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Chronic limitations of neo-liberal capitalism and oligopolistic markets

An urgent case for socialized capital

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Abstract

Purpose – The purpose of this paper is to highlight the serious limitations of neo-liberal capitalism and urge for a shift to socialized capital before further economic deterioration leads to a succession of global conflicts.

Design/methodology/approach – This conceptual paper adopts a macro perspective in presenting argument on how global, financial markets integration and capital flow liberalization have led to inadequate market and corporate governance measures. The argument is couched in a selected literature and is preceded by a proposed solution – the requirement for socialized capital. An analysis of the nature of socialized capital is outlined and the questions that require attention identified if a paradigm shift from neo-liberal capitalism is to take place.

Findings – The need to urgently shift to a new philosophy of capitalism is overwhelming. Emphasized is that capital needs to adopt a socialised identity and is supported by investment horizons of 30 years or more. It is argued that non-market (e.g. state, NGOs, civil society) intervention is critical in setting appropriate frameworks within which socialized capital can operate.

Research limitations/implications – This is a theoretical paper, in which questions are raised which require transparent, public debate.

Originality/value – The paper presents the case for a fundamental reconsideration of present day markets, the role of capital and the influence of elites in determining the public good.

Keywords Social capital, Globalization, Economic integration, Governance, Investments

Paper type Conceptual paper

Introduction

Although international trade is as old as nations themselves, during the last few decades, advances in technology have changed both the scope and the method of international trade. When a trader on the New York or the London stock exchanges executes a billion-dollar currency transaction in Hong Kong, in a matter of seconds,

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this trader may (un)consciously impact upon the residents of New York, London, Hong Kong or the rest of the world (Vaidya, 2006). The increase in international trade has been termed, globalization which, in turn, is based on financial liberalization, defined as progressive regulatory initiatives such as the roll out of depository receipts and country funds and structural breaks (structural change that generates a process of various financial returns) in portfolio flows (Berkaert, 1995; Bekaert and Harvey, 2000). Globalization also means economic integration or a decrease of barriers in the mobility of goods and services and financial integration or the dismantling of barriers allowing access to international investors in local capital markets and local investor access to international capital markets.

There are several reasons why economic prosperity has triggered international financial liberalization, causing financial integration, whose downside is global financial crisis (GFC). Some argue that stability in macroeconomic performance leads to liberalization of capital accounts which opens the domestic market to foreign investors, leading to financial and global market integration (Mathieson and Rojas-Suarez, 1992). Others hold that greater mobility in the exchange of goods and services gives greater voice to foreign investors in influencing the domestic economic policy and that foreign firms become strong lobbyists for international financial liberalization (Haggar and Maxfield, 1996). Thus, despite domestic government control, capital control becomes difficult to exercise due to the ample opportunities of arbitrage and evasion enabled by telecommunication, such as internet transactions, as well as the lax legal requirements of some nations. Such expansive discretions loudly hailed as the answer to human ailments are viewed by some as the other Janus side to globalization, that of a threat to sovereignty (Keohane, 1995; Kouzmin, 2009). In support of this argument, Nobel Laurent, Stiglitz (2010) through his work on asymmetric information traces the origins of the current financial crisis to a deregulatory fervour fuelled by the "ideology" of free market fundamentalism and Wall Street's political clout.

With such in mind, this paper reviews the shortcomings of the current model of the neo-liberal economy based on international inter-dependency and movement of financial capital and argues that there is a need for a shift to a paradigm of socialized capitalism, where the role of capital is for the public good rather than for the benefit of the selected few. A review of the role of markets and corporate governance is undertaken, followed by a focus on the integration of financial markets. Then capital flows and liberalization are discussed, followed by presenting the case for the paradigm shift – from international inter-dependency to socialized capital. The concluding argument is that unless governments initiate new platforms for social capital then, as predicted by Smith (1759/2002, p. 50), a "great body of the people, must necessary fall".

Markets and corporate governance

The last three decades have been marked by a new constellation of power between markets and states and market and society, with markets becoming increasingly dominant and disembedded from society (Harvey, 2005). Some scholars have argued that neo-classical economics and conservative libertarian, "ideological" initiatives pose threats to the legitimacy and efficacy of sovereign governments (Saul, 2005; Kakabadse *et al.*, 2006; Klein, 2007; Kouzmin, 2009). For example, Kakabadse *et al.* (2006) hold that globalization encourages the good of capital against the rights of individual nation states to determine their destiny in a similar manner that human rights challenge the rights

of the state in favour of the rights of the individual. Before the emergence of rapid integration on a global level, fueled by liberalization initiatives and advances in information and communication technologies (ICT), the issue of state sovereignty was rather clear with the downside being the pursuit of internal and external wars on the basis that each state exercised its right to govern as it saw fit. Thus, many issues and conflicts within sovereign borders had little impact on the world at large. However, the globalization of capital has led to commentary, with Friedman (1999), Franklin (2003) and Kakabadse *et al.* (2006, p. 191), amongst others, arguing that "low trust in democratic processes is due to the globalization, or liberalization, of markets, which emerges as antagonistic to domestic systems".

