IPSP International Panel on Social Progress

Chapter 6 – Markets, finance and corporations: does capitalism have a future?

Chapter *Chapter 6 – Markets, finance and corporations: does capitalism have a future?* has been updated.

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Markets are widely seen as a source of innovation and dynamism within modern economies, but their relationship to social progress is highly contested. Markets are mechanisms for allocating resources to uses, not for achieving just or fair outcomes. They often promote the well being of some while harming others. Markets have historically coexisted with nation states and transnational regulatory systems which were needed not just to bring about fairer and more sustainable distributions than those arrived at through private ordering, but to create the very conditions under which markets themselves could operate. Beyond textbooks and formal models, markets are not naturally self-adjusting. The legal system, an arm of the state, is needed to secure property and enforce contracts, to protect private exchange from collusion, and to create the conditions for productive organizations to survive and prosper. Without the

legal institution of the corporation, there would be no financial system as we have come to know it, and no possibility of the globalised capitalism that we currently experience. Against this background, we can see how the recent tendency in law and policy to prioritise the shareholder interest above all others is distorting the legal system's historic and essential function of embedding and containing the market. Shareholder-orientated capitalism is leading to less innovation, lower consumption and slower growth, as well as huge inequalities. The corporation is being reduced to an instrument of tax evasion and regulatory arbitrage. We diagnose the root causes of these problems and propose alternative ways of thinking about relations between markets, finance and corporations, as well making as a number of specific policy recommendations.

6 **Summary** (4 pages)

7 This chapter provides an overview and a critique of certain core institutions of capitalism; the market, finance and the corporation. It considers the degree to which they foster or inhibit social progress. For the purposes of this chapter we see social progress as the removal of inequalities in wealth and power and the facilitation of innovation and technological progress from which all people can benefit. The chapter acknowledges that the institutions of capitalism have developed over time, within nation states and in relation to those institutions in other nation states. Their contribution to social progress, or in the alternative, social regression, varies according to historical, political and geographical context, which we aim to show through a number of examples. We show that while globalization has significantly impacted the institutions of capitalism, making them global as well as national in scope, they continue to be grounded within nation states. Throughout the chapter we aim to show the integration of the state and the capitalist economy and the dependence of the institutions of capitalism on the state.

8 The chapter begins with a brief narrative about the nature and scope of the market. We show how attributes of the market, including its tendency to expand, and high productivity driven by labour saving innovations, have created huge wealth. We note, however, that the capitalist market economy has also produced huge inequalities between persons and environmental pollution which disproportionally effect developing nations. The chapter also notes the failure of market modelling in practice, citing the examples of IMF-induced liberalization in many parts of the developing world and the social and economic catastrophe that was the 'shock therapy' experiment in Russia and other transitioning economies. We also note the problems caused by moving the market into areas of social life such as education and health. Social progress is also inhibited by the control powerful market actors can exercise over regulation and

innovation opportunities. Not only does this restrict access by new and potentially brilliant players to realize their vision, it ensures that products are made only for profit. As society becomes more unequal, we claim, innovation become increasingly focused on the desires of the wealthiest.

9 We then go on to consider the corporate form as an institution of capitalism and a legal mechanism which has enabled economic progress and innovation but has also enhanced inequality and social regression. We suggest that in a period where there has been scant economic recovery after the global financial crisis, social regression is likely to be the dominant feature of corporate activity. The chapter considers the historical emergence of the company as a legal person and the development of the share as a fungible and transferable property form. This shift began in the early period of industrial capitalism and was later enhanced by the institution of limited liability. Our analysis notes that shareholders do not own the firm: they emerged historically as outside investors akin to bondholders, and their continued claim to control rights in the company came to be justified in the modern period as a device for reducing monitoring and other transaction costs, or for partitioning corporate assets from shareholders. However, in terms of social progress, the idea that it is the duty of managers to deliver value for shareholders has enhanced inequality and stymied innovation. Increasing value for shareholders has been achieved through lowering pay and conditions for workers in most developing countries, particular the US and the UK, and through utilizing low-cost and often unprotected labour from developing countries in an increasingly globalized corporate economy. A catalogue of human tragedies in the thousands of factories in Bangladesh testify to this, as does the huge and growing disparity between the global wealthiest 1% – mainly based in the global North (Lakner and Milanovic 2015) – and the rest of the world. We show how extracting value from developing countries is achieved by multinational corporations through subsidiaries and through contractual networks. Either form generally protects the parent or lead company from liabilities arising from industrial accidents such as the Rana Plaza. Corporations at the top of global value chains have claimed the vast part of value through rents and claims to the most valuable part of the chain which are frequently protected by intellectual property rights. We consider, among others, the case of large pharmaceutical companies. We show that innovation has been stymied by the market pressure to deliver shareholder value, resulting in more profit being utilized for dividends and share buy backs rather than research and development. In any case, the drive to innovate, which is essentially the drive to make labour more productive, creates both unemployment or underemployment and

more goods which cannot be bought by an increasingly impoverished workforce. Hence there is a crisis, many argue, of under-consumption.

10 In addition, we examine financial institutions, which have become increasingly important and increasingly global. Corporations both rely on access to finance and incorporate financial businesses in their own operations. Global wealth is centrred around global financial hubs and it those centres that essentially decide who will have access to funds. Financial institutions rely on extracting a portion of global wealth and do not extend finance by reference to criteria of social progress. The chapter also notes the growing role of finance in the delivery of public goods and the regressive effects of this shift. The institutions of finance have come to inhibit social progress because as intermediaries between global production and finance they reflect the hierarchies of nation states and thus reinforce global inequalities.

11 Intrinsic to financial institutions, markets and corporate legal structures and activity, is the capitalist state. At a fundamental level, the state protects private property and market exchange. Particularly significant is its role in securing the conditions for the operation of labour markets. Via the legal construction of the employment contract, the state shapes the exchange of values between capital and labour, and ensures the subordination of labour to capital which is essential to a capitalist economy. In the middle decades of the twentieth century this fundamental inequality was tempered by the operation of the welfare state. Since the 1980s, mechanisms of risk-sharing and redistribution which were characteristic of the welfare state have been weakened in many countries. Not just in the labour market but in a number of related economic contexts, there has been a shift away the publicly instituted regulation of the post war decades, in favour of forms of 'governance' suitable for more liberalized and less welfare-orientated economies (Supiot, 2015). In part this is happening because states see themselves as competing with one another for investments and corporate relocations. International agencies which previously operated to contain the destabilising effects of cross-border flows of goods and resources, now actively promote the removal of social and environmental protections which are described as 'non-tariff barriers' to trade.

12 These developments will require, in due course, a systematic legal and political response, which will set limits to markets and re-set the relationship between free trade and the state. We cannot all aspects of the process here, for reasons of space, and because it is still unfolding (indeed, in some respects has yet to begin). To illustrate what might be done in one of the areas which form part of our remit, we conclude the chapter by looking at how reforms to the legal

institution of the company could help reverse the trends we have identified in the earlier parts of the chapter. We show how certain specific reforms could impact on the operation of markets and on finance and financial institutions. We discuss reforms to tackle tax evasion and the obfuscation of wealth which have been enabled by multinational corporate networks gaming regulation and tax law. Our analysis also discusses reforms to protect productive companies from rapacious speculators and shareholders and to consider the claims of employees. We consider reforms to halt corporate lobbying, from Brussels to TTIP. We consider the problems which arise when corporate regulation shifts from public control to soft law and voluntary social responsibility practices. We propose a radical restructuring of corporate decision making which should see the removal of control rights from shareholders. The chapter also proposes reforms to stop companies opportunistically using public funding to develop products for private profit, and then evading tax and using IP rights to extract rents. We suggest ways in which inclusive innovation could be promoted.

13 The chapter concludes in arguing that global corporate capitalism has come to depend upon the perpetuation of inequality both within and between nation states, and as such is inhibiting progress which is truly social. The slow growth which has proceeded from the global financial crisis has enhanced these problems. We conclude that reform which delivers for all people is now both an economic and social imperative.

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14 1. Introduction

15 The collapse of Lehman Brothers on September 15, 2008, was the first institutional domino to fall in the financial crisis that spread from the global North to the global South. It was not the first global economic crisis, for the economic history of capitalism has been steadily punctuated by economic crisis. While the toll of the years 1772, 1825, or 1873 (and many others) may not ring as clearly as 1929 or 2008 in the modern imagination, their impact on the participants of the day was profound and terrifying. Indeed, as Marx first noted, and economists like Kondratieff later suggested, cycles of growth, stagnation and collapse were features of capitalist economies. More modern economic scholars gave this phenomenon the more benign name of business cycles. By the 1990s, some economists, policy-makers and pundits had begun to suggest that business cycles were a thing of the past. We now know that this is not

the case. In addition, economists and politicians are increasingly aware that the dramatic wealth inequalities that exist in capitalist economies and are expanding in the face of dramatic technical change are not transitory but rather represent a systematic feature of the capitalist system. A growing body of research shows the persistent differential impacts on personal prosperity, individual perception and social behaviour, in and across generations. With the rise of moguls, oligarchs, and princelings across many economies, there is a growing discussion of the distortions to the broader social order that arise with massive wealth disparities. Scientific awareness of the multiple links that exist between capitalist organization of the economy and the ecological crisis – conducive to the formulation of the Anthropocene as a new subdivision of geological time – have also pointed the debate in new, critical directions. The capitalist system might suffice for the creation of a plethora of material goods, but it pays scant attention to the fair distribution of these goods and to the unintended consequences of their proliferation. Any economic system has to be judged by not only what it delivers but also by how sustainably, responsibly and democratically it does so – in particular by the degree to which it delivers the capacity for all individuals in a society to achieve safety, dignity, and the potential to thrive.

16 While there are many reasons to question the soundness of the fundamental foundations of the capitalist economic system, it is hard to deny the impact it has had on creating a vast amount of material wealth enjoyed by more people in the world than under any other economic system. Indeed, with the expansion of capitalism in the 1990s, with the addition of China and other countries into the global capitalist economic system, there has been a dramatic 50% reduction in the total amount of poverty in the world (from 43 to 21 percent from 1990 to 2010) that according to the *The Economist* in 2013 tallied nearly 1 billion people achieving at least subsistence levels of wealth. While this expansion is remarkable, recent reductions in poverty are almost entirely based on China's rapid growth.

17 Accordingly meetings such as the 1999 WTO conference are both sites for the advancement of the world capitalist order and the catalytic events for the creation of national and international protest movements against it. A growing group of protestors across the globe have questioned whether the market system fosters the right type of growth: whether the types of exploitation by international corporations observed in Bangladeshi factory collapses, Foxconn suicides, the many other scandals that have not reached international attention and the vast global differentials in wealth are undermining confidence in the market system. These abuses as well as the myriad environmental disasters that have been documented since Rachel Carson's *Silent Spring* – in fact way before – have called into question the long-run trajectory of capitalism.

18 We do not have a complete theoretical or empirical understanding of the (in)capacity of institutions to respond to persistent inequalities and inequities across and between nations. In the shakeout from the last worldwide financial crisis, the interests of the financial elite were protected at the cost of individual taxpayers. This has only sharpened current critiques of capitalism. We now must question whether the problems associated with capitalism, particularly in its current form which sees a prominent role for financial interests and for finance as a mode of governance, threaten the conditions which make capitalism possible in the first place.

19 In order to answer these questions, a first step is to arrive at an agreed understanding of 'capitalism'. There are many extant types of capitalist societies, and at least as many theories of the nature of capitalism. Our discussion focuses on how markets, finance and corporations, although present to some degree in earlier and alternative systems assume distinct roles and functions under capitalism. In the sections below, we will provide a historically focused account of the emergence of the key interlinked phenomena of the current capitalist system. For our exposition of markets, corporations and finance, we will describe the current state of the world, provide a brief sketch of its historical emergence, and provide commentary on both the capacity of these aspects of the current capitalist system to help foster social progress and their tendency to foster social regression. After we have outlined each of the key phenomena of the system, we will then look at a number of specific ways in which institutional change could address some of its shortcomings.

20 Our attention to the historical emergence of corporations, markets, and modern finance is not at odds with the overall goals of this report to diagnose the necessary changes in the world capitalist system that may increase its capacity to deliver well-being and engagement to a broader population of citizens throughout the world. In the alternative they may suggest that piecemeal reform cannot redress the problems we outline. By focusing on the historical emergence of our current system we hope to underline the many ways in which our current world order is contingent on a multitude of historical events (and sometimes accidents) that have critically shaped our economic system. In so doing we do not suggest that the capitalist system does not have key attributes which are present in all the varieties presented in different nation states.

21 We hope that this report will provide a framework for understanding both the broader mechanisms of the capitalist system forward and the changes necessary to make society provide for the well-being of

all. Our analysis is underpinned by the question of whether capitalism has a future, and if so, is it one which is socially progressive.

22 # 2. The Market

23 ## 2.1 The emergence and nature of capitalist markets

24 While once rare, markets are now a pervasive institutional feature of modern life, with a substantial impact on the amount and distribution of resources throughout most developed and developing economies. Today, that distribution is much skewed to the wealthiest. In market-oriented economies, a vast proportion of society's resources are said to be organized to make profits by servicing the individual preferences of consumers. The organisation of this effort is supposed to be accomplished through the functioning of business firms within a wider institutional setting to which many groups contribute including those within the public realm. From the perspective of liberal market principles, market-based economies operate by enabling a set of individuals (variously called merchants, entrepreneurs, speculators, and many other terms across time and societies) to pursue for profit the fulfilment of the needs and wants of consumers in increasingly new and inventive ways. Defenders of capitalism would argue that the collective action of this multitude of profit-seekers leads to the dynamic adaptation of an economy's productive capacity to ever new and better ways of meeting market demand. Schumpeter called the distributed capacity of market economies to innovate in both new products and new processes to deliver products more cheaply 'creative destruction' and suggested that this capacity is one of the innate facts about market-based capitalism (Schumpeter, 1942). Yet it is also an undeniable fact of modern capitalism that it has evolved alongside a particular type of state structure, one which has been designed with the aims, among others, of constituting markets by defining contract and property rights, and of protecting markets against anti-competitive practices. Today's advanced capitalism requires an equally advanced 'market state' to deliver the conditions for capitalism to function (Bobbitt, 2002), including those driving technological innovation (Mazzucato, 2013).

25 Some of the key institutional features of a market economy such as standardized prices, debt, rudimentary commercial paper, as well as standardized weights and measures can be traced as far back as the

third millennium BCE (Hudson, 2010). However, market-based capitalism as we now understand it did not emerge until the 17th century at the earliest (see Braudel, 1977, 1992; Polanyi, 2001). For much of their history, the creation of markets, the determination of who is allowed to participate in them, what can be transacted in them and the concomitant development of an entrepreneurial merchant class have been tied to the needs and institutions of the state and the dominant ruling class, who provided both the legal and social justification for their actions. Markets and market-based capitalism were never (and by extension will never be) divorced from their broader social and institutional setting.

26 Industrialization, which emerged with some force in 19th century England, spread quickly to Germany and the United States, in particular. By these means, most of the key elements of the modern economy came to be established in the developed world. There was a world-spanning network of trade with a well-developed system of finance allowing credit to both large enterprises and small merchants. Crucially there was a market in labour which could be used to create huge wealth from the ideas of innovators and entrepreneurs. Yet these developments depended on the gradual shifting of law and cultural norms. For example, the modern economy required major revisions in the law on usury and a shift in cultural attitudes to the usurious norm of money making money (Hudson, 2010). At various times, there have been restrictions on the trading of goods such as alcohol, narcotics, and prostitution in market settings. While these products and services are imbued with a moral charge, the ability of financiers to offer complex products like collateralized debt obligations or for pharmaceutical executives to raise prices on a dru are determined not by market or economic fundamentals but by broader social understandings of the scope of markets.

27 More generally, it would be incorrect historically to describe the process which led to the rise of the modern market economy as one in which the fetters of the medieval state were simply removed from a rising entrepreneurial class. Alongside the 'free circulation of labour and stock' celebrated by Adam Smith, the first industrial nations of northern Europe depended on what by world standards was an advanced state apparatus for the regulation of the emerging market economy. Among the functions assumed by these early 'market states' were not just the protection of property and contract rights but the creation of institutions for the pooling of risk including the forerunners of social insurance and other aspects of modern welfare states and the institution of shareholders' limited liability. Thus at every stage in their development, modern capitalism

depended on the capacity of states to constitute the market and at the same time to channel its impacts (Deakin and Wilkinson, 2005; Deakin and Supiot, 2009).

28 Capitalism relies on national and international expansion and thus nation states have aggressively pursued free trade and the free flow of capital across many markets and many countries. Moving forward, in the last 40 years there has been a persistent and dramatic increase in the amount of goods and financial capital exchanged between countries. From 2005 to 2015, there has been an 80% increase in world trade and there has been an 800% increase from 1980 to 2015. Products are now routinely produced in multiple steps in multiple countries and a substantial portion of world trade is across countries but within one firm. The financing of Silicon Valley, which originated in massive state funding, now comes from all corners of the world.

29 Some of the earliest economic thought noted the tight connection between trade and national prosperity. Both Adam Smith and Ricardo provided positive theories for how free trade could enrich individuals and nations by allowing them to focus on the creation of products for which they were most capable (i.e. had a comparative advantage), yet frequent stories of abysmal working conditions in developing countries should remind us that the comparative advantage of many developing countries is their willingness to relax the labour standards that reign in the developed world.

30 While the expansion of international trade and international finance has been an important source of growth, the more distinctive source of economic growth in the market economy has been the creation of the scientific-market interface that dramatically increased the rate of innovation in the economy. The early Middle Ages began a period of rapid (and rapidly increasing) introduction of new ideas and products into the economy, but this process began in earnest with the industrial revolution. All of these new tools and products meant that the mean hour spent by a worker in the modern economy produces significant more than at any other time in the world economy. As Marx noted, the driving force of capitalist innovation was to make labour more productive. Economists began to focus on the 'residual' left over in the world economy after accounting for labour and capital inputs and began to realize that it was productivity enhancements, new recipes for making new or old products that are responsible for the majority of growth. Economic theorists including Schumpeter and Hayek suggested that the market economy was particularly suited to introducing these innovations into broad use because it automatically provided incentives for innovators to work hard to identify new recipes. Key to these developments of market-based innovation has been the emergence of a class of innovators,

scientists and engineers, capable of developing new ideas and moving them into the economy. While universities have existed for centuries, their ability to consistently generate knowledge that was exploitable in the economy was a relatively recent evolution. Post-1945, the production of scientific and engineering knowledge became thoroughly enmeshed in the U.S. and other economies through permanent funding for basic research and institutional reforms giving universities property rights for their discoveries (for example, the Bayh-Dole Act in the U.S.).

31 Interestingly, the growing focus of economists on the importance of knowledge inputs into the economy as well as the focus on the post-war world on fostering more academic achievement led to the first crack in market optimism amongst mainstream academic economists. If the production of new knowledge was so valuable for society and business, then why wouldn't business pay for it? One reason identified was that investments in plant and product improvements made by one firm can easily 'leak' out into the broader economy, allowing firms that have not invested in this knowledge to benefit through a 'spillover' and dampening the incentive of any one firm to invest. As the second half of the 20th century progressed, economists realized that externalities (like the spillovers) nearly always cause markets to depart from the socially optimal allocation of resources. Economists also began to realize that efficient markets require full information available to all market participants, yet this benchmark is rarely achieved. Much of the effort of economic theorists over the past forty years has been dedicated to exploration of the ways in which information asymmetries lead to the collapse of markets. While very different in their details, these streams of thought provided documentation of some of the ways in which the market might not be sufficient to achieve the particular goals of a society.

32 Inherent in the ideas propounded by these (and other) economists was faith in the ability of market participants to find the best opportunity for their hard work. This belief in the unalloyed benefits of markets would have a strong hold on the mind of economists and policy-makers for a wide swath of the 18th through 20th centuries, despite evident excesses and failures of markets. In the face of such evidence, market theorists and ideologues consistently pointed to the incomplete implementation of markets instead of questioning, as others did, the capacity of market systems to meet a broad set of social needs demanded by society, or the role of state coercion in constructing market capitalism (Polanyi, 2001).

