis.

The coalition government's programme to eliminate the public sector deficit in four years is therefore a first order intellectual mistake which compounds the mistakes made that caused the crisis. Instead it should be finding ways to use the public balance sheet to support the stricken banking system and to get business lending rising rather than falling. The Bank of England's quantitative easing programme should be channelled into new bank lending. The mechanism is simple: the Treasury must indemnify part of new business lending, which is then aggregated into securities that the Bank of England buys.

This needs to be buttressed by a recognition that we require a five year period of closely managed but higher inflation to inflate away the real value of debt. The government should replace its target for inflation with targets for the growth of prices and growth of output combined (money GDP in the jargon).

There also needs to be an increase in demand. This can be done directly – with targeted and time-limited tax cuts or spending increases. And the government can also move indirectly, taxing the rich more aggressively and re-allocating the proceeds in tax cuts to those on middle incomes and lower who tend to spend more. There is also an overwhelming case for a financial transactions tax – both to raise crucial revenue but to cap the growth and frenetic speed of financial transactions.

2. Ownership, investment and innovation

British economic and business structures are palpably not fit for purpose for the evolution of the 21st century economy: an accelerating pace of technological change driven by an avalanche of new general purpose technologies. We are entering a world in which wealth will be more overtly co-created in an onging and ever denser process of iteration between firms, universities and financiers. The watchwords will be open innovation, mutuality and co-creation – rather as they were during the British Industrial Revolution which was a product of the Enlightenment. Today the task is similar if in a very different context. Science and technology need to be harnessed and commercialised in a wholly recast British economy and culture – an industrial Enlightenment for today.

Britain has a very weak innovation ecosystem. Banks and firms exist in a stand alone relationship. Risk is too little socialised and mitigated. It is too hard to reach production at scale quickly and easily. Too few owners steward their companies. We need to find better and more effective ways of getting long term equity capital into our small and rapidly growing businesses – and beyond that fit for purpose loan capital. The financial system – from the way the Bank of England banks to the banking system, risk weightings are assigned to which loan categories, banks concentrate decision making in London, the way infrastructure is financed and so on – needs recasting.

British companies should be more than networks of contracts: they must embrace plural, engaged and stewardship-oriented ownership, founded on trust and a sense of common purpose. The Ownership Commission, which for the past two years I have chaired, has suggested a suite of small interventions that cumulatively could transform business – directors being mandated to pursue a business purpose to which institutional shareholders were more closely connected. Britain needs an ownership revolution; a new wave of employe -owned companies, small and medium sized family businesses, co-operatives, mutuals and more ownership commitment from shareholders.

In *The State We're In* I argued that German companies, with unions represented on supervisory boards and incorporated into business decision-making through 'co-determination', represented a model that Britain should follow – albeit recognising our different starting point. I stand by that argument even more firmly today. Worker buy-in is essential to successful capitalism.

Small businesses need to be incorporated in the open innovation processes of large firms: but to do that large firms need to be more ready to expose themselves to outside ideas and alliances, an agenda which the Big Innovation Centre (an innovation think and do tank that I founded and chair) is working hard to open up.

3. A twenty first century social contract

Individuals must be able to mitigate the risk of unemployment, lack of skills, old age, disability, homelessness and illness in much more fast moving globalised times. Yet the political debate is currently solely about how to minimise the cost of welfare, not how to make it more effective so that individuals can feel more confident both as workers and consumers – a confidence that will spill over into efficient workplaces and busier shopping centres. I advocate a new bargain: so-called 'flexicurity' that combines greater workplace flexibilities with higher unemployment benefit, greater training and job guarantees – a far cry from the government's Gradgrind 'work programme'.

All this requires careful design and a smart state – but another casuality of Osborneconomics is the hollowing out and dumbing down of the British state. A Treasury report worriedly observes that turnover in the Treasury is now so high that the average age of an official is 32 with a mere three years experience. It is a similar pattern across the board, with the £142,500 cap on senior pay beginning to limit the capacity of the public sector to attract the best. A smart state requires smart people with a strong performance orientation. I have proposed that all senior executives in the public sector should place a significant part of their pay at risk to be earned back by meeting a broad set of performance targets. The aim is not only to introduce a stronger performance ethic; it is to show to the public at large that the public sector is committed to performance. We need a smart state: but we also need a legitimate state.

Conclusion

These goals – a responsible good capitalism; a twenty first century social contract; the creation of an open innovation ecosystem along with a commitment to science; the reinvention of the state as smart and enabling; and a reconceptualisation of economic policy – must be at the heart of the left's agenda in power. But this is more than a technocratic shopping list of to-dos. This is putting the Enlightenment back into capitalism. In my view this should always have been the left's mission, and that its seduction by state–led programmes of socialisation was a false trail. Indeed top-down planning, the creation of state monopolies, the lack of care over ensuring that state ownership contained checks and balances and ill-designing the social contract so that it was full of entitlements but too few obligations was an abrogation of the left's roots in Enlightenment values. The call for a responsible capitalism is a repudiation of twentieth century socialism and a redefinition of what should inspire and mobilse the left. It is a coming back home – and if Labour does this right will make it the natural party of government.