Saul (2005, p. 196), for example, holds that the globalization, as an ideology, declared itself as a market force for capitalism and risk and was further prompted by economics, and management academic gurus such as Freidman, whilst being led by technocrats (private sector bureaucrats, working in joint stock companies rarely owned by active shareholders), working to reduce competition. Stiglitz (2010) argues that market imperfections and mis-aligned incentives have distorted decisions made by everyone from mortgage originators to credit-rating agencies. The process of mercerization implies both the increasing dominance and the scope of markets in social life as markets have gained more autonomy *vis-à-vis* the state, becoming more deregulated and more globalized. The state withdrawing both from intervening in the workings of the market and from ownership of "the commanding heights" (Yergin and Stanislaw, 1998) has, in turn, accelerated making the economy and social life in general, more liquid, chaotic and complex (Bauman, 2000; Urry, 2003).

Liberalization of trade though The General Agreement on Tariffs and Trade/WTO, with neo-liberal recipes pushed by the World Bank and the International Monetary Fund (IMF), has empowered and engaged trans-national corporations (corpocracy) and weakened governments to the point where national economic policies can no longer be decided by elected officials alone but must take into account, if not favour, the interests of huge corporations (Jones, 1993; Saul, 2005; Kakabadse *et al.*, 2006, p. 191; Klein, 2007). Currently, many citizens around the globe are absorbing negative experiences from the US financial meltdown of 2007-2009 and other crises of corporate capitalism and globalization. For example, for some 30 years, the consensus amongst UK policy makers has been that Britain has more to gain than to lose from its open embrace of globalization, until the GFC of 2008 (*The Economist*, 2010). Now Britain's policy makers are no longer sure that they have got a good deal as foreign ownership also means power shifts abroad and Britain risks becoming a "branch factory" economy, compounded by increased factory closures and job losses as companies need to cut capacity, closing first factories far from home (*The Economist*, 2010).

Three years after Corus, an Anglo-Dutch steelmaker, was taken over by India's Tata Steel, its complex at Redcar, on Teesside, is being taken out of operation whilst plant equipment is being protected so that it can be used again at some time in the future (*The Economist*, 2010). This has been echoed by Kraft's purchase of Cadbury which promised during the takeover battle that it would keep the plant at Keynsham, near Bristol, open but then changed its mind (*The Economist*, 2010). In addition to the UK, the so-called Celtic-tiger, Ireland, as well as Argentina, Latvia, Spain, Turkey, Dubai and Japan are faced with three brutal options of inflation, high taxation and/or default if either consumption does not resume or the private sector does not start investing

again (*GEAB*, 2010). The absence of one of these two positive dynamics leaves these states with no other alternative in 2010 other than to raise taxes to match their huge public deficits, let inflation soar to diminish the relative weight of their debt, or else file for bankruptcy (*GEAB*, 2010). To date, both consumption and investment trends are extremely negative as the consumer is incited to save money, re-pay debt and in turn reject the Western model of consumption of the past 30 years. Companies, due to consumer lack of spending, are cutting on investment leading to shrinking economic activities. In turn, Western economies are looking for foreign demand particularly from Asia and China. No matter how urgent the search, this does not mean that these markets will provide the "new Western-style consumer" (*GEAB*, 2010).

The failure of financial markets in the late 1920s, corporate fraud in the 1990s and the recklessness of so-called US "sub-prime" mortgage crisis (2007-2009), or "junk debt" disguised by "Triple A" ratings by risk agencies (Kouzmin, 2009), are all examples of deep structural issues and are a reminder that the "invisible hand" (self-regulating nature; Smith, 1776/1976) of the market is inextricably bound to an unaccountable, invisible governmental presence, that in the words of Thorne and Kouzmin (2006) are looking after the hegemonic interests of globally expanding, corporate capital. As noted by Stiglitz (in Altman, 2006), "the reason that the invisible hand often seems invisible is that it is often not there". Social mores such as discrimination and inequality are not solvable by markets and, with such a lacunae, one needs regulation (Spitzer, 2009). Even the Committee on Climate Change (CCC, 2009) has concluded that the market, left to its own devices, is failing to deliver desired benefits. Climate change has cast doubt on the wisdom of markets, at least amongst the energy sectors and many academics (*The Economist*, 2009).