33 Despite a slow growing awareness of the limits of markets in the economics profession, the hegemony among economists and a broad range of institutions (e.g. the RAND Corporation and the IMF)

developed by the 1970s to promulgate the litany of markets into society-wide and global action, overseeing a dramatic expansion of the number of economies that were set up in a market orientation. From a core of developed economies including the United States and Western Europe, we now see an essential market orientation in the internal economies of nearly every country and every developed and fast developing countries. Despite the success in the diffusion of the market economy and the related alleviation of poverty for a huge number of individuals, the march of the market-capitalist system was not without some hurdles and glitches. First, not all of the expansions of the market economy were made on an entirely voluntary basis. Global institutions like the International Monetary Fund used opportunities of economic crisis to promulgate the existing economic orthodoxy of market capitalism, forcing internal institutional reforms in countries where they provided aid. Most famously when American banks lent heavily and recklessly to developing countries which could not repay them and Mexico threatened to default, the IMF stepped in to provide the means to repay the banks, through "aid" on onerous and socially regressive terms.

34 The role of western economists in the transition of command economies to capitalist economies revealed the vacuity of economic modelling and panglossian ideas about capitalism when put into practice. A number of the transitions to market-based capitalism, especially in Russia, were accomplished through 'shock therapy' where the redistribution of state assets into private ownership was accomplished without regard to equality and social justice. Western economists believed that because private ownership was always more efficient that collective ownership, all property should be put into private hands regardless of whose hands those were. Accordingly those that benefitted from privatization were those in a political position to exploit it. The result was the emergence of oligarchs who were more dedicated to self-enrichment and crony capitalism than they were to the productive use of resources in their economy.

35 Beyond the expansion of markets globally, we have seen the attempt to move markets into areas of social life where they were previously excluded, like education and healthcare. In the U.S. there have been calls for education reform that have ranged from introducing competition (e.g. charter schools) to the introduction of price mechanisms (e.g. the voucher movement and for-profit schools) which invoke economic theory to justify their policy positions. Similarly, a range of healthcare reform proposals have advocated the introduction of prices directly into patient choice behaviour. In all of these debates, the policy makers and the economists backing a plan present highly idealized models of individual choice behaviour that often obscures the cold realities of how markets might operate in

these domains. In the UK, the introduction of the profit motive into such areas as juvenile detention has resulted in the systematic abuse of many troubled young people. It is reasonable and just for a society to consider the allocation of certain goods and services (like health and education), which are critical to the prospering and progress of its polity, to be outside the bounds of market mechanisms which have been consistently shown to be overly sensitive to serving the needs of the privileged where there is wealth and income inequality.

36 ## 2.2 Markets and social progress

37 Markets are embedded in a broader social and economic order and their usefulness in serving this broader social order should be evaluated, at least in part, for their ability to deliver prosperity and social safety to all members of a society. While market economies have frequently provided the scope for disadvantaged groups to advance, the functioning of markets is rarely divorced from politics and this creates opportunities both for the perversion of markets and politics. In considering the role of politics in markets, there is the frequent imposition of regulations and restrictions that benefit existing powerful market actors over the less-powerful, including future entrants. Government officials have developed a vast repertoire of ways to tilt the advantage within a market in favour of actors that are favourable to those politicians including: the provision of local monopolies, restriction of access to capital to individuals that are politically or socially acceptable, licensing restrictions, non-competes, etc. The generation of vast fortunes in the capitalist system provides the scope for existing market actors to create relationships with politicians that ensure their continued profitability through the mechanisms enumerated above. While markets can accomplish many things, they cannot ensure that individual capitalists will be less interested in innovation than rent-seeking. At the same time, one of the forces leading to the corruption in the governmental sphere is the idea that a market-based logic should apply to buying and selling of public influence (Hamilton and Deakin, 2015).

38 One of the most pressing concerns in the operation of market-based capitalism with regards to social progress is the ability to protect future individuals from the impact of the current system of production on the environment. The march of innovation in the capitalist economy has been equally matched by a steady beat of environmental disasters – and by the prospect of geological shift (Bonneuil and Fressoz 2016). This stems from a cultural syndrome of environmental 'disinhibition' which includes, in part, the ability of individuals and firms to pursue profit using resources in a way that are not 'adequately' priced in their production decisions.

39 A broad range of economic literature demonstrates that the most advantaged in the world economy are reaping the lion's share of the increase in wealth generated by the most recent spate of innovations. While there are a plethora of explanations for the recent rise in inequality, the potential for massive inequality is always present in market economies and thus is an issue that we must carefully consider. As we have begun to realize, there are a number of challenges that emerge with the increase in wealth and income inequality.

40 First, the market system of allocation becomes less responsive to the needs of the less fortunate as inequality increases. This has been documented theoretically (Weitzman, 1977), but we are also beginning to see it empirically. While innovations have the potential to impact the lives of all participants in a market economy, some economists have begun to document the increased rates of innovation targeting wealthy individuals, creating a potentially self-sustaining wedge of inequality that market mechanisms have no means of overcoming (Jaravel, 2016). Any market with liquidity constraints will favour ideas with the largest potential for profit (i.e. those focused on the wealthy) even if there are profitable innovations for the less well-off, and this problem increases with wealth inequality.

41 Next, the creation of massive wealth disparities increases the ability of the current privileged class to create roadblocks to the success of the less-fortunate can create problems in allocation through the creation of starker wealth constraints on certain economic actors. While early economic theory suggested that the initial allocation of assets in an economy did not matter as they would be traded to their most productive user (Coase, 1960), there is a growing awareness amongst economists both empirically (Bleakley and Ferrie, 2013) and theoretically (Che, Gale and Kim, 2013) that these allocations do matter. Wealth and income constraints can force people with good ideas and opportunities to forgo them or give them to wealthier individuals with fewer constraints. These basic constraints on the exchange of assets and ideas in society create a growing hurdle for individuals from less privileged backgrounds as wealth inequality increases.

42 Lastly, there is the problem of the increasing environmental costs of our market economy, which is largely based on the burning of fossil fuels. While some market-based mechanisms have been developed to deal with local pollution problems such as sulfur dioxide emissions, the capacity of governments to deliver market solutions to larger geographic areas has been limited. Carbon dioxide emissions currently pose one of the largest issues facing the world. While it is clear that the large-scale emission of carbon dioxide has led to an

increase in the temperature of the globe, it is less clear how to remediate this problem. To make a blanket restriction on emissions would penalize countries that are industrializing now relative to countries (like the U.S.) that were able to burn carbon-based fuels in abundance to fuel their economic rise. On the other hand, determining the allocation of emission rights requires careful political and economic calculations that are almost impossible to make. Nonetheless, the continuation of emissions at current levels could potentially create an environmental disaster which significantly hinders the ability of future generations to enjoy the type of economic and social bounty we have experienced in recent generations.

43 # 3. The corporation

44 ## 3.1 The nature of the corporate form

45 For current purposes we define corporations as legally structured entities engaging in production for the purpose of profit. Most of our discussion will focus on larger corporations operating on a transnational basis. The term 'corporation' or 'company' is ambiguous and can be taken to refer both to the juridical form which is used, among other things, to attribute legal personality to productive activities, or to the organisational structure through which production occurs (for discussion see Aoki, 2010; Robé, 2011; Deakin, 2011). The relationship between the emergence of the corporate form in its juridical sense and the rise of capitalism is a complex one but there is no doubt that there is a close link between them and that the attribution of legal personality to business firms was a historically momentous step.

46 The idea of legal 'personality' more precisely indicates the 'capacity' to hold property and enter into contractual relations. As such, capacity is the gateway to participation in a market economy (Deakin and Supiot, 2009). Many entities, such as states, universities and churches, had legal capacity before the point at which the law recognized that all human beings also, in principle, possessed it. The recognition that 'every human person has capacity' was an invention of the 'age of reason' which coincided with the rise of modern industry and markets in the century from 1750. The natural law thinking which gave rise to the civil law codes, and also influenced the English and American common law, understood legal capacity as a human right which it was the role of the rule of law state to define

and protect. Private law visualized the autonomous legal subject in much the same way as neoclassical economics (a later development by nearly a century) came to understand the individual rational agent (Deakin, 2009).

47 Extending legal capacity, so defined, to trading entities, was highly controversial in part because it was seen as undermining the equal protection extended by the state to all its citizens: according to the jurist Savigny writing at the dawn of the corporate age in the 1840s, 'every individual human person, *but only the individual human person*, has capacity' (Savigny, 2013; see Wijfells, 2009). This is why, to begin with, the corporate form was confined to commercial ventures set up with the support of the state and granted monopoly status in order to fulfill public goals, such as the first overseas trading companies, which were largely instruments of state policy, and domestic utilities in energy and transport. It was not unusual for corporations established for private commercial gain to be time-limited, as in the case of New York's corporate laws of the 1830s, and the ultra vires rule, restricting companies to the pursuit of the objects for which they were founded, was strictly enforced in virtually all jurisdictions well into the twentieth century.

48 Prior to the point where incorporation became generally available for business firms, the assets of trading entities had been protected by a mixture of different legal devices (Ireland, 1999; Harris, 2000). During the industrial revolution in Britain, for example, most manufacturing firms were constituted as hybrids of the trust and partnership forms. They could raise equity capital and issue stock without the need for separate legal personality. The idea that the business firm should operate as a legal person separate from the shareholders and endowed with a 'permanent' existence emerged alongside the identification of the 'share' as an item of property which could be traded in its own right (Williston, 1888). This legal innovation (which occurred in stages in the century to 1850) allowed the firm to retain control over its working capital while providing investors with liquidity. The effect was to shield equity capital from risk, a trend reinforced when, in a related development, it became normal (from the mid-nineteenth century onwards) to recognize shareholders' limited liability (that is, shareholders' immunity from suit, except to the extent of any unpaid equity, for the trading debts of the entities in which they held stock).

49 Today, the legal institutions of corporate personality and limited liability for shareholders are justified as devices for reducing monitoring and other transaction costs, lowering the cost of capital, and facilitating the trading of shares (Armour, Hansmann and Kraakman, 2009). Corporate personality is not confined to these broadly capital-protective functions, however. 'Asset partitioning', it

is argued, shields the firm's working assets against direct control by shareholders and creditors, and so supplies the institutional basis for corporations to become enduring organisational forms (Hansmann, Kraakman and Squire, 2006). The resulting 'capital lock-in' provided the basis for the innovations associated with the network industries of the 'second industrial revolution' of the final decades of the nineteenth century (Blair, 2004). During this period the corporate form also became the basis for modern enterprise liability, and hence for a legally-recognised form of corporate responsibility, in areas including accident liability and environmental law, and for the treatment of corporate profits as taxable income for the purposes of fiscal law, so assisting the financing of the regulatory state (Deakin, 2003). Entities of various kinds, including non-profits and cooperatives owned by customers and workers as well as industrial firms constituted as companies limited by share capital, benefited from the availability of the corporate form, and continue to do so (Adams and Deakin, 2016), although businesses like the mutual building society have largely failed under the corporate form (Talbot 2010).

50 The multi-functional nature of company law means that the solution to the abusive exercise of corporate power is unlikely to be found in the simple abolition of the corporate form. However, it does not follow that measures cannot be taken to limit abuses of the right to incorporate. Techniques for 'lifting the corporate veil' are well understood, and can be applied in the context of fiscal law to limit artificial asset partitioning (as we shall explore in further detail below). In numerous jurisdictions, the law provides that the firm's shareholders may lose immunity from suit in the case of environmental or labour violations. There is no shortage of legal techniques for countering tax evasion and regulatory avoidance; the failure to deploy them is much more the result of lobbying by vested interests than the inadequacy of legal mechanisms (Blumberg and Strasser, 2011).

51 ### 3.2 The evolution of the corporate function

52 In the mid-1960s, most US corporations stated their mission in terms of producing value for communities, workers and the public at large; virtually none referred to maximizing shareholder value as their goal (Jacoby, 2005). In the UK, the industrial relations norm involved corporate decision making in consultation with labour unions and government (Talbot, 2014). However, today, it is normal for the promotion of shareholder value to be the sole objective of corporate mission statements. The current salience of the shareholder interest in the thinking of executives in listed US and British companies is the result of three decades of concerted institutional effort to align the interests of managers and shareholders. The need for such an

alignment is the premise of agency theory, the cornerstone of modern corporate finance, and the guiding principle of corporate governance codes which, from the early 1990s, have spread the essentials of this model, which originated in the USA and Britain, to the rest of the world (Aguilera and Cuervo-Cazurra, 2009).

53 There is some elision in the idea that shareholders are the owners of the corporation and that the managers are, as a result, their agents. Lawyers know that it is misleading to talk of the shareholders owning the firm as such (Ireland, 1999; Robé, 2011), but recognize, at the same time, that the standard corporate contract grants shareholders voice, income and control rights which are unique to them as a group and are not shared with workers or creditors (Armour, Hansmann and Kraakman, 2009). Directors have a duty to promote the corporate interest which in principle may not mean the same thing as maximizing shareholder value, but in practice often does. English case law has tended to respect the principle of shareholder primacy except, on occasion, when it threatens the ability of the company to produce future value. Boards are generally free to take a range of interests into account when setting corporate strategy and may choose to prioritise investment over dividends, for example. However, there are many external pressures that force directors to pursue shareholder value as well as personal incentives (Talbot, 2016). Furthermore, when a change of control is imminent, through a takeover or restructuring, their room for manoeuvre tends to narrow down to a duty to safeguard the financial concerns of the shareholders, at least in the English and American common law; countries with a French or German civil-law tradition tend to be less protective of the shareholder interest (Deakin and Adams, 2015).

54 The corporation is inevitably an exercise in delegation, but it does not follow that a policy of empowering the presumed principals, the shareholders, at the expense of managers and workers, necessarily results in improved corporate performance (Deakin, 2014). Thus there is mixed evidence on the relationship between board independence, generally regarded as a mechanism for safeguarding shareholder interests in the face of strong managers, and corporate profitability. Independent directors on British and American boards appear to be effective, on the whole, in reminding executives of the importance of maintaining investor confidence. They are less effective in setting strategy and in assessing corporate risks, a failing which became apparent in the course of the financial crisis of 2008. In countries with limited experience of independent boards, such as Japan, external directors are confined to an advisory role, and monitoring is internalized at the level of largely autonomous senior management teams. This model, while far from best practice as recommended by international corporate governance norms, has remained largely unaffected by global trends, and has proved

resilient in the face of attempts to introduce features of shareholder-centric corporate governance, including hostile takeovers and confrontational hedge fund activism, into Japan (Buchanan, Chai and Deakin, 2011).

55 The standard corporate governance model in countries such as the USA and Britain has no role for employees other than as contractual counterparties and potential creditors, a view which assumes that labour inputs can be completely contracted for (Easterbrook and Fischel, 1991). This view not only goes against the grain of modern institutional economics, which recognizes the open-endedness and asymmetry of the employment relation (Coase, 1988; Williamson, 1994), but fails to explain the widespread managerial practice of recognising that employees make firm-specific inputs which are at risk if the firm fails, and granting them voice and income rights which go some way to protecting their interests (Deakin and Adams, 2015). In other countries, mostly influenced by German practice, with two-tier boards and a role for employee-nominated directors, employee involvement in corporate governance is not simply a matter for firm practice, but has a legal underpinning. Virtually all legal systems recognize a role for employment protection legislation in protecting employees' investments in firm-specific skills and knowledge, although on the whole the degree of such protection is lower in common law countries than those of civil law origin.

56 It seems, then, that there is no single or uniform view on the issue of corporate purpose (Veldman, Gregor and Morrow, 2016). However, the recent trend in both labour and company law has been to elevate the interests of shareholders over those of other corporate groups, and as we shall see, this has affected all systems no matter which variant of capitalism they have, historically, been associated with.

57 ### 3.3 Corporations in emerging markets and low income countries

58 In emerging and low-income economies, a different set of issues arises. For many inhabitants of these countries, the informal economy and self-employment provide the main source of income. Formal employment is decreasing, or at least not increasing as fast as informal employment, in many parts of the global South, although east Asia has been an exception to this trend for the past quarter century (ILO, 2015)..

59 In the formal corporate sector, subsidiaries of multinational corporations, operating through supply chains sometimes involving thousands of strategic 'partners', are one important source of employment in emerging economies. Such employment is highly targeted, often seeking out particular groups such as young women, who work in manufacturing and assembly plants or call centres, often

located in free-trade zones (FTZ) where special jurisdictions apply. Corporate law in the corporations' 'home' countries is used to offload risk on to these subsidiary companies in low wage economies, with courts in industrialized countries only rarely finding parent companies liable for health and safety breaches and other labour violations.

60 In contrast to seeking to bring more of the inhabitants of middle and low-income economies into the range of formal employment, another approach seeks to turn them into consumers of the products made by transnational corporations. Following the writings of C.K. Prahalad, in what has become known as the Bottom of the Pyramid (BoP) approach, companies aim to produce products and services appropriate and affordable to the several billion people who live on less than $5/day at base of the world economic pyramid, which represents the world population according to its purchasing power parity. In addition, new marketing strategies and sales channels, sometimes involving low-income people themselves as door-to-door sales people, have to be established to reach these proto-customers. Corporate BoP strategies are seen as necessary to open up new markets, but also as very difficult to operationalize and make profitable. How far they contribute to the fulfillment of human needs and to poverty alleviation remains an open question.

61 Emerging economies are also home to growing numbers of indigenous corporations, especially in strategic sectors such as natural resource exploration, infrastructure development and telecommunications. Many of these have been state-owned but under the impact of economic globalization are becoming (partly) privatized, often with part foreign investment. This has important implications for governance structures and employment practices. Countries like India and China have a growing indigenous high-tech industry, often clustered around software, which has been able to adapt to challenging infrastructure or regulatory environments.

62 ### 3.4 The corporation and globalization: the rise of global value chains

63 It is often thought that the current era of globalisation is unprecedented. However, comparing the turn of the twentieth and the twenty-first century we can observe similar levels of integration, that is, in both periods there was a broadly equivalent share of global trade in global production (Baldwin and Martin, 1999; Kaplinsky, 2005). Appearances can be deceptive, though, since lying behind these similar aggregates is a key structural difference in the character of global integration in these two periods. Trade during the deepening of internationalisation in the second half of the nineteenth century was largely in finished products: manufactured

exports from the north traded with commodities from the south, and with manufactures and commodities from other northern economies. By contrast, the rapid growth of global trade after the 1970s was increasingly in intermediate products exported through the medium of Global Value Chains (GVCs). This trade in intermediates in the current era of globalisation dominates the imports and exports of virtually all economies, southern and northern alike.

64 By one measure, more than 80% of world trade now occurs within GVCs (UNCTAD, 2013). The definition of GVCs used to make this estimate refers to the situation in which exports from one country either involve the processing of imports from one (or more) other countries, and/or are processed in the destination country and then exported to one (or more) other countries. Amongst the many ramifications of this explosion in GVC-led global trade is the confusion which arises with respect to output and trade statistics. The Apple iPhone4, for example, retailed in the US for $495 and was exported from China at $175. But 'production' in China was in fact merely assembly, and the value actually added to each iPhone in China was a mere $6.50 (Xing and Detert, 2010). Hence the value of China's net exports of iPhones (and virtually all other manufactured exports) was substantially lower than its gross exports, while its manufacturing value added was substantially below its gross manufacturing output value. Similarly, the screen in each of these iPhones was double-counted in global trade statistics since it was both included in the value of Korea's exports (screens exported from Korea to China) and China's exports (iPhones to the world). Thus it is estimated that the real value of global trade (netting out these double-counted intermediates) was 28% lower than its gross value, that is, $14trillion compared to $18trillion in 2012. There are no equivalent gross numbers which estimate the difference between the gross and net value of global manufacturing. The difference will of course be lower than that for gross and net trade values (since not all manufactures are traded), but will nevertheless be substantial, particularly in economies with large trade/GDP ratios.

65 The origins of GVCs are to be found in new types of corporate strategy which diffused rapidly after the mid-1970s. Increasing competition and the increasing knowledge-intensity of technology led firms to concentrate on their core competences and to outsource non-core links in their chains to other firms. Initially this outsourcing was local, but after the development of lower-cost transport and communication technologies, and following the reduction in barriers to trade in market structures, it took an increasingly global form. Associated with the growth in capital formation and capabilities in the south, this in turn led to rapid economic growth in much of the formerly un-industrialised and low income south.