Smith (1776/1976, p. 50) was aware of the limitations of "free" markets and that markets, by themselves, often destroy the possibility of a decent human existence "unless government takes pains to prevent" that from happening. Smith (1759/2002, 1776/1976) made the case for the need of moral sentiment and acknowledged that markets are never perfect, suggesting that an "optimal" range of government interventions can induce superior, later to be termed Pareto, outcomes (an allocation of resources such that no other allocation is "better") these being greater than the traditional "market-failure" school of thought has acknowledged (Greenwald and Stiglitz, 1986). This argument was supported by Polanyi (1944) who was skeptical of the market as an efficacious and socially beneficial basis for organizing every aspect of society. Polanyi (1944) urged government intervention as a corrective to market failure and social disruption.

Whilst the origins of private-sector "rent seeking" (Berle and Means, 1932) are often disguised or forgotten, rent-seeking behavior or the process by which an individual or a firm seeks to profit through manipulation of the economic environment rather than through trade and the production of added wealth, is well known (Berle and Means, 1932; Krueger, 1974; Tullock, 2005; Kouzmin and Dixon, 2006; Kouzmin, 2009). Rent seeking can become a serious social problem caused by a lack of power-balancing mechanisms within social structures exercised through the interference of seemingly dominant groups. In a rent-seeking society, politicians sanction certain policies, such as privatization and outsourcing, and are active in the promotion of sharing "rents" (Tullock, 2005; Kouzmin, 2009). This in turn has often led to corrupt practices.

For example, the report (Pyke, 2010; Walke and Walker, 2010) into the sell-down of $15 billion of Queensland's State-owned assets that had been funded and accumulated by past generations, in response to the GFC and in order to solve a short-term

revenue shortfall, found that Queensland's policy makers had undertaken a serious step that potentially could cost current and future taxpayers billions of dollars in lost value and earnings potential. Contravening the commonly accepted view that government need not maintain budget surpluses at all times, and that it is good practice to run deficits during economic downturns – provided that the budget is restored to a "balanced" position over the course of an economic cycle, Queensland's policy makers have subsequently embarked on an unnecessary, "unwise and un-supported sale of profit-generating and unique publicly-owned assets, raising the question of corruption" (Walke and Walker, 2010, p. 4; Pyke, 2010). The Queensland case is simply one example of the fact that neo-liberal economics has acquired a distinctive distaste for the public sector, which if not complying with market forces is under suspicion for being inefficient, wasteful and, thus, not giving value for money. This argument is based on the premise that the absence of any automatic "disciplining mechanism" permits "rent-seeking" behaviour by bureaucrats, their clients and, even, the politicians who govern them (Tullock and Eller, 1994).

Firms have transformed themselves from entrepreneurially driven and privately owned entities into public companies in order to reap the benefits of scale and scope available, first in the domestic market (Chandler, 1990) and, now, across the global market. This development has also spawned a fundamental "principal agent" conflict (Berle and Means, 1932; Shleifer and Vishny, 1997, 1998; Johnston and Kouzmin, 1998). As a result, corporate governance is taxed with the burden of solving the agency problem by designing mechanisms, both internal within the firm and external outside the firm, to assure providers of capital security of return on their investment (Berle and Means, 1932; Shleifer and Vishny, 1997, 1998).

Although corporate governance monitoring is considered to be a public good, as every shareholder benefits from the monitoring activities of others (Edlin and Stiglitz, 1995), these monitoring mechanisms are costly processes. The marginal cost of monitoring often exceeds the marginal benefits of improved performance and is often exercised only by institutional investors, whilst, in the long-run, the equilibrium of economic institutions is often sub-optimal (Acemoglu and Robinson, 1999; Acemoglu, 2004). At the end of 2003, institutional shareholders (investors, insurers and pension funds) controlled roughly 80 per cent of the UK equity market and close to 60 per cent of the US market (Aguilera *et al.*, 2006, p. 148). The GFC is testament of their failure to exercise their mentoring function, especially as the efficiency of corporate governance mechanisms, as well as ownership concentration, vary depending on the prevailing political and economic systems (Pagano and Volpin, 2001; Pagano and Lombardo, 2002; Roe, 2003), the dominant industrial sectors and labour relations in each country, all kept divided by those who control these concentration of wealth (La Porta and Vishny, 1997; La Porta and Lopez, 1999).

Reform of institutional arrangements such as corporate control and governance arrangements often implies the erosion of power for those groups wielding that power. As these groups cannot be credibly compensated ex-post for their loss of power, they have an incentive to block change. This, in turn, implies that ownership structures might not adjust sufficiently to changes in economic conditions or the needs of the firm (Acemoglu and Robinson, 1999; Zingales and Rajan, 2003; Acemoglu, 2004). Moreover, as noted by Zingales and Rajan (2003, p. 2), "financial systems do not [. . .] emerge simply as a result of their 'superiority' in a particular environment. The power of vested interests distorts the process of evolution".

For example, some markets may encourage or "require" banks and other firms to maintain certain capital ratios (ratio of equity to assets) in the absence of regulatory capital requirements. This market "requirement", which may differ for each bank, is the ratio toward which each bank would tend to move in the long run in the absence of regulatory, capital requirements (Miller, 1977; DeAngelo and Masulis, 1980). The departure from market capital requirements has two Janus-like faces. The value of the bank will decline if it has either too little or too much capital. This leads to the tension between taxes and the cost of financial distress (which occurs when the bank is expected to have difficulty honoring its commitment) in negotiating the optimal capital ratio (Modigliani and Miller, 1958; Berger, 1995).

However, since interest payments are tax deductible in some economies, such as the USA, but dividends are not, substituting debt for equity enables firms to pass greater returns to investors by reducing payments to government. Other things being equal, owners prefer to fund the firm almost entirely with debt, although increasing leverage also increases the risk of incurring the costs of financial distress. Such will continue as in neo-liberal markets, capital and the assets of the company are the property of shareholders for which directors and managers are accountable as agents of shareholders and have no legal obligation to any stakeholder (Friedman, 1962; Hayek, 1969; Allen, 1992).

Financial markets integration

Early studies (Sharpe, 1964; Lintner, 1965) put forward the framework of a pricing model of capital and suggested that when markets are segmented, local risk is the only relevant element in the price of the returns and, due to the volatility of local markets, the expected returns are also higher. In a completely integrated market, the expected return with respect to world market portfolios and world risk would be at a premium. The corollary is that in the integrated market, expected returns are lower and, hence, the assumption behind the theory is that as markets move from being segmented to integrated, security price must go up and returns will decrease. The traditional pricing model (Sharpe, 1964; Lintner, 1965) suggests that with effective liberalization processes, the cost of capital goes down, which induces more initial public offerings and decreasing market concentration, and individual securities may become less sensitive to local information and more sensitive to world events.

The influence of world events in the last two decades has been illustrated a number of times. The general consensus has been that ever-increasing economic and financial liberalization measures have led to risk sharing, a reduction in the cost of capital and markets demanding identical compensation for being exposed to identical sources of world risk (Bekaert *et al.*, 2006). Integration also leads to an increase in the correlation with world markets which, in turn, reduces the potential for diversification benefits (Bekaert and Harvey, 2002). Moreover, the increase in foreign investment portfolios augments market integration further, supplementing information to explain market co-movement (Errunza, 2001). However, when integration takes place, it also creates structural changes making it important to notice when these occur as they trickle down other changes (Bekaert and Harvey, 2000, 2002).

Liberalization may not necessarily be effective and thus may not lead to integration. However, if integration takes place, it is manifested in events such as regulatory reform; announcement of a first-country fund (relaxation of investment restrictions because of changes in government policy in the origin of the funds; country fund premiums reflect

barriers to international investments which may be overcome by listing new financial instruments in foreign markets); announcement of first-local listing or country fund on a foreign exchange; changed behaviour of financial assets; changes in economic aggregates and changes in market infrastructure. The barriers to integration, whether direct, such as legal barriers (restriction on ownership) or indirect, such as information asymmetry, accounting standards and investor protection, as well as emerging market's specific risks, such as liquidity risk, political risk, economic policy risk and currency risk, are often removed gradually and the speed of the process is specific to a country's situation (Bekaert and Harvey, 1995).

Capital flows and liberalization

As the barriers to investments are removed, foreign capital flows into the economy, often rapidly creating a "return to integration" to level out within three years (Stulz, 1999; Bekaert *et al.*, 2002). Generally, a newly integrated economy pursues competitive strategy to lure foreign investment and to realize the beneficial influence of integration. This also leads to the disruptive impact of foreign capital mobility during distress conditions, as exemplified by Mexico (1994-1995), East Asia (1997-1998), Russia (1998) and Brazil (2000), all experiencing the down side of rapid, capital mobility and, in particular, portfolio investment mobility. As Lietaer (2001, p. 74) predicted, these crises were the dislocation symptoms that in the decade produced a global melt down and a global repression which was experienced in 2008. The windfall increase in the correlation between markets during a crisis period, termed contagion, is another important side effect of integration, hotly debated as to whether it is due to the weakness in fundamentals or political motivation.

An increase in foreign investment portfolio augments market integration, further supplementing information to explain market co-movement (Errunza, 2001, p. 711) as the "removal of inflow capital controls and subsequent portfolio flows result in complete integration and the expected return would then depend on the global price of risk and global covariance risk". The essence of the cost of the capital/segmentation hypotheses is that "a move from local pricing and shareholder base to global pricing and global shareholder base" (Errunza, 2001, p. 711), allows the market to be priced at global levels, eliminating the national risk premium. However, considering that only 2 per cent of global foreign exchange transactions relate to the "real" economy reflecting movements of real goods and services in the world, and 98 per cent are purely speculative (Lietaer, 2001), the events of 2008 have shown that global pricing is not panacea for hedging risks.