66 The rise of GVCs has important implications for how we view the corporation and its relationship to both markets and finance. For example, it means that transnational corporations are increasingly able to transfer-price rents by shifting the tax-take from the source to the residence principle. This affects the ability of states to tax transnational companies and it also impact on the global distribution of wealth. GVCs also enhance firms' capacity to source inputs (particularly labour) from the least-cost global sources. This has considerable implications for the distribution of income within the firm (capital and labour), and within individual countries (for example, managerial salaries are often influenced by global rates rather than living standards in the economy in which production occurs).

67 GVCs have led to adverse impacts on labour in the North, as jobs and wages have been undercut by competition from labour in the global South, and the capacity to regulate the firm is diminished as firms operate and optimise on a global scale, whereas governments operate on a national scale. With regard to markets, trade and market entry are no longer governed solely or principally states but increasingly by the corporate sector itself, which imposes standards and which governs access to niche markets. As in the case of taxation, competitions law operates at a national scale, whereas competition and exclusion operate on a global scale. With regard to finance, the financial sector itself has been penetrated by the advance of GVCs, slicing its activities to maximise rents. Many of the valorisation opportunities open to the financial sector (for example, through transfer pricing) are affected by the extension of GVCs in the same way as for the productive sector.

68 ### 3.5 The corporation and innovation

69 As we have seen, innovation is the wellspring which has delivered the sustained economic growth which in turn has greatly augmented the duration and quality of the lives of much of humankind. The origins of innovation are not specific to capitalism, but arguably lie in humankind's quest for power and control – over people and over the physical environment. But although the pace and trajectory of innovation are in part affected by different technological opportunities at particular points in time (for example, steam power in the early industrial revolution and ICT in the contemporary period), innovation is socially and institutionally shaped, including by the nature of corporate structures, the character of markets and the availability of finance.

70 A variety of actors and institutions are involved in this innovative process. The corporation is a central institution. But there are other actors too, including the state, civil society organisations,

community-based innovators and global private sector actors such as the Gates Foundation. These may act individually, or in concert (for example, firms engaging in joint programmes, and public-private partnerships such as GAVI). Significantly, there is also a geographical dimension to global innovative efforts, and this has changed in major ways over the past few decades. Whereas in 1970 only around 2% of global R&D occurred in the south, this proportion has grown to more than 22% in recent years.

71 Innovation can take many forms – there is no single evolutionary process which determines innovation trajectories and the role which innovation plays in social progress. A number of key factors drive innovation trajectories.

72 First, markets are an important shaper. Factor and input prices are important determinants of the character of innovation. Given the locale of most innovation since the industrial revolution, much of innovation has been labour-saving and scale-intensive. The labour-saving character of innovation (central to a Marxian view of accumulation) has meant that capitalism has an inherent tendency towards under-consumption (contrary to Jean Baptiste Say, supply does not create its own demand) and this has contributed to the periodic crises in capitalism (Harvey 2010). The market structures in which factor and input prices are determined (such as taxes on labour but not on natural resources) have both induced labour-saving technological change and contributed to the environmental crisis which we are increasingly living through. There is a massive overhang of unemployment, underemployment and informal sector employment in the global economy. In India, soon to be the world's most populated country, for example, only 10% of the labour force is employed in the formal sector.

73 The demand side is a critical and under-appreciated factor in shaping innovation outcomes. Since innovation responds to purchasing power, and since the overwhelming share of global demand has emanated from high income consumers, innovation has resulted in products which predominantly meet the needs of the wealthy rather than those excluded from the fruits of growth. For example, in pharma, the search for cures has focused on the needs of higher income consumers such as dementia and cancer, rather than on the Neglected Tropical Diseases (NTDs) such as malaria, ebola and zica which affect the lives of hundreds of millions of the human population. An important development in recent decades has been that in higher income economies, the satisfaction of basic needs has increasingly led to consumer demands for greater product variety and differentiation, and hence user-pulled innovation has played a growing influence on the character of innovation. At the same time,

the growth of incomes in the south has meant that user-pulled innovation in these economies has the potential to contribute positively to spreading social progress globally.

74 In addition, a combination of the growing knowledge-intensity of technology, inherent economies of scale in some sectors (particularly in process industries) and the development of grid infrastructure (particularly in energy) has underwritten the geographical unevenness of development in the global economy and the rise of urban living. A countervailing tendency to this global division of labour in recent decades, particularly in manufacturing and agriculture, has been the growth of global value chains which now account for three-quarters of global trade. Corporations have increasingly invested in their core competences and have outsourced the production of many inputs as well as the processing on some outputs to global suppliers and customers. This has contributed to the stagnation of development, increased inequalities and created the largest ever global proletariat. China is an exception. Here it has been an important driver of growing technological capabilities particularly of rising per capita incomes. Indeed, almost all of the reduction in the number of the global absolute poor has occurred in China since 1990.

75 A third shaper of innovation is time preference. Financialisation has significantly shortened the time-horizons of corporate investment in innovation with a growing reluctance of firms, particularly in the financialised Anglo-Saxon economies, to invest in long-term R&D. The reluctance to engage in long-term innovative investments is one of the reasons why the corporate sector is currently sitting on such large stockpiles of liquidity.

76 Fourth, since innovation in capitalism is driven by the profit motive, this results in an underinvestment in public goods, that is, in those goods which the corporate sector finds difficult to appropriate. This has particularly important implications for social progress. For example, in the pharma sector, R&D is concentrated on curative products (which can be 'owned') rather than preventive medicines (where the fruits of innovation cannot be appropriated easily). Related to this, the failure of market-determined pricing systems to force innovators to internalise environmental externalities has meant that innovation has frequently been environmentally damaging.

77 Fifth, the consequence of a number of these drivers of innovation (for example, the growing demand in high income economies for differentiated products and the failure to price externalities into innovation outcomes) has been the development of an environmentally destructive throwaway society. Overpackaging is

endemic in market-intensive sectors, and instead of a culture of producing long-life products capable of repair, contemporary corporate structures have led to the innovation of short-life disposable products.

78 Sixth, particularly in recent decades, the myth has been propagated that virtually all innovation arises from investments by the private sector and that the state should withdraw from this realm of economic activity. In reality, virtually all recent technological developments of significance have arisen from prior investments in the state sector. Linked to this, the development of publically-supported knowledge generation in educational systems is critical to the sustaining of innovation. The reality is that not just does much of innovation affect the actual or potential generation of public goods, but innovation is in many respects itself a public good. That is, left to the market alone, there will be a systemic tendency towards the underinvestment in R&D and other inputs which foster innovation.

79 Finally, a critical factor which has determined the pace and trajectory of innovation and which has had particularly important (and generally deleterious) impacts on social progress has been the military imperative. Although the origins of this driver of innovation transcend economic systems (and are to be understood in humankind's search for power and domination), there are nevertheless important interactions between innovation, militarism, the corporations and markets. Many of the world's largest corporations – as well as their suppliers and customers – earn a significant share of their profits from producing products for the military sector. In some cases, firms are wholly oriented to the production of arms, but in other cases such as aerospace, production of weapons underwrites their capacity to innovate products for the civilian sector.

80 ### 3.6 Contemporary challenges: the corporation and inequality

81 A growing body of evidence links certain features of the contemporary corporate form to rising inequality. Econometric analysis suggests that laws and regulations strengthening shareholder protection leads to increases in inequality, as indicated by a fall in labour's share of national income and a related increase in the share taken by dividends and profits (Deakin and Adams, 2015). Restructurings resulting hostile takeovers and hedge fund activism are diminishing the capacity of firms to provide stable employment linked to seniority, as was common until the 1980s in the USA and other developed countries. More generally, the strengthening of shareholder rights, when coupled with declining levels of union membership and collective bargaining coverage in many industrialized economies, might be expected to lead to reduction in

the relative bargaining powers of shareholders and workers, and to reduce the power of organized labour to capture part of the surplus from production. It is also notable that the labour share has been going down even while labour productivity has been increasing. Between 1973 and 2014 labour productivity in the US grew by 72% but wages for the average worker increased by just 9% (Oxfam, 2016).[3]

82 A feature of inequality not captured by data on the labour share is that even within the diminishing portion of national wealth taken by wages rather than profits, an increasing amount is taken by very high earners in corporations, whose pay and benefits are linked to share prices through the use of stock options and bonuses. The theory was that linking pay to performance as measured by share prices would help mitigate agency costs. There is little evidence of this, as even adherents of the theory have concluded, but the pay of senior executives has multiplied exponentially as financialised modes of executive pay have become the norm. Between 2000 and 2014 the median total earnings of CEOs of companies the FTSE 100 (that is, the top 100 companies by market value listed on the London stock exchange) increased by 278%, while the rise in total earnings for full-time employees was only 48%. In 2000, a FTSE CEO earned 47 times more than an average full-time employee; by 2014 they earned 120 times more. The pay of US CEOs has increased by 54% since 2009, while that of ordinary workers has been stagnant (Incomes Data Services, 2014).

83 A related feature driving inequality is the rise of the financial industry. This has exacerbated the general trend towards earnings inequality which has been a feature of the US economy since the 1970s and of Europe since the 1980s. The rise of the financial sector is driving inequality between professions, and also causing geographic disparities, both within and between states. Wealth is increasingly concentrated in global financial centres, most prominently London, New York, Tokyo, Singapore, Hong Kong and Shanghai.

84 Although business firms ultimately depend for their existence on national legal systems which grant them entity status and provide state protection for corporate assets, including intellectual property rights, globalization has created new opportunities for corporate power to transcend the nation state. Global production is dominated by multinational corporations which often have subsidiaries in dozens of nations and operate through supply chains sometimes involving thousands of strategic 'partners'. However, these multinational businesses are not always the networks they are often supposed to be, but vertically integrated structures in which power is vested in the parent company. Corporate law is used to offload risk

on to subsidiary companies in low wage economies, with courts in industrialized countries only rarely 'lifting the veil' of corporate personality to find the parent liable for health and safety breaches and other labour violations.

85 The rise since the 1980s of retailer or 'merchant' corporations echoes the legal form and mode of operation of the charter companies of the early modern period, which used layers of vertical contractual relations to extract value from foreign trading while avoiding ultimate legal liabilities for their activities overseas. Today, a company like Nike does not engage in production of its own; it contracts with producers, mostly in low-wage markets (Nike suppliers operate in over 600 factories in south and East Asia), to supply the goods which it markets and sells (Harvey, 2010).

86 It is part of the strategy of global garment brands to ensure that suppliers compete on price, so directing them into a strategy of making savings through low wages, job insecurity and hazardous working conditions. The Rana Plaza disaster, discussed later, in which over 1,000 garment workers were killed when a factory building collapsed in the Bangladeshi capital Dhaka, is simply one of the more visible results of this business model. The brands which used the products made at factories such as Rana Plaza are customers at the end of a long chain and are not legally responsible for working conditions on overseas sites.

87 # 4. Finance

88 ## 4.1 The notion of finance in capitalism

89 The notion of finance is overtly ambiguous. It can denote a particular body of technical knowledge or academic science concerned with the valuation of economic assets, the assessment of investment strategies or the development of financial instruments and techniques (this is the meaning of finance found in expressions such as 'financial analysis,' 'corporate finance,' 'quantitative finance,' or 'financial engineering'). The notion of finance can also refer to the actual organisation of the banking system, and to the processes, actors and institutions that shape money provision policies (as in 'financial institutions,' 'financial regulation,' or 'financial markets'). This meaning can be extended to governmental budgetary processes and the management of public money (as in 'public finance'). The notion of finance can finally convey the mundane meaning of

handling money for the purpose of household life (as in 'personal finance'). Finance can therefore be considered as a multifaceted set of institutions, mechanisms, practices, actors, instruments and ideas whose common feature would lie in their relation to the distribution of money in society.

90 For the purpose of assessing its impacts on social progress – and without abandoning a comprehensive understanding thereof – we focus here on a definition of finance that corresponds to what has been often termed the 'global financial industry,' that is, the set of interconnected financial institutions (commercial and investment banks as well as other financial establishments such as insurance companies, and central banks) that control today the largest portion of the circuits of credit and investment worldwide. Finance encompasses both the actual organisation of this set of interconnected financial institutions, and the worldviews, policies and measures that they produce and inform.

91 Finance has a long history. An assessment of the present situation certainly requires awareness of the multiple and changing forms in which money, credit, debt, funding or capital have functioned in humanity (Graeber, 2011). There is however considerable agreement on two broad facts that define the present situation. The first fact is that the capitalist economy, understood as a system in which the means of economic activity largely rely on private ownership and profit, has progressively come to play a dominant role in the organization of society worldwide (Braudel 1992; Polanyi 2001). From commercial banking and credit institutions to investment management and insurance, the financial services industry has come to play accordingly a crucial role in economic life in advanced liberal democracies and, to a lesser extent, in so-called 'emerging economies.' The second fact is that the contemporary evolution of the financial services industry is characterized by the emergence of what has been labelled 'global finance,' and which consists in an internationalized network of financial institutions characterized by a tendency to capital-intense oligopolistic concentration (Abdelal 2007; Fligstein 2001; Ouroussoff 2010; Woll 2014). This correlates with observable shifts in the organisation of power relations, in the form, for example, of the formation of global financial elites or the importance of phenomena of regulatory capture and regulatory oversight in the financial sector.

92 ### 4.2 Contemporary international financial dynamics

93 From the perspective of international dynamics, the global expansion of the financial industry and its increasing role in the organisation of the distribution of monetary resources are subject to controversy so as to their contribution to economic growth. Countries that have

embarked on the expansion of their financial industries nationally – in particular rich countries in Europe, the US and Japan – have not only known little GDP growth in the last thirty years, but have also experienced growing inequalities. A similar situation has derived from the 'lost decade' of the 1990s for developing countries that opened their economies to global financial flows, in the former Soviet bloc, in South-East Asia and in Latin America. India is somewhat an exception, since the expansion of stock markets accompanied high level of growth since the early nineties, but this has occurred within an economy that is notoriously disconnected from global financial flows. At the other side of the spectrum, China, with a nationalized financial industry under explicit control of the government and of the Communist Party of China, has experienced drastic reductions of poverty and unmatched levels of long term GDP growth (Aglietta and Bai, 2012). It is still under debate whether finance played a negative or positive role in each case, and whether these developments are not mostly independent of the financial structure. The answers lie most likely in a nuanced combination of positive and negative effects and on the acknowledgement of the impact of several interdependent and independent variables.

94 In Europe and the US, in the 1970s and 1980s, regulatory changes (often designated by the name of 'deregulation') contributed to the expansion of the role of the financial industry in the distribution of monetary resources without the guidance of government (Aglietta, 2000; Abdelal, 2007; Coriat, Petit and Schméder, 2006; Krippner, 2011). This was followed by similar changes in Japan and most of the low and middle income countries, in Latin America, Africa, South-East Asia and the former Soviet bloc. For the latter, except Japan, the aim of the transformation was to partake in global financial flows that were expected to enhance growth and reduce inequalities. The several crises of the 1990s and early 2000s, in Mexico, Russia, South-East Asia, Argentina, Turkey, and in the US with the Internet bubble, to name a few, did not necessarily stem the regulatory trend. The expansion of global regulatory bodies, in particular around the Basle agreements, was structured around the main principles guiding this regulatory trend: the creation of markets where the financial industry would be able to operate freely, albeit with certain rules of transparency and risk management, the latter most often based on the industry's own standards (Huault and Richard, 2012). The financial crisis of 2007-2008 was the occasion of a temporary revision of this trend, in particular of the lack of separation between investment banking and the rest of the banking system, and in general concerning the inability of governments to control the risk exposure of industry actors (Admati and Hellwig, 2013, Engelen et al., 2011; MacKenzie, 2011; Stockhammer, 2015; Tett, 2009; Woll, 2014). Yet, the obvious negative economic consequences of the last crisis, for almost a decade now, have not really stemmed this trend,

as the minor regulatory changes in the US and Europe attest. In many developing countries, the focus has shifted from accessing global financial flows as primary source of growth to profiting from the economic expansion of China by participating in its global trade circuits. The consequences of this on regulation and government are still to be seen, with varying cases in Latin America, Africa and South-East Asia. In any case, the debates about regulation do consider as a premise that the current financial organisation has been mainly fostered by regulatory changes since the demise of the Bretton Woods agreements, and that it remains a political issue how to deal with the role taken up by the financial industry since then.

95 ### 4.3 Contemporary issues: financialisation and austerity

96 A number of researchers in economics, management science, political science, sociology and anthropology have used the notion of 'financialization' in order to characterize the growing role of finance in the organisation of the firm and in economic conduct at large. This term covers three partly interrelated, partly independent processes (Van der Zwan, 2014): a particular organisation of the economic system where the financial industry occupies a central role in the distribution of monetary resources among firms and between firms and the rest of society (see also Epstein, 2005; Krippner, 2011); an orientation of business management that gives priority to shareholder value above other concerns, such as labour rights, human rights and environmental and social responsibilities (see also Fligstein, 1990; Froud et al., 2006); the growing presence of credit and financial pressures in the everyday life of the majority of the population, as exemplified by the extension of mortgages before the US 'subprime crisis,' but also by the extension of microcredit, among others (see also Deville, 2015; Langley, 2008; Mader, 2015; Martin, 2002, Schwittay, 2014). These phenomena have an impact not only in the concrete distribution of monetary resources, among firms, between firms, and between companies and the rest of social activities, but they also impact the legitimacy of different discourses about the organisation of society, limiting social and political imagination to models where finance occupies a central role.

97 The concept of 'austerity' is essential for an assessment of the role of finance in the present situation. It gained political prominence with the 'neoliberal' revolution in the US and the UK in the 1980s, stressing the need to limit the economic size of state-funded activities, through programs of privatization of public resources (see Birch, 2015; Blyth, 2013; Davies, 2014). Several analyses highlighted the expansion of this rationale through the notion of 'New Public Management', and the negative impact of these policies in the quality of public services such as health, transport and education in the UK, for instance (Hood et al., 2004; Pollitt and Bouckaert, 2011).

98 Since its initial application in the UK and the US, the concept became central in the redefinition of the notion of development standing at the centre of the programs funded by the World Bank and the International Monetary Fund. Since the 1980s, financial crises, in particular related to government debt default and currency collapses in poor or middle income countries, led to help by these organisations that was tied to the condition of applying 'structural adjustment programs' consisting in state budget reduction and privatizations. This led to the 'lost decade' of the 1990s in most of the countries where these programs were applied, in Latin America, South-East Asia and Africa, and to a lesser legitimacy of the concept in the early 2000s, in particular after the South-East Asian crisis of 1997 and the Argentinean crisis of 2001, in countries that had avowedly followed strictly IMF conditions. The growth of the early 2000s in countries that detached from these policies, notably profiting from the extremely high growth rates of China, further discredited the concept. The case of India offers a rare example of the application of IMF policies ensuing in high levels of growth since the early 1990s, in a context where these policies where nevertheless applied along with a strong presence of the state, which virtually owned until recently almost all the banking system, and with growing levels of inequality. Yet, the concept has reappeared to decry or justify the policies proposed or imposed by the IMF and the European Union to help financially the countries of the Eurozone that were affected by the 2007-2008 crisis, in particular Ireland, Portugal, Spain and, most notably, Greece.

99 ### 4.4 Finance and social progress: financial power, inequality and sovereignty

100 It is evident that, thus broadly defined and contextualized, finance entertains a crucial, yet complicated relationship with social progress. On the one hand, the provision of credit within society certainly stands as a central requirement for the progress of human life, social cohesion, personal liberty, environmental sustainability and world development. Money is thus featured, in a number of liberal and progressive philosophies, as part of a project aiming for a society of equal and independent individuals (Hart and Ortiz, 2014). Contemporary financial institutions, which stand as crucial intermediaries that facilitate the circulation of monetary credit and the allocation of capital, are thus expected to fulfill a crucial role in the attainment of social progress. On the other hand, financial rationales translate into the establishment of hierarchies between what is deemed financially valuable and what is not, which ultimately results in the establishment of social hierarchies and power cleavages. Money thus does also appear, in a number of critical

accounts, as the prime vehicle for inequality and domination, and the global financial industry is indeed often signalled, more precisely, as a threat to social progress.

101 The expansion of finance in the last thirty years is indeed marked by the difficulty to assess its impact on social progress. On the one hand, it is considered that whatever benefits of the massive global integration of trade circuits exist for global social progress, these benefits depended partly on the availability of globally circulating funds that have been mainly managed by the private-sector financial industry. At the same time, the countries with higher economic growth and poverty reduction, i.e. China and India, have not participated in the expansion of the financial industry which has been mainly directed from the US and Europe. And those who have participated in this expansion (e.g. Europe, the US and Japan) have experienced low growth and growing inequality. The many countries that integrated global financial flows since the late 1980s and early 1990s in Latin America, South-East Asia and the former Soviet bloc, experienced a severe contraction in growth and so reverted this trend in the 2000s mainly through commodity exports and their participation in Chinese economic growth. On the other hand, it is possible to claim that indeed finance allows the global North – and particular the US – to maintain its position in the global order while developing countries have to accept what finance they can get on whatever terms they are given (Norfield, 2016).

102 Recent analyses of growing inequality in income distribution, in particular in the US and Europe, have shown that the expansion of the financial industry has been accompanied by a very rapid increase of income for the higher levels of management in that sector. The statistical impact of this trend on total income inequality is actually very significant, and it attests to the magnitude of the change (Atkinson and Bourguignon, 2000, 2015; Godechot, 2012; Piketty, 2014; Picketty and Zucman, 2014; Saez and Zucman, forthcoming). This income inequality is not just between professional groups, but also geographical, within states and between states. Global financial centers have continued to accumulate wealth, in London, New York, Tokyo, Singapore, Hong Kong or Shanghai. This has contributed to geographical inequalities, between the countries hosting financial centers and those that don't, and inside the countries and even the cities where these centers are hosted, between their locations and the rest of the territory. In many cases, this has contributed to reinforce geographical inequalities inherited from the 18th and 19th centuries' colonial distribution of financial centers. In other cases, it has allowed certain locations to rise as regional financial centers, such as Johannesburg, Singapore, Hong Kong, Shenzhen and

Shanghai. Managing these inequalities implies a complex balance between local and global politics (Sassen, 2006; 2012; Leyshon and Thrift, 1997).

103 The major potential impact of finance for social progress comes from the concentration of monetary resources in the hands of the financial industry since the 1980s. Managing pensions in the US, and savings of middle classes in most rich countries, the financial industry has the capacity to impose hierarchies and orientations in economic activity, by granting credit at different levels of cost, potentially all around the world. Professional methodologies of valuation, analysis and investment are today gathered in a common body of officially sanctioned rules of practice often referred to as 'financial economics' or 'quantitative finance,' which have gained scientific legitimacy in part due to the fact that some of their authors have obtained reputable academic awards such as the Nobel Memorial Prize in Economic Sciences (Bernstein, 1992; MacKenzie, 2006). The debates concerning the role of this type of finance techniques oppose two views. That favoured by regulation in most rich countries, by mainstream academics and by the industry itself, considers that these methods render financial markets close to informational efficiency, thereby allowing financial prices to convey accurate information to other economic actors, and ensuing in a distribution of monetary resources that most approaches social optimality. The other view considers that these methods only give priority to investments that have a short term monetary profitability, which is incompatible with the need for long term investment in public utilities which offer low or even no monetary profit, such as education, health and heavy infrastructure, such as roads and communication networks. Yet the latter are a pre-requisite for economic growth and social progress. The development of public-private partnerships has aimed at bridging this gap, giving rise to concerns about the possibility that this would be public subvention for private profits without further gains in efficiency. The debates remains locked in the fact that, since the financial industry needs short term profitability to survive in the long term, it has serious limitations to address long-term social investment. The very small scope of experiments with impact bonds, microfinance, and social or ethical investment only highlights these limitations.

104 Since the creation of bond and stock markets in the wake of European colonial expansion, the growth of the financial industry has been also closely tied to its capacity to collect private capital to finance sovereign debt. In the US, Europe and many countries of Africa, Latin America and Asia, the Bretton Woods agreements provided the frame for a growing issuance and international circulation of sovereign debt instruments. For most countries in the world, state budgets are unthinkable without the use of government

debt. Yet, there are different scenarios that do not allow for a clear-cut assessment of the impact of this symbiosis between private finance and public management concerning social progress (Kolb, 2011; Lienau, 2014). The US stands as a unique case, the global prominence of the US dollar giving it the right to fund the federal budget by issuing debt beyond the means affordable by any other country. Its financial strength has enabled it to force developing countries to open up their borders for trade or risk being cut off from finance. Protection of this power accounts for US ambivalence to the Asian Infrastructure Investment Bank established in China in 2014. The US unsuccessfully sought to persuade South Korea and Australia from joining and was critical of the UK's then Chancellor George Osbourne's announcement that the UK would apply to join the bank. The Japanese state has been able to issue debt reaching a ratio to GDP unmatched by any other rich country, but which is funded almost exclusively by Japanese big banks and insurance companies, thereby isolating government budgetary decisions from foreign, i.e. not nationally elected, pressure. The Chinese and Indian economies, which have almost closed off their sovereign bond markets to international investors, are in a similar situation. Most other countries lie in the middle, and while some manage to find cheap funding to orient their budgetary decisions according to internal political aims, in line with the idea of democracy, other governments find their policies more or less directed by global private creditors, which are then accused of countering democratic will. In general, this lack of democratic scope is most prevalent in the poorest countries, i.e. those in most need of investment to alleviate poverty and inequality. The impact of finance in these countries is therefore most often criticized as being negative both for long-term investment and for the democratic process itself.

105 The role of finance in the distribution of monetary resources is the object of several controversies concerning the fairness and legitimacy of the social hierarchies that it contributes to create by allocating credit in selective and therefore unequal ways. The rise of finance since the 1980s, in the US, Europe, Japan, Latin America, South-East Asia, India, Africa, the former Soviet bloc, and even, to a lesser extent, China, was premised on the general idea that it would allow for a distribution of credit close to social optimality, due to the free interplay of maximizing investors in markets that regulation needed to ensure would be informationally efficient. Thus, social progress was at the centre of the project, at least in discourse, and the explicit shift of political power from states to the financial industry was legitimized accordingly. In particular, after the end of the Cold War, finance was presented for several years as a major tool for the adoption of an economic system based on competitive

markets that was itself supposed to be a central foundation of political democracy. Three decades later, the results of this call to finance have had mixed results at best.

106 In the US and Europe, the negative effects of the last financial crisis have been obvious and undisputed, but did not lead to a major revision of the role of finance in the allocation of monetary resources, except for the policies of quantitative easing which were partly aimed at bailing out the financial industry itself, while the lower and middle classes continued to experience a relative loss of income and higher inequality. This has led to the accusation that the financial industry has captured regulatory bodies and central banks, which cannot propose radical policies that would go against the industry's interests (Huault and Richard, 2012; Varoufakis, 2011). The role of the financial industry in the political fragilities of poor countries and the return to mild forms of dictatorship in most of South-East Asia and in Russia, for example, have put into question the ability of finance to claim political legitimacy. In the Eurozone, the IMF has been accused of overriding the results of elections and even referendums in Greece, in the name of financial rationales. According to some analysts, just like in the 1930s, the rise of anti-democratic sentiments can therefore be itself blamed on the insistence of the financial industry to obtain short term returns from sovereign debts against the will of the electorate. In all these cases, the case for finance being a factor of democratic governance is being jeopardized to quite an extent.

107 ### 4.5 Finance and social progress: basic human needs

108 The global financial industry connects with the issue of human needs in general only as far as the latter can be the object of monetary profit. The concern is thus whether human needs are best addressed through non-for-profit or through for-profit economic management, irrespective of whether this latter occurs in competitive markets or through state-backed oligopolies or monopolies, as is often the case. International institutions have developed the field of 'project finance' as a way to draw for-profit managerial methods, deemed more efficient, to conduct the development of basic infrastructures concerning human needs such as health, food and water. Yet, this only concerns minor volumes compared to those managed by the financial industry at large, and they fall within the same limits highlighted above: either the projects are profitable, or they must be made profitable through state support, which means a transfer of taxes that requires close democratic scrutiny. The lack of investment in poor and middle-income countries as compared to rich countries, where most of the financial markets are concentrated, attests to the difficulty for the financial industry to venture into risky areas, deeming it more prudent to invest hundreds of billions of US dollars

in the US subprime mortgage market, which can eventually be bailed out by the Federal state, than in war-torn Democratic Republic of Congo, where much smaller amounts could have a much bigger impact in terms of access to health, education, food, water and, ultimately, peace.

109 Agricultural production is increasingly being perceived as an asset class by the financial industry, treated with the same methods of valuation and investment used for stocks, bonds and derivatives (Cheng and Xiong, 2014). This has led to the massive purchase of land and the reorientation of production towards profitable and, especially, standardized markets that can be monitored at a distance by fund and asset managers (Clapp, 2014; Fairbairn, 2014; Isakson, 2014; McMichael, 2009, 2012; Russi, 2013). This has favoured forms of production, such as the use of GMOs, and choices of crops that may hamper local access to basic commodities and that may not always take into account the need for less intensive agriculture in order to sustain the quality of the land in the long term. The expansion of agriculture land and logging at the expense of tropical forests, following this same logic, may also create environmental and social problems in the future. The development of carbon-credit markets has been proposed as a palliative, where state regulation and limits to investment can be traded to preserve land that would otherwise fall into this short-term investment perspective.

110 Food distribution also raises a number of issues for the understanding of the impact of finance in addressing human needs. The first issue concerns the management of distribution of food through global markets for commodities that are today inherently linked to global financial markets through the massive use of options and futures. This has been shown to lead to sometimes rapid and strong swings in food prices, depriving poor populations of access to basic commodities. The food riots of 2007-2008 around the world were a stark reminder of the limits of the current pricing system and its dependence on short-term valuation methods developed by the financial industry (McMichael, 2009). The second partly related issue concerns the tendencies to obesity in rich countries and in the middle and upper classes of middle income and poor countries, while about one person in eight, or roughly a billion people, live under the threat of malnutrition according to FAO standards. The financial industry could have an impact in the orientation of funding for a better distribution of better food. Yet, this would only be possible with clear return expectations or with state guarantees. So far, finance has followed the strategies of big corporations and even increased their need for short-term return, with lobby and investment more oriented towards sales than towards healthy and evenly spread access to food. State regulation seems to be the only check on this trend so far.

111 Finance also plays a role in the way a basic human need such as peace is addressed. The concern with tangible short or at best mid-term monetary returns has rendered the financial industry very weary of engaging in terrains with high uncertainty. The professional difference between 'risk,' deemed calculable, and 'uncertainty,' deemed unforeseeable, has justified the eviction of entire regions of the planet from the 'investment universe' of the industry, and the imposition of prohibitive high rates of return for regions marked by war and strong social conflicts. On the other hand, the industry has continued to finance corporations deemed able to obtain returns in those regions, such as the weapons industry, the oil industry and mining. These latter are often themselves part of the factors leading to conflicts, and in that sense the financial industry has not contributed to peace, except for the marginal disinvestment strategies of ethical funds, for instance.

112 However, the last thirty years have experienced a massive global financial integration. The central case in point is the accumulation of US-dollar denominated reserves by the People's Republic of China. This has led to a fundamental interdependency of the two biggest economic powers in the world, which seem on the other hand increasingly pitched against each other for the control of resources around the world, a trend that has obvious military components in the South-East China Sea, but that has already implied political instability and the support of authoritarian governments in Africa, South-East Asia, Sri Lanka, and elsewhere. In this confrontation, financial interdependency, mediated by the production and management of financial securities, may be considered a factor of peace and stability, which was for instance absent in the opposition between the two blocs during the Cold War. Besides this case, this financial integration, fostering global trade relations, can be considered to have mixed results. On the one hand, it has fostered a global interdependency that pushes governments to negotiate. On the other hand, through the policies of the IMF, the World Bank, and now through funding by the Chinese Development Bank and other Chinese banks, certain authoritarian governments, and the conflicts they sustain, have found renewed funding.

113 ### 4.6 Finance and innovation

114 Finance has almost become a synonym for innovation, at least in high-value potential sectors such as biomedicine and technology. As such, it accompanies ventures that are often presented in terms of progress. Venture capitalism and innovation investment at large appear today, in many accounts, as the 'bright side' of financial capitalism: concerned with 'long term' futures and concentrating on 'value creation' in the real world. That said the literature points towards two limits: finance may partly fail from sorting desirable

from less desirable innovations according to social progress criteria, and fail also from putting sustainability into the equation. An assessment of this problem can benefit from a focus on biomedical and pharmacological innovation.

115 A most critical link between biomedical and pharmaceutical innovation on the one hand and social progress on the other resides in the capacity to tackle urgent global problems, such as Neglected Tropical Diseases (NTDs), that can offer the currently dominant system of innovation policy and its alternatives. The current system is characterized, to quite a large extent, by a patent regime of intellectual property protection and by financial techniques of project valuation and investor protection. Both aspects have received abundant attention in the literature, and are market by scientific and policy controversy. In legal and economic scholarship, patents are commonly considered as more efficient than other approaches to innovation policy. As a form of property rights, patents act as channels between potential customers or users, potential innovators, and potential investors, guiding investment toward projects with the prospect of value creation, and securing return. A number of scholars have nonetheless identified problems and failures of this system from both an allocative perspective and from the viewpoint of social progress, and explored alternatives that could provide efficient alternatives but which tend to fail from proving viable in a context dominated by the patent system (Fisher and Syed, 2006; Kapczynski and Syed, 2013; Lezaun and Montgomery, 2015). The standard methodologies of financial valuation that determine the value of a pharmaceutical innovation from the point of view of an investor have been also criticized in the literature, with particular attention to the drawbacks of discounted cash flow (DCF) analysis, which tend to devalue exploratory innovation (Christensen, Kaufman and Shih, 2008; Hartmann and Hassan, 2006). Overall, the imperative of economic viability that any innovation faces, including innovations that may fall within the domain of NTDs, for example, is today heavily marked by the requirements of finance, that is, of a mode of distribution of monetary resources that, in order to function, needs to contribute to the maximization of return on investment.

116 ### 4.7 Challenges to mainstream models of finance

117 Recent evolutions of contemporary financial capitalism have been characterized in the literature by a turn to moral values as a possible palliative to the threats posed to social progress by the excesses of financial rationalities, with a focus on rules of good practice and economic activism in financial services. Notions such as ‘corporate social responsibility’ (CSR) and ‘socially responsible investment’ (SRI) have permeated today mainstream corporate cultures, both inside

and outside the financial industry. These are scrutinized in the relevant literature as vehicles for the development of a socially and environmentally virtuous rationale in capitalistic enterprises but also, critically, as stratagems to legitimatize forms of corporate conduct that are in reality still driven by profit maximization (Banerjee, 2008; Fleming and Jones, 2013; Ghadiri, Gond and Brès, 2015; Gond and Crane, 2010). Comparable considerations can be observed in the case of Islamic banking and finance (Maurer, 2012; Pitluck, 2012), microfinance (Schwittay, 2014) or corporate philanthropy (McGoey, 2015). And a similar logic can be identified in debates around the development of ethics curricula and measures in business education. Ultimately, discussions revolve around whether the financial industry can integrate moral and political aims in its operations that do not infringe on its need to obtain profits to survive and that impact the distribution of monetary resources in the sense of greater social progress. Given the varieties of actors, in these debates, the definitions of morality and social progress are diverse and not always compatible.

118 Overall, the global financial industry seems to be confronted today to a series of moral and political critiques that locate in its most defining rationales the engine of both the widening of social inequalities and the endangering of democratic order (Piketty 2014). Responses to the moral and political quandaries of finance that emerge from within the financial field proper have provided only limited insights.

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119 5. The state

120 5.1 The nature of the capitalist state

121 There has been enormous debate across the social sciences about the nature of the capitalist state and of its relationship to firms and markets. As we have seen, one view is that it would not have been possible for labour and capital markets to come into existence without state-based institutions of a particular kind, including a legal system identifying property and contract rights as the subject-matter of market-based exchange. There is significant theoretical and historical evidence for this view (Deakin et al., 2016). However, the functions of the legal system are not confined to defining private property and contract, nor, conversely, is the law the only locus of institutional development under capitalism.

122 There are many extant types of capitalist society, and at least as many varieties of the state under capitalism. Historically, capitalism is associated with a number of interlinked social and economic phenomena, the core of which is the emergence of a particular type of production, based on wage labour, and a specific variant of finance, identified with equity capital, each of which arose in a distinct institutional context.

123 According to Marx, the form of the employment contract under capitalism is the source of capitalist dynamics, which implies, on the one hand, inequality and exploitation and, on the other, innovation and technological change. What the worker sells to the capitalist is not finished labour but labour capacity or power, and the gap between what is contracted for in the market, and what the capitalist firm then extracts from the worker during the process of performance, is the basis for the capitalist's profit. This surplus is the property of the capitalist firm and, residually, of the shareholders, and so is the basis for the creation of capital in its strict sense, that is, equity capital. Equity capital is fungible and transferable, so scaling up the allocation of scarce resources to alternate uses. In a capitalist economy, debt changes its function and mode of operation: it coexists with equity capital, is complementary to it in various ways, but ultimately serves it and follows its logic.

124 The rise of wage labour can be more or less precisely dated to a process which began in the economies of western Europe in the early modern period, that is, in the long transition from feudalism which began in the fourteenth century, and came to fruition in the nineteenth-century 'age of industry'. The institution of wage labour implies the 'subordination' of the worker within the capitalist firm and, more generally, the social stratification associated with the appearance of a working class, a proletariat, with no direct access to the traditional means of production and subsistence (the land and the family). The members of a working class, so defined, are required to sell their labour power under conditions of inequality: in a capitalist labour market, 'capital hires labour', not the reverse. This was not a natural or spontaneous process, but one which, at every stage, involved the creation of an apparatus for governing labour market relations associated with the rise of nation states with significant regulatory and tax-raising capacities (Deakin and Wilkinson, 2005).

125 While 'debt' may be as old as human society itself (Graeber, 2011), equity finance is a modern phenomenon, which is traceable to the first appearance, in seventeenth century Europe, of the institution of joint stock. Equity capital enables the surplus generated by production to be freed from its connection to material assets. Through the creation of forms of intangible property, that is, shares

and similar corporate securities, the surplus becomes fungible, that is, tradable in a market setting. This makes possible its redistribution across different uses, hence the allocative role of the 'capital market'. Again, this would not have been possible without a series of legal and regulatory innovations (Harris, 2000).

126 In short, capitalism is identified by a particular conjunction of labour markets and capital markets which is underpinned by the state through the legal system as well as complementary institutions including systems of taxation and public finance. Without these special types of markets and the institutions underpinning them, we might observe various forms of commodification and exchange, and we may witness inequality and exploitation, but we wouldn't observe capitalism as such.

127 It follows, for example, that the economies of the Soviet type were not an authoritarian variant of capitalism (as is sometimes suggested), since they did not have a wage labour system (labour was directed and wages did not perform a resource allocation function) and did not have capital markets. There was exchange and there were markets of a sort but they operated informally and, until near the end of the Soviet Union, illegally, as the state did its best to suppress private property and did not allow private enterprise to operate in the formal economy. It further follows that China today is, in essence, capitalist, having largely made the transition to a system of wage labour, accepted the legitimacy of private enterprise, and promoted the operation of capital markets (even if these do not entirely resemble their counterparts in the west).

128 In mature capitalist systems, the capital market does not exist simply or even primarily to finance firms. Instead finance becomes a universal mode of regulation, the function of which is to evaluate societal projects. This idea finds its clearest expression in contemporary finance theory, which sees firms' retained earnings as, in principle, dead capital which should be freed up ('free cash flow') through takeover bids and restructuring, or through higher dividends and share repurchases, so as to permit an economy-wide reallocation of resources of the kind credited, for example, with having created Silicon Valley and America's economic revival in the 1990s. The idea that the same mechanism of reallocation should apply across society and not just the economy is behind the contemporary marketisation of public health and education services and the introduction of various 'private finance' initiatives into the public sector. In today's financialised economies, the role of the 'market state' in underpinning the role of finance as a mode of governance has become critical.

129 ## 5.2 The state and political power in contemporary capitalism

130 One of the most important messages from recent research in economics and political science is that economic and social outcomes depend crucially on the interaction between economic and political institutions. It is the interplay between political institutions and processes and those of capitalism, i.e. goods and services markets, financial markets, labour markets, corporations, judicial systems, and government regulations, which shapes the extent to which there is social progress in terms of less unequal societies, better social outcomes and greater well-being for most people. Participation in the political process and empowerment are part of social progress.