However, integration, in itself, is a complex and on-going issue, making the applicability of the standard, asset-pricing model in the international context not necessarily an effective mechanism for informing international investors as to whether the risks they are being exposed to are priced or not. In theory, if markets are fully integrated, then the world factors should be more important sources of risk and should be accordingly priced, otherwise, if fully segmented, then local factors should be important.

A growing body of literature indicates that capital markets around the world are becoming more and more integrated (Bekaert and Harvey, 1995; Lietaer, 2001; Chelley-Steele, 2005a; Basher and Sadorsky, 2006) and, in turn, create global oligopolies which control the basic decision making of the world economy (Amin, 2008). These oligopolies are not exclusive to the financial sector but are also involved in industrial production, services, transport and the like (Amin, 2008). Some argue that markets previously exhibiting high levels of integration have regressed to near

segmentation, exemplified by Argentina, Chile and Mexico (Francis *et al.*, 2002; Hunter, 2006). Some see the issue of sovereignty as a key roadblock to achieving complete market integration, or globalization, of the economy (Hunter, 2006).

The G7 countries, European countries, developed Asian countries and emerging Asian countries are integrated with respect to US macroeconomic views (Nikkinen *et al.*, 2006). Studies found that there has been a consistent increase in the co-movement of some of the Eastern European markets and developed markets (Chelley-Steeley, 2005b); that Central European markets have become more integrated with the global market (Voronkova, 2004); that Mexico and the US show stronger linkages; whereas Argentina and Brazil reveal a weaker linkage and attribute this difference to trade flow differences (Soydemir, 2000) and report that equity markets are unstable over time (Kaplanis, 1988). Some critics of globalization argue that the collapse of globalization has already begun and that the re-invention of the "world" is occurring (Saul, 2005; Klein, 2007).

Depending on the ideological and philosophical perspective taken, many causes have been blamed for the GFC. Some blame the credit boom which began to unravel in early 2007, when problems of payment arrears surfaced with sub-prime mortgages offered to less, credit-worthy borrowers and, as a result, house prices in the USA began to fall. Mortgage delinquencies and defaults were matched by an intensification of a downturn in house prices (Bernanke, 2009). Others, such as US Treasury Secretary Geithner (2008), blames the so-called, parallel or "shadow banking system", non-banking financial institutions outside of the regulatory controls governing commercial banking activity as well as the use of off-balance sheet entities to fund investment strategies which, in turn, significantly contributed to the financial crisis of 2007-2009. A recent global survey of risk professionals by Moore *et al.* (2009) reveals that the 2008 banking crisis, which according to IMF estimates have cost US $10 trillion, could have been avoided. A total of 99.5 per cent of the respondents disagree with the UK government's line that the most important cause of the crisis was "global economic circumstances beyond anyone's control". Moreover, the survey reveals that most risk professionals believe the banking crisis was caused not so much by technical failures, as by failures in organizational culture and business ethics (Moore *et al.*, 2010).

Bogle (2005, 2006) argues that a series of unresolved challenges that face capitalism have contributed to past financial crises and that these concerns have not been sufficiently addressed. He also holds the view that "Corporate America's" failure is largely due to the unchecked "power of managers". Placing this argument along the lines of the principle-agent problem – that "management capitalism" has replaced "ownership capitalism", for managerial rather than shareholder's benefit – leads to burgeoning executive "compensation" (sic) and that managed earnings focus on share price rather than on the creation of genuine value. The failure of gatekeepers, including auditors, boards of directors, Wall Street analysts and career politicians to exercise their duty of care, is also evident. Foster (2008) holds that the decrease in GDP growth rates since the early 1970s is due to increasing market saturation.

Others differ from the mainstream explanation, arguing that the GFC is merely a symptom of another, deeper crisis. They hold that the symptom is of an underlying systemic crisis of capitalism itself. According to Amin (2005, 2006), the decline of Western economies' "real" investments was matched by growing surpluses (since the early 1970s), through the financial markets and that channel became more profitable than leveraging productive capital. Subsequent de-regulation, in turn, led to recurrent

financial bubbles such as the internet bubble and other deep financial crisis (Amin, 2008). Moreover, the drawing down of the natural resources of the planet, now less abundant than half a century ago, further fueled the current crisis (Amin, 2008; Brown, 2009). Increased water shortages, soil erosion, rising temperatures and population growth all have serious implications for particular areas such as sub-Saharan Africa and the Indian subcontinent, where hunger and disease will prevail.