131 In standard theoretical economics the functioning of a capitalist economy is studied in abstraction from its interactions with politics and structures of power. In that respect the theoretical findings do not show any specific tendencies of a capitalist economy to generate inequality or handicap social progress. In such theoretical analysis the initial distribution of wealth and of property rights is given exogenously and a capitalist market economy generates efficient outcomes. The major insight is that market systems and private incentives produce the most efficient economic outcomes. Such outcomes should allow achieving better social outcomes and improve social well-being. Distributional issues are handled outside this framework.

132 But empirical evidence and experience have consistently shown that economies do not function according to the ideal competitive markets considered in theory. Monopolistic behaviours and dominant positions are most common and often tend to perpetuate themselves. They tend to lead to continuous accumulation of wealth which often translates into political power.

133 More recent empirical, as well as theoretical, research has focused much more directly on the interactions between politics and economics. The effects and outcomes of capitalist systems depend crucially on how politics work and on the political power structures. This research tends to show the possibility of emergence of different equilibria of political and economic outcomes, depending on initial conditions as well as the way the political system and its institutions work. This literature has been based on a few general empirical and historical observations over the last century.

134 First, many historical episodes in advanced countries, especially during the first half of the twentieth century, showed how the political process can induce changes which correct tendencies which started to emerge since the second half of the 19th century towards more inequality and concentration of power. The democratic process has led to political coalitions and access to power of political parties and leaders who introduced various reforms which limited and even

reversed the tendencies towards higher inequality and concentration of power: anti-trust laws, pro-labour union laws, labour protection laws, social security reforms, banking sector regulations and so on. This led to the emergence of the welfare state with a heavy role for government in the functioning of the economy.

135 Second, more recently a reverse process has been observed in some advanced countries. Since the 1980s the political process has tended to contract the role of government, deregulate and intervene less. At the same time income and wealth inequality increased, which led to more concentration of political power, and policies more heavily influenced by the wealthy. This interaction between more concentration of political power and influence on the political process by the rich, and increased inequality tends to perpetuate itself and gets reinforced. Large increases in inequality have been observed in many advanced countries where this process has been ongoing. This is not in fact to say that there is less regulation, indeed there is probably more. It is that the modern, or neoliberal regulation attempts to facilitate rather than inhibit capital (Picciotto, 2011).

136 Third, the study of long term development and the causes behind success and failure of countries to develop and become wealthy has provided insights as well. While the experiences in most developing and emerging economies are not those of capitalist systems as they emerged in western countries over the last three centuries, they are of interest. These experiences show how the nature of political institutions shapes economic institutions and behaviours and development outcomes. They show in particular whether and how political institutions are supportive or not of the emergence of capitalist institutions. Most often the political systems are most consistent with economic institutions which are not open or competitive and property rights are not well defined and enforced. They favour the perpetuation of situations of inequality and little social progress for the masses for the benefit of the few. These are cases of failure of development. On the other hand, the experiences of success in development over the last century have not been clearly associated with the emergence of full-fledged capitalist systems. While some features such as private property rights, private enterprise, open markets, and integration into the global economy are found in such experiences one cannot argue that they were complete capitalist systems which were behind the success. Often enough the role of government was critical, and many features not usually associated with capitalist systems played a significant role.

137 The general implication is that capitalist institutions do not work in a vacuum. They are shaped and influenced by the way the political process works, and they in return influence this process. The central institutions of capitalism require rules and institutions in order to

operate effectively. And it is the political process which generates and adapts these rules and institutions, which are critical for the effectiveness as well as the distributional consequences of a capitalist economy. These rules and institutions pertain to some of the fundamental features of a capitalist economy: the allocation and enforcement of property rights, the nature and extent of enforcement of competition in markets, the nature of contracts and their enforcement, the rules for liability and the nature of corporations and business companies. It is the variety of such rules and institutions which gives rise to the variety of capitalisms we observe.

138 ### 5.3 The evolution of the public sphere under capitalism: from social state to market state

139 Capitalism, evidently, has evolved since the first emergence of wage labour and equity finance. The employment contract, which for Marx was the main site of exploitation and the source of social stratification, has over time had attached to it various social rights beginning with the right to workers' freedom of association and extending to characteristic institutions of the 'welfare' or 'social state' including social insurance and labour legislation in the areas of health and safety, employment protection and equal treatment. This process was the result of the extension of the democratic franchise to the working class and was more generally coterminous with the emergence and stabilization of the institutions of liberal democracy including the practice of legal autonomy or the 'rule of law'.

140 The mode of operation of the social state is to mediate and channel risks which are inherent in the operation of a capitalist labour market: subjection to the power of another in the workplace; exposure to the risk of loss of income through unemployment, illness, age; and social discrimination in the labour market and at work (Deakin and Wilkinson, 2005). The welfare state qualifies capitalism, but also, in a fundamental sense, both presupposes it and endorses it. There is nothing in social insurance or protective labour legislation to alter the fundamental 'subordination' inherent in waged labour ('subordination' is the condition for 'protection' in labour law discourse).

141 More generally, the welfare state captures part of the 'surplus value' created by capitalist modes of production and applies it to the financing of various public or collective goods through the medium of the nation state. This is the Polanyian 'double movement' (although whether it exactly happened in the sequential way suggested by Polanyi (2001) is much debated). Modern public finance, in drawing on the surplus from production, through income tax and corporation

tax, to fund universal health care and public education systems, along with the rest of the apparatus of government, reinforces, and does not undermine, the logic of capitalist forms of production.

142 Is (or perhaps was) the effect of the welfare state to mediate between capitalism and the human person, and so to make capitalism more sustainable, and perhaps more tolerable? Almost certainly. This was the explicit purpose of the welfare state according to many of its proponents, and the result it achieved for most of the twentieth century. The provision of public goods sustained market economies, while the reduction of social conflict associated with the rise of industrial production ensured that capitalist firms could operate with minimal interruption.

143 It may be too soon to use the word 'was' to describe the welfare state, but it is beyond doubt that it has suffered a serious erosion over the past four decades, which may be attributed to many things such as changing work patterns, the narrowing of the tax base, the decline of the nation state, the freeing up of capital flows, and the growth of international trade. Together with this erosion or decline has come an increase in social inequality and a perception that the nation state is losing its capacity to deliver on its social guarantees. This is prompting societal disorder and political fragmentation in parts of the global North, and, with the assumption of public office by authoritarian political parties, is beginning to put liberal democracy into question.

144 In the global south, the picture is rather different, and there is a case for saying that in middle income countries, the welfare state is being constructed or reconstructed as part of the process of accommodating the move to market-based forms of economic organisation. There is a good argument for suggesting that this is currently happening in China, which has recently seen extensive reforms to social insurance and laws instituting and regulating the employment contract. But as China's case also shows, the process is incomplete, and slow to take hold. Nor does China recognize the western liberal model of the rule of law. In some middle-income countries, progress in building the institutions of the welfare state, alongside those of a liberal democracy, has been intermittent and subject to periodic reversals. This has been the experience of most of Latin America over the past century.

145 What has happened to the relationship between the welfare state and capitalism which has put the functioning of social guarantees into question in the global North? Social rights are a charge on the capitalist firm, so even if firms collectively benefit from the provision of public goods including orderly industrial relations, individual profit-seeking enterprises will take whatever opportunities they can

to minimise or avoid social or fiscal commitments. Nation states, themselves competing, as they increasingly see it, to attract capital, have begun to collude in this process, either tolerating regulatory avoidance, or openly encouraging it according to theories of efficient 'regulatory competition'. International institutions designed to build cooperation between nation states and avert a destructive 'race to the bottom' are currently at a low ebb. The linking of trade liberalisation to the acceptance of generally applicable social and environmental standards was a founding principle of the International Labour Organization and of the European Union in its original manifestation. This principle has been undermined by the growing tendency in international economic law to characterise social and environmental regulations as 'barriers to trade'. It can be seen in the practice and jurisprudence of the World Trade Organization and, increasingly, of the EU itself, as well as in numerous regional trade agreements, such as NAFTA, and in bilateral investment treaties, such as the proposed Transatlantic Trade and Investment Partnership (TTIP).

146 At the same time, there has been a debate over the purposes of the corporation, which has played out in the context of company law. The idea of shareholder primacy, although contested, has gradually taken hold since the 1980s. It is associated with developments in corporate finance including the rise of hostile takeovers and more recently the salience of hedge fund activism in the US economy and its growing presence elsewhere. These are various ways of reasserting the original claim of capital (the 'shareholder' in fact has many identities) to the residual from production.

147 The exclusion of worker well-being from anything more than an ancillary result, or by-product, of the operation of the capitalist firm, rather than one of its objectives, has been justified in various ways: as a technical precondition for the operation of the firm, without which workers' interests would ultimately be harmed; as an inherent feature of (shareholders') private property rights; and as the unavoidable consequence of the need to promote innovation-based technological change. Whatever the precise justification given, the effect is to disembed the corporation from its societal context, and to bring about a radical reordering of its goals. As the social state declines, the logic of finance as a mode of resource allocation and, ultimately, of social organisation, takes its place, and the transition to a financially focused 'market state' becomes more evidence (Bobbitt, 2002).

148 ## 5.4 Contemporary trends in corporate governance: shareholder and worker rights in advanced and emerging economies

149 Since the early 1990s, two global trends in corporate governance laws and regulations can be identified. The first is an increase in the enactment of legal protections for shareholders. This trend is consistent across common law and civil law systems, and across countries by reference to their level of development, although the overall level of legal protection remains higher in common law countries and in developed economies. The second trend is one of relative stability in the laws governing employee protection and codetermination rights, with a decline after 2008 (Deakin and Adams, 2015). Thus the picture is one of stagnation in labour rights worldwide, while the rights of capital were being significantly strengthened. The global crisis which began in 2008, although originating in the financial sector rather than in the labour market, has not led to a reversal of this trend; if anything, with the recent fall in labour protection, it has intensified it.

150 The intention behind these policies was that shareholder protection would lead to increased efficiency in capital markets, while stabilizing or retrenching worker rights would lead to an improvement in labour market outcomes, as measured by increases in employment and productivity. The recent development of methods for consistent and transparent coding of changes in corporate and labour laws makes it possible to assess whether these policies have been successful (Armour, Siems and Deakin, 2016).

151 In cross-national panel regressions, after controlling for GDP growth and for differences in the institutional environments of countries, a rise in shareholder protection does not consistently predict a higher level of financial development. There is a correlation, which in some models can be interpreted as a causal relationship, between increased shareholder rights and the level of stock market capitalization in common law countries. In civil law countries there appears to be no similar effect, which suggests that a model of shareholder protection which originated in the common law (or 'liberal market') countries has not translated well into the civil law (or 'coordinated market') systems (Deakin, Sarkar and Singh, 2011).

152 It also appears from econometric analysis that legal reforms are more likely to have an impact on stock market indicators in developing markets than in developed ones (Deakin, Sarkar and Singh, 2011). . This suggests that there may be less leeway for shareholder-centric reforms to change financial outcomes in systems with already mature stock markets.

153 The deregulation of labour law, meanwhile, has no consistent relationship to improved labour market outcomes. Instead, emerging evidence suggests that a higher level of employment protection is correlated with improved productivity and employment outcomes,

and also with a higher level of innovation, as proxied by patenting activity (Acharya et al., 2014). There is some evidence to suggest that strengthening shareholder rights leads to a reduction in reported levels of innovation, measured in the same way (Belloc, 2013). Meanwhile, an increase in worker rights is correlated with greater equality (proxied by a higher share of national income taken in the form of wages and employee benefits), and increased shareholder protection with its opposite (a lower labour share) (Deakin, Malmberg and Sarkar, 2014).

154 We are learning that the recent global consensus on the need to protect the rights of capital while attenuating those of labour has not worked entirely as planned. Shareholder-centric corporate governance was meant to lead to more transparent and responsive management, and to improved corporate profitability. In systems where this model has been taken the furthest, it has succeeded in tilting the balance of power in favour of shareholders and against both managers and workers. Executives are more sensitive to capital market pressures and the disciplinary effect of hostile takeovers and hedge fund activism is tangible.

155 However, this system has not led to the expected increase in equity capital as a source of investment to drive growth. Since the 1980s, in the USA and the UK (but not elsewhere), outflows of capital from listed firms to shareholders, in the form of dividends and share buy backs, have been outstripping equity flowing into the corporate sector in the form of IPOs and new share subscriptions from already listed firms (Henwood, 1998; Lazonick, 2014). It would seem that much of the capital released from the corporate sector through takeovers and restructurings, coupled with regular shareholder pressure for dividends and buybacks, did not support productive investment, but was used to sustain asset prices in shares, until those bubbles finally burst with the onset of the global financial crisis.

156 Also revealing is growing evidence of an inverse relationship between shareholder protection and innovation (Acharya et al., 2014). This appears to be related to managers' reluctance to commit to long-term investment in research and development when faced with growing pressures to maintain shareholders' returns.

157 The conclusion to emerge from the empirical literature on corporate governance, then, is that the strengthening of shareholder rights has effects which are not uniform across different national or regional varieties of capitalism, or by reference to levels of development. More generally, though, this evidence tells us that increasing shareholder protection does not necessarily lead to more productive corporate investment. Particularly in the developed world, it is more likely to lead to asset price inflation and financial turbulence.

158 # 6. Reforming the corporation

159 In this part we analyse a number of specific ways in which corporate laws and regulations, together with related practices and practices of business firms, are currently hindering social progress. We focus on reforming corporate law and regulation is because these are the structures within which most financial and non-financial market exchange takes place. In each case we review what is known empirically about the social and economic impacts of corporate activities; discuss existing reform proposals; and set out our own suggestions for reform. The specific issues we consider are those relating to (1) secret wealth and tax evasion; (2) takeovers, leverage and restructuring; (3) corporate lobbying and influence over the political process; (4) corporate social responsibility; and (5) the corporation and innovation. This is not an exhaustive list of the issues we might have considered; space precludes a more complete treatment. They are, however, illustrative of the potential for social science analysis to address problems arising from the current corporate model, and to propose alternatives.

160 ## 6.1 Secret wealth and tax evasion

161 The ability to create a new legal person in the form of a corporation or company that can have legal existence anywhere in the world has enabled individuals and companies to engage in huge wealth hiding activities (Talbot, 2017). Gabriel Zucman (2015) has meticulously calculated the total amount of wealth that is legally hidden as $7.6 trillion. Company law provides the structures which enable this secrecy. These include shell companies. The US Securities and Exchange Commission define the term 'shell' company to refer to a publicly held company with no or nominal assets other than money. Shell companies have no fixed business assets, but exist as a front for the operations of other entities. Company law also permits the construction of the nominee directors and shareholders to keep secret the identity of those who actually control and own companies. In addition it enables companies to incorporate in low tax jurisdictions by having a figurehead director who signs forms and appears to be engaging in management while the real decisions are made outside this jurisdiction. Obfuscation is a thriving business. A routine Google search in 2016 revealed that there are thousands of agencies offering to set up nominee directors or shareholders (Talbot, 2017). The standard rate is around £400 in the UK. The US state of Delaware alone hosts millions of such operations. A single building in Delaware will routinely act as the registered office for hundreds of thousands of these companies.

162 The issue here is not just the hiding of wealth. It is also about evading and avoiding tax. Tax evasion, the non-declaration of assets and earnings in order to pay less or no tax, is a crime. However, corporate tax avoidance, structuring corporate networks in order to reduce tax liability is legal, but is so endemic and enabled by global corporate capitalism that it has become a highly publicised global scandal.

163 Taxation within nation states is based on one of two principles (Kaplinsky and Davis, 2016). First is the 'source' principle, according to which a state will tax on the basis of the location of an actual economic activity. The second is the residence principle, according to which persons pay tax in the jurisdiction in which they are resident. Because multinationals will have economic activity in many places in which they are not resident, it was early recognised that such companies could be taxed twice, which was considered likely to retard global growth. The double tax convention was drafted in 1927 by which time thousands of tax treaties were in place to ensure that incomes were only taxed once. However, it soon became apparent that this measure could be used to ensure that tax was not paid at source *or* at residence. For example, companies incorporated in the United States, where tax is based on residence (place of incorporation) could transfer valuable assets to countries where tax was based on economic activity (determined by seat of management). The use of complex corporate groups has enabled multinational corporations to organise the business across the globe so as to avoid or reduce tax. Jurisdictions with low or zero corporate taxes have been pivotal to such schemes.

164 The use of complex corporate groups has enabled multinational corporations to geographically locate the most profitable part of their value chain in regimes with low corporate tax. The LuxLeaks tax avoidance scandal, revealed in 2014, showed that up to 340 multinational corporations, ranging from Ikea to Pepsi, had funneled profits through Luxemburg, thereby reducing their tax to as little as 1 per cent. Another well-known example is that of Boots after it was acquired by Kohlberg, Kravis Roberts & Co LP (KKR). The company through which KKR purchased the company was re-incorporated in Switzerland. The purpose of this restructuring was to locate the profitable parts of Boots in a low tax regime, while the debt incurred by the company in acquiring Boots was located in the higher tax regime of the UK. Estimates on tax avoidance in the UK ranges from the Tax Justice Network's of £30bn a year to the HMRC estimates of £120bn a year.

165 Transferring valuable assets within corporate networks is very difficult to regulate. Asset transfer is particularly easy for IT corporations whose value in intellectual properties is easy to move and difficult to evaluate. Monitoring the thousands of transfers has

proven impossible. Microsoft, Hewlett-Packard, Apple and Google are just some of the corporations that have cropped up as massive tax avoiders. Using figures from 2013, Zucman calculated that one third of corporate profits in the US are made abroad and 55% of that total are 'made' (through asset transfers) in zero or low tax countries (the Netherlands, Bermuda, Luxemburg, Ireland, Singapore and Switzerland). This puts corporate tax avoidance in the US at about $130 billion every year.

166 A 2016 Oxfam report showed that in spite of the various initiatives and political rhetoric around corporate tax evasion, it is, in fact, on the increase. It estimates that the loss of tax revenue to developing countries is at least $100billion per year (Oxfam, 2016). This hits the poorest while meanwhile the indigenous wealthy hold their wealth in offshore tax havens. Oxfam's analysis of the 200 biggest global corporations (who are also World Economic Forum's strategic partners) showed that 9 out of 10 'have a presence in at least one tax haven' and that in, '2014, corporate investment in these tax havens was almost four times bigger than it was in 2001' (Oxfam, 2016: 20).

167 The latest and perhaps greatest revelation about the hiding of assets and tax evasion in offshore havens has been the Panama Papers. An anonymous source provided an estimated 11.5 million documents from the Panama-based, German law firm Mossack Fonseca which specialises in providing off shore accounts to its clients. It revealed details from thousands of clients and implicated nearly 10,000 UK and 3,000 US companies and nearly 2,000 UK financial intermediaries including banks and accountants. 500 banks and their subsidiaries registered nearly 15,600 shell companies with Mossack Fonseca. HSBC accounted for over 2,300 companies UBS 1,100, Société Générale, 979, the Royal Bank of Canada 378, Commerzbank 92 and Credit Suisse 1,105. Oxfam's Report of 11 April 2016 showed that of the 68 companies that were lent money by the World Bank's private lending arm (IFC) in 2015, to finance investments in sub-Saharan Africa, 51 used tax havens with no apparent link to their actual business.

168 The scale of the scandal is global. The Panama Papers name over 70 states, and heads of states in Argentina, Iceland, Saudi Arabia, Ukraine and United Arab Emirates are personally identified. In some cases political leaders who had been active in maintaining the status quo were identified. The British Prime Minister at the time of the disclosures, David Cameron, was seen to have benefited from an offshore investment fund, Blairmore, controlled by his father. The then executive chair of the UK tax authority HMRC, Edward Troup, was a partner of Simmons and Simmons, the city law firm which acted for Blairmore when he was still a partner. In the late 2000s Troup led the opposition to reforms put forward by the then Prime Minister

Gordon Brown to curb corporate tax avoidance. The integration of politicians' self-interests and their role as policy makers is also demonstrated by then Prime Minister Cameron's lobbying for trusts to be excluded from the EU Anti Money Laundering Directive (on which see further, below).