For example, the population of the advanced economies accounts for 15 per cent of the planet's population and monopolizes for its own consumption and waste 85 per cent of the world resources (Amin, 2008). Between 2000 and 2007, US households pushed the ratio of consumption to GDP up to 77 per cent and accounted for a third of the growth in consumption globally in 2005 (Baily *et al.*, 2009; Baily and Elliot, 2009). Although household incomes were not growing as fast, wealth incentivized consumers to spend beyond their means. In the USA, the ratio of household debt to disposable income rose from 103 per cent in 2000 to 139 per cent in 2007, whilst the personal savings rate fell from 12.2 per cent in 1981 to 2.3 per cent in 2000 and to 0.7 per cent in 2005 (Baily *et al.*, 2009; Baily and Elliot, 2009). Some scholars (Saul, 2005; Kouzmin and Dixon, 2006; Klein, 2007) have argued that from 1971, globalization has involved an "imperial extension" of the neo Liberal economist hegemony. Saul (2005), for example, argued that privatization was equated with entrepreneurship, and "rent seeking" and money markets were deemed as being new "real trade". Added to this has been the view that the size of corporation was all that mattered, promoting frenzies of mergers and takeovers, and, in turn, global corporatism, leading to a mindset of unlimited consumption.

A primer for a paradigm shift: from international inter-dependency to socialized capital

Long business cycles, the so-called long waves or Kondratiev waves, regular sinusoidal-like cycles in the modern capitalist world economy have been known to economists since 1925 (Kondratiev, 1925/1935). They were recognized as playing an important part in economic swings as they explain interaction between technological innovation and associated clusters of managerial, financial and institutional innovations (Schumpeter, 1939). The current financial crisis could have been expected and understood in terms of innovations relating to securitization and leverage which, in turn, could not have grown to such a scale or so rapidly without the ICT revolution which changed investment patterns following the dotcom bust.

Schumpeter (1939) noted that business cycles suffer from gaps in statistical information, although he also noted that there is more than statistics needed to understand the swarms of innovation producing economic changes and lags in institutional arrangements. These jerks and lags are termed "discontinuity" and are initiated by innovation and subsequent ferment which is marked by competition and dominance which ends in a subsequent dominant design lasting until the next cycle (Tushman and Anderson, 1986). However, once a dominant design emerges, a firm's incentive to offer a variety of designs declines (Tushman and Anderson, 1986).

Supply-side economics, or supply-push, was promoted by Irwing (1978) – nicknamed the "godfather of neo-conservatism." Together, with intermediaries, who focus on economies of scale and/or comparative advantages in the production of information about borrowers (Diamond, 1984), Irwing became the mantra of neo-liberalism (Bailey, 2001). In the neo-liberal economy, the view that large corporations deal with

internal "conflict," such as competing with different parts of the same organization in the market place, has been re-cast as "synergy," spawning ever larger corporations and global oligopolies (Spitzer, 2009). It is not that more regulation is needed, rather, that basic, common law principles need to be respected. Regulators do not need more power, but need the will to use the power they already have.

Markets drive people in business to pursue market share and profits and, in turn, drive business people to respond to these pressures by focusing on ever shorter time horizons as every business aspires to become a monopoly (Spitzer, 2009). Two critical components of effective markets – market vibrancy (competition) and market integrity – ensure the role of the regulator in preventing monopolistic behavior. However, realizing such balance has not been achieved as concentrated economic resources readily translate into political influence. This situation was one which even the eighteenth century mercantile economy (Table I) recognized. Political power exercised by economic interest is dangerous and Adam Smith (1776/1980, p. 359) warned about legislative proposals originating from the business sector:

> [They] ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. Such legislation come from an order of men, whose interest is never exactly the same as the public, who have generally an interest to deceive and even to oppress the public, and who generally have, upon many occasions, both deceived and oppressed it.

Smith (1776/1980) was critical of the mercantile economy and advocated an economy based on maximizing consumer and citizen choice. His proposal was somewhat distorted and became later known as Laissez-Faire capitalism. In fact, Smith (1776/1976), who shared much in common with the founding fathers of the American Constitution, "a blend of republicanism and democracy" (West, 1979, p. 140), jointly promoted the concepts of Laissez-Faire and consumer sovereignty which were radical at the time and led to radical policy implications for his era (Sowell, 1979). In the same vein, this paper, written during the GFC, argues for the comparable radicalization, namely the shift to "social capitalism" (Table I).

System	1. Mercantilism (eighteenth century)	2. Laissez-Faire capitalism (Adam Smith's design for the nineteenth century)	3. Neo-liberal capitalism (late twentieth century)	4. Social capitalism (proposed for the twenty-first century)
Structures	Centralized	Decentralized	Decentralized	Regionalized/ decentralized
Political system	Authoritarian	Representative democracy	Representative democracy	Participative democracy
Markets	Monopoly	Competitive	Oligopoly	Social
Role of capital	Autarky (economic self-sufficiency)	International interdependence through spatial division of labor	International inter-dependency through movement of capital	Public good (socialized capital)
Producer-consumer relationship	Producer push (appropriation of the social surplus)	Demand pull (consumer sovereignty)	Intermediary (through leveraging of debt)	Poly-mediary (multiple interest negotiated sustainability)

Table I.
Paradigm shifts

Historical evidence shows that both Laissez-Faire capitalism and neo-liberal capitalism lead to massive concentrations of economic resources in the hands of a small number of funds, firms and property holders (Wilson, 1989; Jones, 1993). This is evident in many sectors, such as finance, media, energy, technology (Jones, 1993; Kakabadse *et al.*, 2007). Such concentrations of economic resources are often readily translatable into political power, undermining democratic processes.

Even Stiglitz (2010) argues that the finance sector needs structural change and that the "too-big-to-fail" banks need to be broken up. Apart for more and better regulation, Stiglitz (2010) condemned policymakers as incompetent and beholden to special interests. Whilst Johnson and Kwak (2010) argue that unlike the oligarchs in emerging economies, who use overt bribery or blackmail, Wall Street's financiers tools are the soft power of campaign-finance contributions, the revolving door of jobs in government and on Wall Street, and the creation of a culture that equated Wall Street's gain with America's gain. The power of the Wall Street's financiers is visible in a "blank cheque" government approach for dealing with the financial crisis and, in turn, is no less nefarious than the power of oligarchs (Johnson and Kwak, 2010).

For a viable democracy, concentrations of power must be avoided and all participants in the political system require adequate resources to engage fully in the domestic contest (Lindblom, 1977). In globalized work, foreign economic interests are increasingly able to exert influence over domestic politics through leveraging their position as owners (e.g. the Murdoch and Berlusconi influence of the media), investors (e.g. telecom) or creditors (e.g. the IMF; Jones, 1993). Under increasingly complex economic and financial interdependencies, sovereignty no longer enables the state to exert effective policies over what occurs within their territories (Jones, 1993; Keohane, 1995; Klein, 2007). In addition, there is a "loss of effectiveness of state action in the policy arenas of welfare, security as well as culture and communication" (Zuran, 1995).

Today, sovereignty is a "less territorially defined barrier than a bargaining resource for politics characterized by complex transnational networks" (Keohane, 1995, p. 177). Sovereignty has been "de-territorialized" by being transformed into influence over other states through international institutions such as the IMF, WTO, World Bank and many other forms of coercion (Jones, 1993; Keohane, 1995; Saul, 2005; Klein, 2007). The argument that neo-liberal capitalism is an unworkable proposition for the twenty-first century and will lead to major wars for resources currently on the brink is increasingly taking hold.

There is an urgent need to shift to new systems of capitalism – that of social capitalism, where the role of capital is socialized for the benefit of all stakeholders and where investment horizons are long-term – 20-100 years and beyond. Similar to what Smith (1776/1976) recognized, in order to ensure that some necessary activities could not be rendered profitable because of "free-rider" problems, such activities, never the less need to be available to the public – hence the role of government (Rosenberg, 1990). The need for state intervention in setting appropriate frameworks within which social capital can operate has long been recognized and has its powerful advocates.

Socialised capital is preferable to "social capital" (a form of monopolised capitalism), where state expenditures are required for profitable private accumulation (O'Connor, 1993). Socialised capital requires long-term investment expenditures, productive as social investment, social consumption and social expenses. Within monopoly capitalism, social investment consist of projects and services that increase the productivity of a given amount of labour and, other factors being equal, focus principally on increasing

the rate of profit. Further, concentrating only on social expenses consists of projects and services which are required to maintain social harmony to fulfil the state's "legitimization" function exemplified by a welfare system designed chiefly to keep social peace among unemployed workers (O'Connor, 1993). However, within socialized capital, investment is made for social benefit in a sustainable manner, whilst social expanses such as a social welfare system are minimized and employment increased.

The new stakeholder model of capitalism considers capital as well as corporations as "social entities", responsible and accountable to a broader set of actors than just owners – employees, suppliers, local communities and others affected by the behaviour of the company (Sullivan and Conlon, 1997; Kakabadse and Kakabadse, 2001). The "standard of corporation usefulness is not whether it creates individual wealth but whether it helps society gain a greater sense of the meaning of community by honouring individual dignity and promotion of overall welfare" (Sullivan and Conlon, 1997, p. 713). Drawing on notions of socialized capital to guide societal and institutional reform calls into question the urgent need for debate on the following issues (Kakabadse, 2009):

- What financial system do we desire?
- What functions should the financial system perform?
- How should the financial system(s) be governed?
- How should the fragile space between market and non-markets be governed/navigated?
- How does one minimize "the abuse of entrusted power for private gain"?
- How does one transit to new systems of work?