169 *Current reforms and their shortcomings*

170 As part of their implementation of the EU Anti-Money Laundering Directive, EU countries are due to introduce central registers of corporate beneficial ownership no later than 2017. The UK was committed to doing so by June 2016. However, an amendment to the Directive in 2015 provides a mechanism to hide the identity of beneficial owners through nominee directors if states, after having exhausted all possible means, find that there are no grounds for suspicion. Furthermore, the UK's concern to exclude trusts from the register is enabled by drafting which the Tax Justice Network (2016) has described as 'restricted, ambiguous and squirrelly'. Excluding trusts creates a serious loophole in the whole initiative which the tax avoidance industry will rush to exploit. It also seems that the UK register will not include British tax havens.

171 In 2013 the G20 leaders endorsed an Action Plan on Base Erosion and Profit Shifting (BEPS) and over the following 2 years the OECD produced 13 reports on the issue. These reports contained proposals to reform tax rules to ensure that multinationals are taxed according to `where economic activities take place and value is created' – 'Country-by-Country Reporting', a concept developed by tax activists as the most effective mechanism for garnering corporate tax. BEPS was also concerned with asset pricing transfers, tax treaties and tax havens.

172 The European Commission's proposal for their version of a Country-by-Country Reporting has been criticized by the Tax Justice Network. Limitations on the data required, they argue, exclude the scale of companies' investment, and will not allow the public to track their activities. Too much data is lumped together so that the 'failure to require a list of subsidiaries, means that it will remain impossible even to know what business a given multinational group is doing, and in which country' (Tax Justice Network, 2016). Multinationals which are established outside the EU will be subject to 'different' obligations, almost certainly precluding public reporting. So by excluding non-EU jurisdictions from reporting, the Directive creates an incentive to use non EU profit havens (Tax Justice Network, 2016).

173 *Policy proposals*

174 We propose that registers of beneficial ownership should be compulsory, publically available and should not have exceptions which can be exploited. Tax havens are adept at creating legal forms that can hide beneficiaries, and avoid liabilities including tax making keeping this activity under control a priority. For example, the Isle of Man Purpose Trust Act 1996 enabled the creation of 'non-charitable purpose trusts' (Beckett, 2016). These trusts can be created by companies with no named beneficiaries for the purpose of holding shares in those companies. They can exist until some triggering event, written into the trust, terminates the trust and the shares return to the original company. This defeats all current initiates to discover and hold liable company beneficiaries. According to Beckett, 'no enforcement mechanism … will be the slightest use if the structure under investigation has in fact no beneficial ownership at all'.

175 Country-by-Country Reporting should provide a clear picture of where business takes place and where value is created. This would help developing countries in a chain or part of a corporate network – in which the majority of the value is likely to have been made – to assess their claims against corporations. It would also assist trade unions as the full extent of companies' contribution to global wealth became more evident. However, a genuine commitment to tackling tax avoidance should not end with disclosure but with sanctions of sufficient proportion to affect tax avoiding behaviour. Sunlight can show you where the dirt is, but it won't clean it up. Disclosure and transparency have not reduced many of the tax havens' ability to enable tax avoidance. In the OECD's report of global tax transparency, many tax havens ranked higher for transparency than the mainland. The Cayman Islands, The Isle of man and Guernsey all scored higher than the UK mainland.

176 Corporate tax avoidance could be tackled by an all-state agreement on the rate of corporate tax with sanctions against those states that continue to set their own rates. There are both conceptual and procedural difficulties in tackling corporate tax evasion in this way. Conceptually there is the problem of undermining sovereignty. Tax is one of the ways that the state can redress social deprivation and environmental destruction. Progressive tax regimes allow social inequalities to be addressed, cradle to grave, from the provision of free childcare to free adult social care. Less edifyingly, tax policy is also used to garner votes and to favour some groups in society over others for political purposes. For various reasons, individual states are protective of their right to levy taxes where they see fit. Tax is an important part of government policy. However, in respect of corporate tax, this is a part of a state's sovereignty that must defer to the broader aim of tackling global tax avoidance. While different rates of corporate tax are set in different jurisdictions, the corporate

form can be used to take advantage of this, depriving countries in which they really operate of the means to address its citizens' needs – some of which are created by the non-tax paying corporations. Restricting a state's right to set tax rates will be a difficult argument to win and there will be a great deal of resistance.

177 In the case of the many tax havens this may be easier to manage. A number are dependencies, who draw many advantages from their connection with the parent country in areas like business and defence and yet enjoy almost full independence in their internal decision-making. There is no moral or economic justification for their tax policies and secrecy, as indicated in a letter signed by 300 economists in 2016. Their sole aim is to thwart legitimate legal claims. They thwart individual claims, such as in divorce proceedings – the database on the Panama Papers is expected to generate a flood of law suits once the true extent of individual wealth is known. And they thwart the claims of states and undermine their ability to meet the needs of citizens. Many tax havens are UK overseas dependencies which turned to tax sheltering as a deliberate economic strategy. The UK government can exert a great deal of political and economic pressure on them to conform to a standard tax rate, if it so chooses. There may be limits to this pressure. Some constitutional lawyers maintain that the UK does not possess the constitutional power to assume control over its dependencies in respect of tax laws because their tax regimes are not sufficiently unreasonable and extreme as to meet the high threshold for intervention. However, the interlinkage of the UK's huge finance economy, with these havens means that the UK government has a great deal of economic and political leverage.

178 Finding agreement between sovereign states will require more nuanced arrangements. Countries need to adopt a standard corporate tax, but to do this a supranational body on corporate tax may need to be established. It must be represented by all nations, with particular emphasis on representation from the global South, who suffer disproportionately from tax avoidance. It needs to agree accounting and auditing standards. The wealthy tax industry and concentration of big auditing firms is generating and perpetuating corporate tax avoidance. So, as proposed in the next section, accounting and auditing of corporations would be best achieved by a state based organization and further exploration of this radical proposal is needed.

179 ## 6.2 Leveraging and 'going private'

180 In most jurisdictions there is a difference between a public company in which the public can buy shares and a private company where in which there is no share market and shares are held by a close knit

group of persons, often within families. Public companies are subject to much greater scrutiny, are required to make more disclosures and are subject to more stringent laws, particularly in respect of the company's capital. However, the law allows companies to change their legal status. A private company may grow and become more suited to being a public company. This, in and of itself, is not problematic from a social progress perspective. However, the law also allows public companies to become private companies, a simple matter under UK law requiring just a special resolution and an application for re-registration. This re-registration can be problematic from a social progress perspective in that it effectively allows big business to use the (less exacting) regulation intended for small business (Talbot, 2017).

181 This happens in a leveraged buyout. When a company is subject to a leveraged buyout, the result is the placing of control over a very large company in the hands of a very few people in their capacity as shareholders and/or directors. Those individuals then usually take the company private, thus enabling them to use the governance system developed for small companies. They achieve the buyout through debt secured against the company's assets which must be repaid. For some commentators who consider leveraged buyouts to be a good thing, the leverage part is an essential mechanism for pressurizing management to profit maximise and thus enhance efficiencies (Kaplan, 2010). The buyout will also give much of the equity to the directors adding to their incentives to profit maximise. Private equity firms will often seek out industry specific management as part of the buyout package. For advocates of leveraged buyouts, they are effective mechanisms to strip out unproductive parts of an underperforming business creating a leaner and more profitable business that may be floated on the share market in around 5-7 years, that is, 'go public' again. Ideologically, they are part of the neoliberal armoury of justifications for shareholder-orientated corporate governance.

182 However, a close analysis of what actually occurs in leveraged buyouts reveals a picture of value extraction which is shared between the new shareholders, directors, deal makers and lenders. Valuable and productive company assets are frequently sold and then leased back to the company. The profit from the sale can be declared as a dividend. Workers lose their jobs or have to accept wage cuts and less favourable terms and conditions. Assets can be revalued and enjoyed as dividends paid for by loans. Shareholders/directors can lend the company money on terms which are not scrutinized. Bit by bit, all that is valuable in the company is drained away. And it happens within the law. The most recent case in the news of buyouts, going private and value extraction to have

emerged is that of Philip Green's purchase of Bhs plc and later Arcadia, which is set out below by of illustration (for further details see Talbot, 2017).

183 *Case study*

184 British Homes Stores was established in 1928 and since then it has maintained around 164 stores. In May 2000 Bhs Group Ltd (this company was previously called Measuremarket Plc; it was re-registered as a private company in April 2000 and renamed Bhs Group in April 2001), a company whose shares were wholly owned Philip Green and his wife who was resident in Monaco, concluded a successful bid for the shares in Bhs Plc from Storehouse Plc for £200 million, having borrowed £170,477,000 in order to do so. The deal maker was American banker Robin Saunders and the transaction was partly funded by multimillionaires Sir Tom Hunter and Richard Caring. Bhs plc also included the shares in Bhs (Jersey) Ltd and Mothercare (Jersey) Limited which were sold soon after. Bhs plc had had patchy profitability. Its profits in 1999 were £45,650,000 but in the year it was purchased, 2000, it had made losses of £45,987,000 due to a number of exceptional items as part of a reorganization of the business (principally stock clearance). Its accounts up to March 1999 put its net assets at £388,086,000 (April 2000 at £342, 099, 000) far in excess of the £200 million paid to Storehouse. This was accounted for by offsetting the assets with 'negative goodwill' of £311,488,000. After the sale, Bhs plc was re-registered as a private company. It was renamed Bhs Ltd. The Bhs Group comprised of Bhs Ltd, Bhs Properties Ltd (acquired from Stonehouse), Davenbush Ltd (acquired from Stonehouse)Bhs Services ltd (a newly incorporated company that worked as a part of the retail business providing the sales and distribution of Bhs vouchers) and Bhs Ltd (Hong Kong).

185 The accounts for years 1999-2001 show that the group had debts of around £220,000,000 and assets of around £350,000,000. Accounts for 2002 show a dividend of £166, 535,000 (interim dividends of £100,035,000 and final dividends of £66,500,000) but a rise in debts to £312,501,000 and a drop in assets to £84,534,000. The net profit upon which the dividends were legally justified were mainly composed of the value of negative goodwill; an accounting device. Negative goodwill is not actual money. The dividends were funded with additional borrowing together with the sale of £105, 000,000 of property which were then leased back by BHS. By 2004, an additional £256,000,000 in dividends had been declared, while debts totalled £373,870,000 and net assets only £5,358,000. For the remaining years of its existence, the company languished in debt and the diminished negative goodwill meant that even 'paper' profits were low. No more dividends were declared for the Green family but

they were repaid a £28,975,000 bond and they charged the company an estimated £124,000,000 in rented property until 2015. £41.9 million in 2007 and £60.9 million in 2008 were invested in the business in an attempt to raise its fortunes but the business had been terminally drained of value.

186 To go back a little to the acquisition of Arcadia, in October 2002 Taveta Investments Limited acquired Arcadia Group Limited for a cash sum of £866,395 a sum borrowed from HBOS. Taveta owned 92% of the shares while HBOS owned 8%. Tavata Investment's ultimate parent company is Taveta Limited, a company incorporated in Jersey whose shares are owned by Tina Green. The business of Arcadia Group consisted of well-known high street retailers such as Topshop/Topman Ltd, Burton Retail Ltd, Evans, Dorothy Perkins Retail Ltd, Miss Selfridge Retail Ltd and Wallis Retail Ltd. and the 'goodwill' in these business was estimated at a combined £318,688 million of the purchase price.

187 In Taveta Investment's consolidated profit and loss account for the year ending August 2005 it showed post tax profits of £184,894,000, slightly up on the previous year giving an accumulated value of around £400 million. The same 2005 accounts, showed that interim dividend of £1,299,167, 000 had been distributed to the shareholders. The pension scheme was in £11.6 million deficit. How was this possible? Group accounts make teasing out some of the details difficult but what they did have to reveal was that Taveta Investments Limited sold its shares in Arcadia group to a newly named wholly owned subsidiary company Taveta Investments (no 2) Limited in return for shares in that company. The whole of the issued ordinary shares of Arcadia Group was revalued by PriceWaterhouseCooper as £2.3 billion (up from £866, 395,000). Tavesta duly declared an interim dividend of £1.3 billion for its shareholders (ultimately Taveta Ltd).

188 Philip Green declared that Arcadia would pay a £500m dividend after paying off all the company's £866m bank debt to HBOS, borrowed to buy Arcadia. He also said that he would borrow £500m from HBOS in a five-year loan to pay the dividend. In paying the dividend on the basis of a relatively modest profit, Taveta No 2 sustained a loss of £1,120,397,000. (the consolidated accounts for its parent company Taveta Investments showed a similar picture) PriceWaterhouseCooper approved the distribution given the consolidated profits of the group were stated as £1,267,511,000 (in the financial statements of the parent undertaking and taking into account the revaluation of Arcadia Group's shares).

189 The purpose of using Taveta (No.2) was to allow a transfer of newly and highly valued shares of the Arcadia Group so that the increased value could be in some sense 'realised' and thereby becoming distributable reserves, qualifying as dividends. The UK law on dividends at the time and since states that a company can only make distributions out of profits available for the purpose. These are defined as its 'accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.' The revaluation might have indicated that the shares were worth more than their original purchase price but that additional value was in no reasonable sense 'realised'. Nor did the revaluation produce extra actual cash. But it did allow PWC to approve the dividends, notwithstanding that they were funded by loans. Philip Green described it as 'a technical move … approved by the courts, the Inland Revenue, our auditors Price Waterhouse Coopers, our lawyers Allen & Overy and our tax advisers, Deloitte.' Thus UK company law allows shareholders in private companies to use company assets as if they were their own and not (as the law also says) the company's assets. Auditors are content to concur with this version of shareholder ownership.

190 On 27 February 2009, ownership of the shares in Bhs Group Ltd which held a number of Bhs subsidiaries as well as Bhs ltd, were transferred from offshore companies based in the British Virgin Islands which had held its shares for many years to Taveta Investment (No,2) Ltd. However, Taveta itself had struggled to overcome the burden of the huge 2005 payout and since then had paid no additional dividends. Little money was invested in the weakened business and the weakest of them seem to feel the brunt of this. As a part of Arcadia, Bhs Group went from a modest profit maker to a loss maker. In 2007, its net profits were £35,343,000 in 2008 that dropped to £25,464,000. Once within Arcadia it made losses of hundreds of thousands every year. In 2010 it made a £242,000 loss, steadily rising until 2014 with losses of £490,000. It had regularly paid £13m a year for properties rented from Carmen Properties Ltd, whose shareholders and directors were the Greens.

191 In 2015 Bhs Group was sold by Taveta (No 2) to consortium Retail Acquisitions for £1. Since then the company has taken payments worth £25 million to cover management running costs and interest payments. On 25 April 2016 BHS was put into administration, owing over £1.2 billion including £517m in pension obligations. As Richard Murphy (2016) tersely put it,

192 '…it can be argued that this is simply efficient capitalism in practice. BHS has been in a vegetative state for 20 years: leveraging up the near-corpse allowed the Greens to pump money into other job-

creating things such as the crafting of a solid gold Monopoly set, featuring Tina's high street acquisitions. As they prepare for the dole-queue, those 11,000 workers will know that and are bound to understand.'

193 The pattern of activity associated with both BHS and Arcadia, under the orchestration of Philip Green's complex corporate network, has been to declare large dividends, far in excess of actual profitability, funded by crippling loans which destroyed the ongoing profitability of BHS and which has left Arcadia in a precarious position. Arcadia financially benefited from its short lived association with BHS, but now that facility has been used up. The whole scheme was based on huge loans, but Green and his family, have made a net profit of nearly £I billion. His ability to do this is both ideologically condoned and legal. When Bhs and Arcadia became private companies, Green availed himself of a system that is designed for small firms in which shareholders, directors and even employees tend to be the same people. This system allows director/shareholders to exercise more discretion over the organisation of company capital and applied a laxer regime in respect of dividends. The company has a separate legal personality, it can exist where the shareholders do not (including tax havens) and yet the director/shareholders often act like the company assets are their own, including its pension funds. Company auditors seem happy to embrace that vision. Arcadia and BHS were treated as the private property of Philip Green when in fact he was a director of both and held various shares in them. In this way, the value that had accumulated in an enduring organisation was rapidly siphoned off through the leveraging of assets, and then redistributed through dividends.

194 *Policy proposals*

195 We propose that, except in extreme circumstances, a public company should not be allowed to re-register as a private company. It cannot re-register through a shareholder vote. It must make an unassailable case to go private. If successful, the new private company must be required to protect assets and pensions. Dividend law must be applied strictly so that a transfer of revalued assets to a company within the group cannot legally constitute 'realised' profits. Paper profits, such as negative goodwill cannot be sufficient to declare dividends.

196 The corporate veil must be attended to as strictly in private companies as it is in public companies. The law understands that shares are a title to dividend and not to the company's assets. The corporate veil is the legal outcome of this. The current regime of re-registration allows these fundamentals of company law to be set aside. As between the shareholders/management and a company

whose shares have been purchased in their entirety, there appears to be no corporate veil. The new shareholders can extract years of accumulated corporate assets, in tangible or money assets. It is clear, therefore, that the corporate veil needs to be firmly drawn between the company and its shareholders/directors to underline the legal truth that it is a separate productive entity. The purchase of shares, which are often undervalued, should not give the purchaser an entitlement to the company in its entirety.

197 Colluding in this de facto veil piercing is the auditing business. Auditing is dominated by the 'Big Four'; auditors to nearly all FTSE 100 and 250 companies. These auditors do what their clients want and the reduced controls over private companies makes their job all the more easier. Their incentives to comply with the spirt of regulations is very weak. Furthermore, the leading auditing firms are part of the regulation of their own profession. There is a strong case, therefore, for making auditing a state/regulatory function, thus ensuring that audits comply with regulation. It would produce much needed revenue for governments and would help ensure that pensions were protected. This would increase trust in the pension system and reduce the public cost squandered funds. j

198 We additionally propose that a thorough study should be undertaken of the role of audits and the practice of auditing to make more detailed recommendations to ensure that it does not enable parasitical value extraction by company directors and shareholders.

199 ## 6.3 Lobbying

200 Lobbying is an activity engaged in by many groups representing different interests. They include civil society groups concerned with labour standards or the environment, trade unions and business corporations. In principle, it is useful and equitable for policy makers to consult all relevant 'stakeholders' however there are huge differences in their ability to influence. In Brussels, for example, lobbyists representing corporations are more numerous (around 70% of all lobbying personnel), better funded (it is a multi-billion euro industry funding partisan scientific studies) and better connected than other lobbyists. This means that the lobbying of corporations have much more impact than that of other groups and ensuing regulations tend to reflect their interests. Corporate lobbying undermines democracy and the state's duty to serve the public. It provides corporations with a mechanism to have their demands and their world view attended to while the demands of the public have no such forum (Talbot, 2017).

201 The locations of national government and multi-state forums in which law and regulations are made determine the location of corporate lobbyists. One of the key sites of corporate lobbying is the geographical and political centre of EU law making in Brussels where the European Commission, the European Council and the European parliament reside. Within this small area (the so-called 'Brussels Bubble') are located the lobbying offices of many of the largest corporations, 1000s of lobbyists and numerous private consultants and law firms employed to lobby on behalf of the corporations. Philip Morris International, for example, employed 161 people to use their contacts in the EU to resist a proposed tobaccos products directive aimed at cigarette packaging.

202 Brussels also hosts a number of think-tanks funded by corporations, producing scientific studies on everything from the environment to public health and labour rights, which back corporations' claims and regulatory desires. Generally, officials will lack the technical expertise on a particular subject and rely on expert studies but this is particular acute in Brussels where officials may be dealing with issues arising outside their nation state. They will often seek advice from, and become over reliant on, experts groups which are connected to corporations. Expert groups may even draft the first legislative proposal.

203 Anti-lobbying activists such as ALTER-EU and Corporate Europe Observatory, have also highlighted the 'revolving door problem' where EU officials are head hunted and then employed by lobbyists for their contacts and insider knowledge and may later leave the lobbyists and return to public office. ALTER-EU claim that over half of the lobbyists at four well-known Brussels lobby consultancies have previous experience inside the EU institutions.' According to one of their examples:

204 '2010, Mårten Westrup moved from DG Enterprise to BusinessEurope and lobbied former colleagues on climate change issues on behalf of BusinessEurope's industry members. Yet under the current rules, his job move did not require approval from the Commission because of a loophole which excludes staff on contracts from systematically requiring authorisation. Westrup has now gone back through the revolving door and can be found working in DG Energy.'

205 The EU has a Transparency Register for all lobbyists to declare who they are, how much they spend, how many people work for them and what issues they are hoping to influence. It contains the names of just under 6000 lobbying organisations and has been in operation since 2008. However, it is a voluntary register and although there are many thousands of entries, activists claim that lobbyists do not fully

declare the extent of their interests and that the EU has little interest in chasing up incomplete or absent declarations. To illustrate the patchy nature of the EU register, ALTER-EU showed that while Goldman Sachs declared expenditure in the EU was 50,000 euros, in the US, the declared expenditure was $3,630,000, a disparity that can only be explained by the fact that the US has a mandatory lobby register with precise requirements. It also argues that Facebook's claim that it employs only two people to lobby and Apple's claim to spend just 250,000 euros in Brussels is a patently incomplete picture. The European Parliament has been calling for a mandatory register and this may yet introduced in spite of the Commission's lack of enthusiasm.

206 The aim of lobbyists representing corporations is to press for policies that will maximise those corporations' profits be it in pesticides, alcohol, junk food or tobacco. Pharmaceutical companies have particularly well paid and active lobbyists.

207 European and government officials are charged with representing citizens and social welfare, but too often they are captured by persuasive lobbyists. Oxfam gives the example of the European Commission's pressurization of the Thai government to reverse its decision to allow the import of inexpensive generic versions of certain medicines (allowed under TRIPS). Similarly the US Trade Representative put Thailand on the Special 301 list of countries that could be subject to trade sanctions.

208 In the UK, think tanks including the Adam Smith Institute and the Institute of Economic Affairs, received funding from various tobacco groups, while they argued against controls over the tobacco industry and attempted to debunk the World Health Organisation's campaign against tobacco related deaths.

209 In Washington where there are just under 13,000 lobbyists listed on the congressional register. Lobbying is a business with an annual turnover of over $3.5 billion, a conservative estimate (George, 2015). Collective lobbying by the finance industry to remove laws passed in the New Deal, laws which essentially restricted the fluidity of capital and thus its ability to search out short term returns in potentially socially destructive ways, cost an estimated $5billion. The repeal of the Glass-Steagall Act, which required retail banking and investment banking to be separate, was a particular focus of the finance lobbyists and often attributed with causing the global financial crisis. Pharmaceutical corporations are also very active in Washington, spending $228million in 2014. Their principal concern is to influence the government to extend their intellectual property rights and to persuade the government to pressure other governments elsewhere to extend IP rights in their favour (Oxfam, 2016).

210 Research Centres, institutions and think tanks also play an important role in US lobbying (George, 2015). One example is the International Centre for Alcohol Policies (ICAP) funded by a collective of major alcohol corporations. The agreed science showed the extreme dangers of alcohol consumption. The World Health Organisation showed that alcohol was third highest global killer. ICAP's response was to cast doubt on the science, citing other factors. It counselled responsible drinking and lobbied against proposals proven to reduce consumption such as banning advertising and reducing 'opening times' for drinking alcohol in licensed places. The alcohol lobby needed to ensure the heaviest drinkers stayed drinking as they consume over half of the amount bought in this $1trillion/yr industry although they represent just 10 per cent of total drinkers. (Geirge 2015)

211 The increasingly oligopolistic nature of corporate capitalism has increased the effectiveness of companies as lobbyists. The alcohol industry has consolidated its power through mergers so that by 2006 the 10 largest beer producers owned 70 per cent of the global market. Oxfam's 2016 Report notes that the largest of these, the Belgium company Anheuser-Busch InBev, (AB InBev) spent $3.7m lobbying the US government in 2014. It has campaigned vociferously against restrictions on adverting and against increasing taxes on alcohol. 56 of the 141 lobbying reports it filed in 2014 were on the tax issue alone. Oxfam also notes that AB InBEV together with FIFA put pressure on the Brazilian government to change its law banning alcohol consumption during the 2014 World Cup matches.

212 Corporate lobbying has been particular active around the issue of global free trade. This is, in part a response to the failure of the World Trade Organisation (WTO) to get agreement on the terms of global free trade. The WTO which was agreed in 1994 and launched in Marrakesh in 1995 aims to facilitate open trade as a negotiating forum and to expand the governance of trade in goods established and developed under GATT to all other substantial areas of trade including intellectual property rights and government procurement. However, as agreement depended on the consent of all 160 or so countries signed up to the WTO, few negotiations have concluded with a resolution. As a result, corporations, lobbyists and states have pursued other strategies to enable free trade. Countries have agreed individual free trade agreements with between themselves including bilateral investment treaties (BITs). UNCTAD 2013, estimated that there were over 3,200 BITs in force from WTO signatories. These are registered as WTO compatible in that they do not contradict it, but invariably they go beyond it.

213 Countries lobbied by corporations have pursued long term open trade strategies in the form of wide reaching international trade and investment treaties. The largest of all is TTIP, a proposed treaty between the EU and the US, which aims to cover all aspects of trade. Negotiations on TTIP formally began in Brussels in 2013. TTIP's aim was to cover all aspects of trade but specifically those parts which benefit corporations.

214 Although BITs historically preceded TTIP, they have evolved in tandem. The corporate lobbyists which promote TTIP visualise it as mirroring the forms and practices of BITs, particularly in its investor dispute resolution system. The lobbyists and forums for discussions on what became TTIP began soon after the WTO was established. These discussions occurred under the auspices of many different organisations. The most important to emerge in the post WTO period was the 1994 Transatlantic Business dialogue (TABD) set up in 1995 by the EU and the US Department of Commerce as 'the official business sector advisory group for EU and US officials on trade and investment issues'. The aim was facilitate official discussion between governments and business and to this end TABD set up numerous working groups to assess national and EU policies. It provides over 70 corporate members (mainly CEOs of European and American companies) to advise US and European governments on how to direct policy in respect of trade and trade related matters. TABD describes itself as 'the only CEO-driven business organization solely dedicated to advancing the U.S.-EU economic agenda. TABD provides its member executives high-level access to U.S. Cabinet Secretaries and European Commissioners.'

215 TABD has always represented the free trade lobbyists, aiming to create a barrier-free world for corporate trade. It has been instrumental in pushing forward discussions on TTIP, defending it against any criticism. TABD is part of the discussion in the Transatlantic Economic Council (TEC) formed in 2007 to facilitate dialogue and agreement between the EU and the US on economic issues and the harmonisation of regulation. The TEC is currently chaired by Caroline Atkinson, Deputy National Security Advisor for International Economic Affairs, and Cecilia Malmström, European Commissioner for Trade. In January 1, 2013, the Trans-Atlantic Business Council (TABC) was created as the result of a merger between TransAtlantic Business Dialogue (TABD) and European-American Business Council (EABC). The purpose was to directly and almost exclusively lobby for TTIP and to defend its most controversial aims. One of those was the proposal to use the dispute resolution applicable in BITs, which is generally in accordance with Investor to State Dispute Settlement clauses (ISDS) inserted in individual treaties to enable corporations to sue countries which adopt policies which might reduce their expected profitability. The

TABC is an enthusiastic supporter of ISDS, seeing it as essential protect the vast global investments made in the EU and US (57% of inward FDI and 71% of global outward FDI).

216 Past settlements under BITs have included large payments to corporations as compensation for sstates introducing such policies as price caps on water, plain packages on cigarettes or a minimum wage. This mechanism for resolving disputes was approved by the World Bank in 1964 through the International Centre for Settlement of Investment Disputes (ICSID) Convention 1966. Before ICSID, investors seeking remedies were obliged to lobby their governments into negotiating with the 'offender state' on their behalf. This new ADR provided for a private arbitration system allowing corporations to directly sue states, thus, so the theory went, avoiding inter-state conflicts. Although the ICSID was unpopular particularly with developing countries, ISDS clauses were inserted in most BITs. Many countries saw these clauses as standard small print. However, their latent power became apparent in the late 1990s. Since then ISDS clauses have provedhighly profitable for corporations, and over 200 disputes have been settled with over 500 outstanding by these means. The system has been variously shown to be biased to corporations given the vague rules: 'discriminatory treatment or direct or indirect expropriation', the usual wording in dispute clauses, has been interpreted very widely. As only investors can initiate proceedings, the lucrative arbitration business ISDS clauses have spawned is dependent on keeping the corporate client happy and encouraging more business. A pro-state position would detract from that. The TABC, of course interprets this differently, characterising ISDS as providing a 'fact-based, and non-politicized forum' thus ignoring the economic incentives behind decision-making.

217 ISDS provide no appeal and there no 'loser pays' principle so that even when states win, (and given the opportunistic nature of many claims, they do win in 43% of cases (UNCTAD, 2014)), the legal costs make them averse to challenging the expectation of its corporate investors. The vast majority of defending states are from developing countries (around 90%), for whom millions of dollars in legal fees is a substantial chunk of public money. The TABC cites the purely monetary rewards as one of the advantages of ISDS in that it does not require the state to restrain its policy making but merely to compensate affected corporations if it chooses to change policy. Again, this is to ignore the financial position of the defending states. Indeed, even the threat of potential proceedings from investing corporations has caused many states to back away from further protective regulation,'. *The Guardian* cites the case of two cement companies which filed an action against the South African government. The case went on for four years, costing $4 million in legal fees, before it was dropped. Soon after, the South African

government allowed the companies to 'transfer only 5% of their ownership to black South Africans – rather than the 26% mandated by the state mining authority. "No other mining company in South Africa has been treated so generously since the advent of the [new mining regime]," one of the investors' lawyers, Peter Leon, boasted at the time. The government seems to have agreed to this deal, which goes against the spirit of post-apartheid reparations in South Africa, to prevent a flood of other claims against it.'

218 Corporations have benefited from ISDS in BITs and corporate lobbyists like TABC are well positioned to ensure they continue to benefit from it *if* agreement is reached on TTIP. And although France has signaled its rejection of TTIP following the documents leaked by Greenpeace, TTIP is by no means dead and buried. The agreement in February 2016 of the Trans-Pacific Partnership (TTP), a free trade and investment treaty between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the United States will put substantial pressure on the EU to agree a similar treaty. However, countries have two years to ratify TTP, the route to making its many provisions part of national law, and it may yet fall.

219 What is interesting about TTP from a corporate perspective is that it is an agreement that brings great benefits to corporations and few to the signatory countries, particularly those that are still developing. For example, the United States claimed that in signing the TTP, Malaysia would receive $40 billion more in investment over 10 years. However, an impact assessment undertaken by PriceWaterhouseCooper indicated that there would be no net increase in value for Malaysia and a substantial risk of falling foul of an ISDS which is part of the treaty (Chen, 2016). Similarly, the proposed benefits of extra investment for developing countries if they adopt a BIT has not been established. Studies indicate that foreign investment is prompted by the likelihood of profit through cheap labour, good infrastructure, natural resources and so on, not the existence of a protective BIT. FDI levels in Latin America did not increase for most following an investment treaty, and Brazil (Porzencaski, 2007), which had no BITs, has been the most successful country in terms of foreign investment. A study from the LSE concluded that TTIP would not generate more investment in the EU. Furthermore, as there is a great deal on investment in the UK, it would be exposed to much more risk as TTIP would incentivise claims against the UK (Skovgaard et al., 2013).

220 The rise of dispute settlements over the last 15 years means that countries signed up to BITs or the TTP may become more attractive to investors purely in anticipation of making huge claims against those countries. The ISDS industry now advising corporations on

investing in countries with investment treaties in place with the intention of benefitting from future claims against those countries. Corporate lobbyists pressing for treaties with ISDS are pursuing a win-win situation for corporations.

221 *Policy proposals: lobbying*

222 Corporate lobbyists operate around every law making or regulatory body. This will include national governments, intrastate and transnational organisations. Therefore, a reform of lobbying (which must also include non-corporate lobbyists) to redress the current bias toward corporate lobbying needs to be consistent internationally. National registers, for example, have too much variation in the quality of the disclosures and there is no consistency as to whether registers and voluntary or mandatory. This makes monitoring and controlling the impact of corporate lobbying very difficult.

223 To get some grip on corporate lobbying we need coordinated international action to ensure that national registers are both mandatory and require pertinent disclosures. What do lobbyists wish to influence and why? The Commission launched a public consultation on a mandatory system in March 2016. The consultation was aimed at 'stakeholders' which in this context is lobbyists. The outcome will be interesting.

224 However, the sunlight that is shed on lobbyists' activity needs to have some *consequenc*e for policy makers. They need to shift from the regulatory fashion for embracing business's views, to a healthy skepticism of their motives which is driven by an over-riding commitment to the public interest.

225 In the same vein, the issue of 'revolving doors' needs to be taken as seriously. There could, for example, be a cooling off period before personnel can move from officialdom to lobbying or vice versa, such as to ensure *inter alia* that the information they possess as an official is no longer valuable to the lobbyists.

226 *Policy proposals: TTIP*

227 TTIP is a trade agreement which benefits corporations. It is a regulatory race to the bottom and there is little evidence to suggest it will bring social progress and much more evidence to suggest that it will be socially regressive. Its progress has been guided by big business interests. It should be abandoned in its entirety.

228 *Policy proposals: ISDS*

229 When ISDS clauses were introduced in BITs few realised how lucrative they would be for corporations. This in itself indicates that they need to be radically reconsidered. There is little evidence that they encouraged investment and much evidence that they can cripple developing countries and serve as a lever to ensure corporation friendly regulation. Disputes between countries and corporations should be in public sphere, not a private partisan arbitration system. Terms in clauses should be interpreted within a framework which prioritises a state's right to regulate in the interests of its citizens and social progress without being financially penalised.

230 6.4 Corporate social responsibility: how to respond to it by recalibrating power and control

231 Corporate social responsibility is based on the idea that corporations will voluntarily adopt socially responsible polices without the need for further government intervention. Its origins are often rightly attributed to the debate between Berle and Dodd in the *Harvard Law Review*, but usually attributed for the wrong reasons. (Talbot 2014) Most commentators view Dodd as the father of CSR because he conceived of a company in which wider social interests would be pursued. But what was innovative about his argument was that corporate managers should be freed from regulation so that they could exercise socially enlightened policies. This is the essence of CSR and it is in direct conflict with the idea that corporate controllers would not act in socially responsible ways if unregulated.

232 Both Dodd and Berle thought that the corporate controllers were the management, believing that in the modern corporation shareholders could not exercise collective influence over management decisions. This was important because it assumed that corporate decision-making was freed from shareholders' desire for profit. The question of whether management would exercise that power benignly or self-interestedly, was the core of their debate.

233 Berle did not believe that corporate decision-making outside clear rules could be benign, Dodd did, believing that rules (such as those of fiduciary duties) restricted progressive decision-making. So too do CSR proponents. Thus CSR panders to the neoliberal goal of resisting regulation; the claim that a corporation freed from regulation (like trade barriers) will be free to be socially enlightened. This is wrong, in part because the premise of the Berle-Dodd debate was wrong. Shareholders are not powerless and directors cannot, for this and other reasons, act with full discretion. Dodd argued that less intervention would enable more CSR. Conversely companies use CSR to ensure less intervention. However, reducing regulation actually reduces the ability (or desire) for corporate decision making

to be socially responsible, rather the converse argued by Dodd. Without regulation there is a void filled only by only market demands for profit maximisation. Accordingly, it is only by making CSR strategies less like classic (voluntary) CSR and more like enforceable laws that CSR can begin to be effective. In this more robust form CSR may have some socially progressive potential, but it will also (as discussed below) make capitalism a less viable form of economic organisation.

234 CSR is widely embraced by the largest national corporations and global corporations. Nearly 75% of global corporations report on their corporate responsibility. The emerging economies like Malaysia, India and Indonesia have CSR reporting in nearly 100% of their publically owned companies, as it is mandatory. However, most major economies report on CSR because they recognise that it is a necessary part of demonstrating their business credibility. Reports will often follow similar formats covering key concerns, so that seventy eight percent of global companies that report refer to the Global Reporting Initiative guidelines.

235 CSR projects are often applied in developing countries in which most global production takes place where there is little actual protection of labour, or indeed the environment, even where there are laws which purport to do so. For example, although Bangladesh has labour laws which in principle provide high levels of protection for workers, the near impossibility of an employee being able to enforce the law and the poor socio-economic position they find themselves in mean that the law is unable to actually protect labour in practice (Talbot, 2018).

236 Many advocates of CSR argue that it is necessary when the state itself cannot, or will not, protect labour. This is particularly so in 'captured states', that is, those states where the politicians are frequently the owners and employers of their country's businesses and employees. Such a state of affairs is not uncommon in developing states. Historically, the governments of England and the United States were filled with the landed or industrial wealthy. Today, the interest of business are not pursued through the direct self-interest of politicians (although that does happen) but through lobbying or corporate funding, as noted above.

237 Within global chains, CSR has the advantage of reaching through the chain into various jurisdictions. So while typically the parent company will be located where there are some labour and environmental standards and mechanisms through which to enforce them, other parts of the chains, consisting of subsidiaries companies or other associations will not. They are simultaneously legally distinct from the parent and fully integrated in the value chain which

is created to profit the parent company's investors. Workers involved in production of the tangible product will suffer on two accounts. First, although they are the value producers, the parent company's ownership of 'rents', means they will not enjoy that value. Second, they tend to be located in areas with traditionally poor labour and environmental standards and/or enforcement. So in the case of garment workers in Bangladesh, the majority of the value is captured not by the garment producer but by the lead (merchant) company which claims value through its 'unique' branding and high street presence. The producer organisation claims a small part of the overall value created while labour claims only a small wage. A typical garment factory will spend less than 5% on labour costs.

238 The producers are the cheapest part of the value chain. At the same time garment workers have few institutional mechanism through which to enforce their rights. In this context CSR may be the only protection for workers. So, where the law of the parent company's jurisdiction does not apply to its global subsidiaries and business affiliations, it may be in the company's interest to apply, or to be seen to apply, its domestic business ethics. The company may voluntarily adopt policies which benefit workers throughout the chain. These may be policies which provide medical care, childcare or education. The construction of a school or day care centre is a popular CSR activity for corporations because of its visibility and proof of good corporate citizenship.

239 Increasingly, corporations might evidence their social responsibility through the adoption of Codes provided by global institutions or private accreditations systems which are largely created, promoted and monitored by civil society groups, (those groups which are not affiliated to government or business). On the former, there is a history of global institutions colluding with corporations in the creation of codes of conduct in order that will have minimal impact on profit making. Following an initiative launched at Davos in 1999 between Kofi Annan and the CEO of Nestlé, the UN and the largest corporations launched a 'principle based' human rights initiative called Global Compact. Designed to usurp the more stringent UN 'Norms', the Global Compact is based on self-monitoring of voluntary action (Talbot, 2013). Corporations can voluntarily sign up to the Compact and thereby commit to observe ten principles which are based around human rights, labour, the environment and anti-corruption. The corporations that sign up to this must produce an annual Communication on Progress (COP), a self-certifying document which shows how they think they are observing the ten principles. That document is publically available on the Global Compact website. The website reports that it has 'more than 12,000 participants, including over 8,000 businesses in approximately 145 countries around the world'. It is popular with business. They get the

credit for signing up and being aligned to UN-endorsed human rights commitments without having to evidence any of their claims, without being monitored by any external body and without committing to any binding obligations. Similarly, the UN convened Principles for Responsible Investment sets out aspirations and involves no external monitoring. The UN's Ruggie 'Framework' sets out a corporation's '*responsibility* to respect human rights' in contrast to a state's *duty* under international law to protect its citizens against human rights abuses. Corporations' 'responsibilities' should be met by having a human rights policy which is publically available and a human rights due diligence process to identify and then to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services. This process of monitoring must be ongoing and should ideally involve dialogue with affected persons, (but doesn't have to). Like the Compact, this is essentially a self-monitoring process although Ruggie clearly anticipated the engagement of a wider stakeholder community as well as the reputational effects of corporate social responsibility.

240 Corporations have also established their own guidelines. The Ethical Trading Initiative is an industry derived code which requires members to submit annual reports to the ETI board showing how they are dealing with labour conditions in their supply chains and how they have complied with ETI base principles. International Standardization Organisation 26000 (ISO 26000), designed to promote CSR in corporations, requires no monitoring, provides no certification, and only gives guidance on best CSR practice. It aims to 'clarify social responsibility'. In both of these initiatives there is no external monitor and no persons or mechanism to ensure these standards are maintained.