Conclusion

Whether the current financial crisis is the worst financial crisis since the great depression (Pendery, 2009) or whether the situation of the financial sector is not quite as bad as pessimists foresee (Baily and Elliott, 2009), it certainly has significantly contributed to the failure of key businesses, a decline in consumer and pensioner wealth, substantial financial commitments incurred by governments and a significant decline in economic activity. Although both market-based and regulatory solutions have been considered, and some initiatives implemented (Obama, 2009), significant risks remain for the world economy (Roubin, 2009). Government response to the financial crisis, by injecting exorbitant amounts of public funds to re-establish the security of financial markets, is not addressing the fundamental issue of the role of capital; rather it reveals that first, profits are privatized, and if and when they are jeopardized, losses are socialized (Amin, 1996, 2008; Kakabadse, 2009; Leopold, 2009; Prins, 2009). What we face is a growing concern around (Kakabadse, 2009):

- governance – global and corporate (global warming, security, poverty, economic recovery and human rights);
- the impact of social engineering: state/private sector experiments in the privatisation of telecoms, utilities, health; education, corrective services and the bailing out of corporations;
- biodiversity (environmental degradation);
- the adverse effect of financial markets on responsible globalization;

- the revenues corporate elites expropriate;
- corporate social responsibility (responsibility for environments, human rights and labour rights within the organisation/supply chain);
- core societal values; and
- integration needs of people, profit, planet and posterity (4Ps).

These issues need to be addressed as the reality is that many of Smith's (1776/1976) fears have come to pass and call into question the stability of contemporary, liberal economies. In particular, the overly focused specialization of labour with the concentration of capital, particularly in the media (Kakabadse *et al.*, 2007), needs urgent attention. As Smith (1776/1976, p. 50) feared, this led most people to become:

> [. . .] as stupid and ignorant as it is possible for human creatures to become. The torpor of the worker's mind renders him, not incapable of relishing or embarking a part in any rational conversation, but in conceiving any generous, noble or tender sentiment and consequently of forming any just judgment concerning many even of the ordinary duties of private life [. . .] specialization seems in this sense to be acquired at the expense of his intellectual, social and even material virtues. But in every improved and civilized society this is the state into which the laboring poor, that is the great body of the people, must necessary fall, unless government takes some pains to prevent this.

The role of government is to re-design policies so that the market is transformed from oligopolistic to social and the role of capital from international inter-dependency, through movement of capital, to public good through the very socialization of capital; "Business cannot succeed in societies that fail" (WBCSD, 2008, p. 1). Despite the fact that governments issue new regulations and corporations comply by inventing new loop holes, basic governance failure remains as the fundamental role of capital has not changed and the endless cycles of boom-bust-regulations accomplish little in the long run (Ricart *et al.*, 2005; Spitzeck, 2009). The case that the underlying assumptions supportive of shareholder-based, neo-liberal capitalism are false, is gaining in momentum. Private ownership does not result in a fundamental desire for social order and does not lead to an efficient economy (Allen, 1992).

Can there be a paradigm shift, from neo-liberal market economies, modeled on Anglo-American countries and also known as "stock market capitalism," centered on the market and short-term investments, to stakeholder models of capitalism which feature "coordinated market economies" such as Japan and Germany, also known as "welfare capitalism" or "Rhineland capitalism," centered on a regulated banking system and long-term investment policies (Dore, 2000; Hall and Soskice, 2001; Kakabadse and Kakabadse, 2001)? The answer is yes, as long as it is recognized that popular political leverage needs to be exercised as opposed to the current practice of elite, transactional governance reform, masquerading as regulation to protect the public and which is, in reality, self-serving political action to maintain the status quo. In so doing, it equally has to be recognized that the socialisation of capital is dependent on the social structure and government policies of each nation state. Additionally, and irrespective of the cultural diversity effect on political action, the political will to rethink the distribution of power and the active involvement of the citizen in the political process is a distinct requirement in order to fully socialize capital (Serra, 1999, p. 33). Yet, irrespective of the challenge, to continue with the process of minimalist market intervention is likely to

enhance the citizen disenfranchisement and continue with the widening divide between the have's and the have not's (Putnam, 1993). Our contention is that those societies that give consideration to the efficient and effective socialization of capital will enhance civic engagement, political equality, trust, tolerance and diversity (Rice and Sumberg, 1997, p. 105; Freitag, 1999, p. 7).

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