241 Other initiatives that go further in conforming to a basic standard of specificity and engagement, have found monitoring and enforcement difficult. Social Accountability 8000 (SA 8000) originally developed by Social Accountability International (an international; accreditation body) in 1998 to reduce sweatshop practice, requires detailed social auditing to ensure that its very specific standards and requirements are met and are verifiable. Corporations will not be certified without this. The veracity of monitoring is ensured through announced or unannounced audits to certify compliance, and corporations which have signed up to SA8000 must keep appropriate records to show compliance and to continue to be certified. Social Accountability International reports that SA8000 is currently certifying 3388 facilities in 71 countries, over 65 different industries, employing a total of 2,019,193 workers. However, a recent report evidenced that many of the agencies which were supposed to be qualified to monitor businesses as SA8000 compliant, were themselves negligent and poorly trained. Good standards have not

been enforced, corporations have not been properly monitored and factories in developing countries continue to be dangerous and exploitative. The system of training and funding means that the auditors invest in their (not inexpensive) training. They then can earn from the companies they audit. Without companies choosing to have this audit there are no customers so audits are unlikely to be so exacting as to put off future clients. These are all problem inherent in voluntary systems. Both the monitors and the monitored become mutually dependent (Talbot 2017).

242 However, it is clear that corporations will only adopt binding agreements in respect of corporate responsibility when not to do would compromise their bottom line. The Bangladesh Accord 2013 is the most striking example of this. This initiative legally binds the retail corporation which buy garments from the hundreds of producers in Bangladesh in agreements to improve the safety of the working environment and to commit to this for a fixed period of years. What drove corporations to adopt this were the commercial threats to their particular rents, in this case their brand. The instance of the Accord was the Rana Plaza tragedy from which the corporate brands sought to distance themselves claiming to be mere customers who were equally shocked by the deaths and injuries caused by the hazardous conditions. Local people, trade unions and local and international activists challenged this version of events, forcing the brands to show contrition through a more stringent CSR programme. The truth was that global garment brands ensured that suppliers competed on price, making savings through low wages, job insecurity and hazardous working conditions. They were often the sole customers of these factories, making specific requirements of management is respect of the workforce and often managing directly. Global retailers accepted the Accord because their brand needed to be rehabilitated. It went further than they would have desired in terms of specificity and legal enforceability. However, over two years after it was launched its impact has been disappointing. Promised safety improvements to factories are rare and there is a distinct feeling that now the dust has settled on the Rana Plaza tragedy (as least as far as high street buyer are concerned) there is little impetus to comply. Furthermore, the Accord has a limited scope, dealing only with safety in the workplace. It does not extend to improved wages and job security. The largely female workforce remains employed until they have children and are then quickly replaced with more cheap female labour (Talbot 2018). As Oxfam (2016) notes, 'firms are consistently using their dominant position to insist on poverty wages. Between 2001 and 2011, wages for garment workers in most of the world's 15 leading apparel-exporting countries fell in real terms.'

243 *Policy proposals*

244 As these examples show, in order to begin to be effective from a social progress perspective CSR strategies must address the social needs that the corporation detrimentally affects, rather than vanity projects that look attractive in their Annual Report. Commitments must be clear and specific. General principles which are open to numerous interpretation such as are found in Global Compact, ETI and the Ruggie Guidelines serve only the corporations. The effectiveness of corporate self-monitoring (again a feature of Global Compact, ETI and the Ruggie Guidelines) cannot be relied upon. Self-monitoring is the preferred method of compliance for corporations. Hence the rejection of the Norms. Self-monitoring provides corporations with a shield to resist external regulation. For monitoring to be effective it must be performed by independent external people and organisations which are capable of understanding what compliance comprises and of enforcement. The lesson of SA8000 is that this is difficult to achieve. There is also a danger of capture as Social Accountability International is a charity dependent on funds, much of which comes from its corporate members.

245 For rules to be effective there must also be behaviour-changing sanctions. When dealing with global corporations this would have to be substantial amounts, impossible to enforce without a prior legal agreement which CSR, by its voluntary nature, eschews. The strength of CSR, such as it is, remains with the corporation's reliance on reputational issues. When death and injury on the scale of Rana Plaza can be connected with corporate policies then those corporations are forced to take such measures that will repair their image with customers.

246 But the Accord is only about safety. The everyday exploitation of billions of workers falls outside CSR. Highlighting the everyday exploitation of workers in developing countries (as many NGOs so expertly do) keeps us informed, but in terms of what can be done there, we believe that it is only through organized labour that workers can claim better pay and conditions.

247 So what can we do here? Many would argue that exploitation by corporations including through global value chains is driven by shareholder value maximisation. So we need to think about curtailing the drivers for this. We recommend that shareholders should not have votes in the company as their control rights contribute to companies' drive to short-termism (Talbot, 2013). Crucially, we need to think about how to socialize claims to the company. Corporate property, after-all, represents the embedded value captured from labour accumulated over long periods. A corporation which is fit for social purpose needs to represent those claims.

248 ## 6.5 The impact of shareholder value maximisation strategies on innovation

249 As we have seen, the capacity of corporate capitalism to engender innovation is said to be one of its main strengths. However, there is evidence to suggest that the now very widespread corporate strategy of shareholder value maximisation is warping the innovation process.

250 In industries such as pharma, it has long been argued that a combination of market discipline and shareholder ownership puts private sector corporations in a better position than government to initiate major breakthroughs in medical technology. However, financialised pharma firms are increasingly using speculative strategies and their monopoly position as holders of IP rights to push up the price of curative drugs, in the process restricting patients' access to life-saving drugs and shifting costs on to public healthcare systems.

251 *Case study*

252 The disease Hepatitis C has infected approaching 170 million people globally and kills around 700,000 persons each year. The disease disproportionately affects low-income and marginalised groups including those co-infected with HIV and imprisoned individuals. Since 2013 new drugs have come on to the market with the potential to achieve cure rates of over 90%.

253 Among these new therapies are the drugs Sovaldi and Harvoni which are manufactured by Gilead Sciences (for the research on which this case study is based, see Roy and King, 2016). In countries where they have been made available at low or no cost (which include some developing countries, such as Egypt, and developed ones, such as Iceland), public health authorities have been able to develop strategies for eliminating Hepatitis C completely. In other countries, such as the USA, where Gilead charges what it regards as a market price for the drugs, access has been more limited. In 2014 the US Medicaid programme paid over $1 billion to fund Hepatitis C treatments which reached only 2.4% of eligible patients. In the US, Gilead was charging in excess of $80,000 for each course of Hepatitis C treatment.

254 Companies such as Gilead maintain that they need to charge the price the market will bear for curative treatments in order to fund future research and development. However, most of the funding which supported the research which led to the development of Hepatitis C cures was supplied by government. After the Hepatitis C virus was discovered in 1989, the problem facing those seeking to

develop a cure was that the virus could not be grown in a cell culture, complicating the process of testing for anti-viral effects. Publicly-funded scientific research in the USA and Germany in the following decade led to the development of a research tool known as the sub-genomic replicon, which made it possible to generate parts of the Hepatitis C virus for testing. A university spin-off based in New York, Apath, commercialised the replicon using funding supplied by the US National Institute of Health's Small Business and Innovation Research Program (SBIR). A company called Pharmasset, a spin off from a lab at Emory University which received financing via SBIR as well as venture capital funding, went on to develop the compound known as sofosbuvir which is became the basis for the new generation of drugs addressing the need for a Hepatitis C cure.

255 Pharmasset spent a total of $62.4 million on the development of the sofosbuvir compound from the pre-clinical research stage to the point of phase II trials, and identified a budget of a further $126 million for phase III testing which would bring the drug to market. In 2011 Pharmasset was bought by Gilead Sciences for $11 billion. Gilead was one of a number of companies investing in Hepatitis C therapies at this point and assessed sofosbuvir as superior to its own products. Gilead was able to combine sofosbuvir with a number of its own therapies to create a new treatment regime capable of curing Hepatitis C within an 8 week period. Gilead reported clinical trial research costs of $880 million between 2012-14 in developing these treatments.

256 Gilead's purchase of Pharmasset and the IP rights it thereby acquired gave it a near monopoly in the Hepatitis C drugs market. Between the launch of its new drugs in 2013 and the first quarter of 2016, Gilead has accrued over $31 billion in revenues from its Hepatitis C medicines, nearly three times the cost of the purchase of Pharmasset. In 2015 Gilead's revenue from Hepatitis C drugs was $19 billion, which was equivalent to around two thirds of the national budget for the US National Institutes of Health in the same period. In the first quarter of 2016, Gilead had cash balances of $15 billion.

257 Although pharma firms argue that they surpluses they accrue from drug sales are needed to fund future research, in practice they are being used for share buy-backs (repurchases of stock which enable profits to be distributed to shareholders) and dividends. Since the start of 2105 Gilead has announced over $27 billion in share buy-backs as well as dividends of $1.9 billion. In the same period Gilead's R&D budget rose from $2 billion to $3 billion.

258 Gilead's story is not unique. In the past decade, Pfizer has spent $139 billion on share buy-backs and $82 billion on R&D. Gilead's model is, nevertheless, a new development in the industry, as it suggests that a strategy of targeted acquisitions of start-ups, coupled with the capacity to exploit monopoly rents from ownership of life-saving therapies, can generate supra-normal returns for shareholders. These returns are in the nature of windfall gains made at the expense of public finances, as public health budgets are diverted to meet the high costs of life-saving treatments largely financed by government in the first place. The losers from the system include the patients whose access to life-saving treatments is rationed by high prices. Additionally, long-term investment in R&D loses out to short-term financial speculation.

259 *Current reforms*

260 The story of Hepatitis C may represent an extreme case of the tendency for a financialised model of innovation to turn in on itself, enabling profit-orientated companies to use government funding and legal protection for IP rights to extract rents from the public sector and ration access to technologies with major potential for improvements in human well-being. However, it could also be that it is a straw in the wind, and a warning of how financialisation and shareholder value maximisation strategies, supported by shifts in the institutional framework of corporate governance, are undermining the potential of the capitalist system to promote social progress.

261 The immediate responses to the problems raised by the Hepatitis C case include proposals for value-based pricing (Bach et al., 2015) and the public funding of clinical trials (Baker, 2008), both of which have recently been discussed by a high-level panel on access to medicines convened by the United Nations Secretary General. These developments go some of the way to addressing the specific problems arising in pharma, but do not address the wider structural issue of the relationship between a financialised form of capitalism and the innovation system. How should we respond to the wider challenge this poses?

262 *Policy proposal*

263 There is no doubt that the systematic and sustained development of innovation since the industrial revolution, driven by a 'Schumpeterian motor' in which the corporation advances through the search for innovation rents, has produced bountiful social progress for much of humanity. Life expectancy has risen throughout the world, even in low income southern economies. Human agency has been enhanced, and the quality of human existence has been

raised immeasurably (for example, a reduction in pain and suffering for everyday illnesses; the capacity to read during the hours of darkness; the capacity to travel and learn about different cultures).

264 But we can also witness a dark side to these developments in innovation which are endogenous to capitalism and which reflect the character of the corporation, markets and finance. Innovation has often been excluding, resulting in high levels of unemployment (labour-saving technological progress), producing products for high income consumers, neglecting products for social consumption and the needs of the poor, and underwriting the geographical unevenness of growth and residential patterns. The market-driven search for profit has also resulted in the maldistribution of incomes (with innovation rents biasing income receipts to those commanding innovation processes), the systematic introduction of dehumanising labour processes and the undermining of the rights to resist of those excluded in capitalist growth trajectories. Further, the biases inherent in much of corporate-led innovation have favoured the current generation at the cost of future generations, particularly with regard to the environment. The failure to internalise environmental externalities in innovation has led to critical stresses to the climate and the biosphere chronicled by the IPCC. Finally, and partly as a result of the manner in which innovation is endogenised in capitalist growth, the production, deployment and use of increasingly destructive weapons threatens a growing number of the human population, if not life itself.

265 Three core initiatives can be identified which can lead to enhanced forms of social progress and which involve the reformulation of the way in which corporations operate, their access to appropriate forms of finance and the market structures which help to determine their innovation trajectories. The first is to foster more inclusive patterns of innovation; the second is to rein in the role of the military in determining the trajectory of innovation; and the third is to foster the introduction of more environmentally-friendly socio-technical systems.

266 1) Inclusive innovation

267 More inclusive trajectories of innovation need to target both process and product innovation. On the process side, there is a greater need for more labour-friendly innovation, both in terms of the quantum of employment and in the character of work. Process innovation also needs to be more environmentally friendly, since a disproportionate share of environmental externalities are thrust on the shoulders of the poor. On the product front, innovation needs to focus on the needs of the poor, with a greater emphasis on low-price functional products and lesser emphasis on differentiated, over-packaged, non-

recyclable and throwaway products. Perhaps of greatest importance is the need to respond to the fact that corporate-driven innovation underinvests in the public goods which have disproportionate welfare implications, such as neglected tropical diseases. A third prong of the inclusive innovation agenda is to develop processes which lead to the greater involvement of other stakeholders in innovation, particularly in those currently excluded from the fruits of growth and innovation.

268 2) Reigning in the military imperative in innovation

269 A disproportionate share of global innovation resources are invested in technologies directly concerned with the development and deployment of weaponry. The increasing destructiveness of much of this weaponry, and the lowering of the barriers to entry in the development and use of these destructive technologies requires urgent action. Much of the necessary response lies outside of the realm of the corporation, finance and markets, but these remain important components of military innovation and need to be addressed.

270 3) Fashioning a new socio-techno-economic paradigm

271 As observed above, innovation occurs at a number of levels, incremental, radical and 'revolutionary'. In this latter category are a series of historically transformational technologies, including steam power, iron and steel, the railways, the internal combustion engine and ICT. Each of these transformational technologies affects and diffuses through a myriad of economic activities. In each case, the core technology is embedded in a socio-economic system with associated residential patterns, social attitudes and patterns of productive organisation and consumption. The most recent paradigm is one associated with the globalisation of the mass production paradigm, driven by the diffusion of cheap energy and the internal combustion engine. It has resulted in an increasing divorce between production and residence, and production and consumption and, as we have seen, the systemic production of environmentally-damaging technologies.

272 This socio-techno-economic system is in crisis. The rate of productivity growth has been falling for some years and we are now witnessing a 'new normal' of low rates of economic growth. The financialisation of contemporary capitalism makes it vulnerable to a renewed financial crisis which will result in harsh economic consequences for many and political turmoil, and reduces the incentive to invest in the technologies required to ensure sustained Social Progress. Underconsumption plagues the system, allied to unemployment and underemployment, and social tensions are rising

in many countries. Amongst other things, this surfaces in mass migrations and the rise of fascist political systems. Overlaying all of this, with profound implications for humankind, is the threat of climate change and climate chaos.

273 It is necessary, therefore, to vision alternative socio-techno-economic paradigms. This is the task of the IPSP. Within this new paradigm lies a role for innovation, to foster both more inclusive outcomes, and more environmentally friendly outcomes. One of the major lessons of historical experience is that a new 'revolutionary' technological paradigm has the potential to provide a growth opportunity and to provide a different trajectory to social and economic systems. Because it is new it also provides the scope for profit-driven corporations to develop and exploit new innovation rents. It is here that a green-technology revolution holds out the prospect of a better, more inclusive and more sustainable future. It will be one which brings production and consumption, and work and residence, closer together. It is one which provides for reduced environmental inputs, and involves a world of less inequality and greater harmony. This need not be a non-capitalist social order, but it will inevitably involve a different type of capitalism, one which requires changes in the nature of the corporation, the nature of markets and in the role played by the financial sector.

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274 7. Conclusion: would reforming the corporation enhance social progress under capitalism?

275 In this chapter we have set out some key characteristics of modern capitalist institutions, the market, finance and the corporation, which directly impact on the issue of social progress. In analysing the key institutions of modern capitalism we have attempted to ground them in some understanding of their historical origins and contextual development. We have found that while capitalist institutions share key features facilitative of capitalism, the politics of the nation state in which they reside will mediate their activities. Early capitalism in developed countries was characterized by laws and ideologies which supported the expansion of capital and conversely did little to protect the growing labour force, thereby creating distinct social classes. Organized labour gradually achieved some legal rights and protections but it wasn't until the end of the Second World War that the state opted to promote substantive equality and social support.

From then it could be properly described as a welfare state. In this context financial markets operated under more prohibitions, equity markets were relatively inactive, organized labour had greater legal powers and political credibility.

276 In contrast, today's capitalism is characterized by a pervasive ideological commitment to neoliberalism held by governments and transnational organizations alike which identifies social progress with a commitment to the success of business. As such, listening and responding to business, through varied forums and lobbying, is considered to be a valid social activity. Business profitability and a facilitative business environment are seen as socially desirable. The role of government is to create that environment. As a result, governments have lost their commitment to equality. This was once achieved through welfare provision, progressive taxation, collective labour power and regulatory environment which protected citizens. But business does not like excessive welfare, it is a cost, which they don't want to pay (if they do pay tax) and it doesn't deliver a compliant, flexible workforce. Business does not like to pay tax and uses the corporate form to avoid doing so. Business does not like unions or protective regulation. And so governments who are committed to business, ensure that business gets the environment it wants.

277 Governments talk about equality and social progress but engage in activities which achieve the opposite, because business comes first. But inequality has been increasing precisely because of business and business's exploitation of labour. This has been a feature of the global economy since the 1980s when the gains made by labour, at least in the West, have been gradually, and often not so gradually, eroded. This process has been essential to resist the downward trajectory of profitability which have characterized capitalism for most of the last 40 years.

278 In this chapter we have put forward legal reforms to the corporate structure and wider business environment such as the regulation of corporate tax and a commitment to inclusive as opposed to profit driven innovation. These reforms, though orientated around the corporation, would impact on the institutions of capitalism we have discussed here. We maintain that social progress is dependent on changing the tide of our economy away from capital (in its many forms) and towards citizens (in their many forms). However, we are aware that such reforms may in themselves not be sufficient.

279 Neoliberalism and the shareholder value driven corporation were, and are, a political reaction to the problems of profitability which underpinned the conflicts between labour and capital in the 1970s (Talbot, 2016). The neoliberal response to falling profitability has

been to attack the rights and material expectations of labour, but the root of the problem is an economy which cannot invest in innovation or employ productive people unless it makes profits, and profits are low. That is why reform is so difficult. Reforming the corporation in a way which enables social progress may well mean that capitalism – the pursuit and maximization of profit – is no longer possible. At the very least, a reformed corporation that may deliver more social progress will certainly deliver a lower level of profits. Shareholders will not want to accept this and so the reform suggested here may need to be accompanied by a reduction in shareholders' control rights. (Talbot, 2013) The alternative is that if capitalism has a future, it is likely to be one in which social progress is side-lined and in which the super-rich elite continue to thrive, and poverty, inequalities and social dislocation increase.

280 Governments consistently submit to corporate demands, and involve them in the delivery (and removal) of public services and in economic governance nationally and globally. A political and economic system that is skewed to the interests of capital necessarily increases inequality within and between nations. It reduces democracy and freedoms as governments divest powers to corporations or to a partnership between corporations, transnational and supranational organizations. Under this arrangement corporations can exploit the environment to ruinous degrees. They can use legal mechanisms to ensure the value from global chains can be claimed for their shareholders. They can lobby for, and get favourable regulation. They can hire law firms and accountants to extract value, to hide liabilities and to avoid tax. They can exploit the workforce in developing countries.

281 And yet despite the huge power corporations have to shape the business environment, capitalism today is characterized by falling commodity prices, low growth and low returns on investments. Money is pouring out of China and the emerging economies, and their debts are huge. Corporate profit is low in most productive industries. Global investment in production is one third of what it was before the financial crisis. Stock markets are falling everywhere in spite of extraordinary financial machinations such as Quantitative Easing and share repurchases. The resulting squeeze on labour has reduced demand while household debt continues to rise.

282 Given the current state of modern capitalism it would seem that were corporations not to exploit the environment to ruinous degrees; were they not to use legal mechanisms to ensure the value from a global chain can be claimed for their shareholders; were they not to lobby for and get favourable regulation; were they not to hire law firms and accountants to extract value, hide liabilities and to avoid tax; and were they not to exploit the workforce in both

developed and developing countries, they would make no profit, or very little. Thus in reforming the corporation in ways that would help deliver social progress, the shareholder-value maximization corporation will be lost. A socially progressive company cannot be one that seeks to maximize shareholder value. So does capitalism have a future? Yes, but in its current form, almost certainly not one that enhances social progress. Thus it may be that in the pursuit of social progress, capitalism itself will evolve into another economic form.

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