Capitalism in Crisis

Scarcely a day goes by without a scandal erupting around greedy or bullying bosses, pilfered pension funds, business tax dodging, chaotic private train operators, rewards for failure, bankers' bonuses, price gouging or exploitation of gig workers, zero hours contract employees or modern slaves.

The public appears to want more nationalisation, more regulation and higher taxes on business.

Populist politicians on the left, like Jeremy Corbyn or Bernie Sanders in the USA, get a respectful hearing at business conferences. Leading business spokespeople and gurus preach contrition, restraint and self-flagellation.

There is a palpable sense of capitalism being in crisis or, at least, facing a crisis of confidence.

Although it does not explain everything, the financial crisis of a decade ago played an important part in puncturing the confidence generated by the collapse of Communism two decades earlier confidence that the capitalist model, the liberalisation of markets and the 'animal spirits' of entrepreneurs, could be relied upon to generate an ongoing, inexorable rise in living standards.

This view was epitomised by Francis Fukuyama's "End of History" thesis now the subject of universal mockery but taken very seriously at the time that liberal democracy and the market economy had conclusively and for all time settled the ideological debate.

Instead, financial markets proved to be highly unstable and prone to excess.

Leading global banks were built around flawed business models and collapsed.

Financiers demonstrated extraordinary greed and went unpunished for failures which crippled innumerable other businesses and livelihoods.

Indeed, state nationalisation was used to rescue the firms that had created the mess in the first place.

The last ditch, unorthodox monetary policies – namely quantitative easing; printing money – which were used to stave off economic slump have rewarded asset owners and widened inequalities.

By contrast, the living standards of workers and their families have stagnated or declined.

It is now ten years since the financial crisis but the economic damage and discontent it has left in its wake explains much of the hostility directed at the unacceptable faces of capitalism.

There are several recurring themes.

The first centres on what are seen as unjustified executive rewards. The ever-widening differential between the pay of Chief Executives and median pay is difficult to justify with reference to overall economic, or even corporate, performance.

There is specific anger – rightly – directed at those in the banking sector who have relied on implicit taxpayer guarantees to line their pockets then there are the executives of house building companies that have acquired vast bonuses backed by government subsidy schemes;

and those who have walked away from serious corporate failures with large payoffs and generous pensions (as happened at Carillion and earlier at RBS, HBOS and Comet).

Executive pay in publicly quoted PLCs has become a lightning rod for general discontent over high pay, though the most extreme payments occur in private limited companies and partnerships, and are largely invisible.

And linked to executive pay in public and private companies is the acquisition of large, individual shareholdings whose value is boosted by buybacks and M&A activity rather than by productive investment…

and which because of the highly skewed ownership of financial wealth (the most unequally distributed form of wealth, with 10% of the population owning 70% of it) serve to widen wealth inequalities.

A second set of dissatisfactions with business has centred on privatised utilities.

Private ownership was originally seen as a recipe for improved efficiency and consumer satisfaction with potential abuse of monopoly curbed by tough sector regulators and investment freed from Treasury controls.

In some cases, privatised companies have delivered better outcomes. But the current public enthusiasm for re-nationalisation stems from a variety of perceived failings of the new system.

Poor services; large dividend pay outs at the expense of investment; costs passed onto consumers rather than reduced through efficiency and large executive salaries in industries where there is little risk.

The complaints have varying degrees of justification.

But a common thread is the belief that regulatory capture or weakness has allowed shareholders to achieve rates of return on their capital in excess of what low risk utilities could reasonably expect while failures (as with rail franchises like the East Coast Mainline) involve a government bail-out.

Meanwhile, those standing on railway platforms awaiting the umpteenth cancelled train since new timetables were introduced three weeks ago are justifiably outraged that the likes of Charles Horton – Chief Executive of the failing Govia Thameslink franchise – are paid in the region of half a million pounds a year.

A related but distinct issue is private sector contracting to the public sector through PFI or outsourcing.

The motives are similar to utility privatisation – improved performance and removal of borrowing from the government balance sheet – but instead of utility regulation the state defines the public interest through performance contracts and competitive tendering.

In the event, many of these contracts have proved very costly – relative to a public sector comparator – and profitable for the private sector

A third strand to the critique of modern capitalism is a more traditional one: lack of competition and abuse of monopoly power.
Too many industries remain stubbornly concentrated: retail and investment banking (despite the entry of some challengers); audit and accounting (where despite reforms the Big Four continue to dominate); media and news; government outsourcing; house building (with a decline in competition from small builders); manufacturing (aerospace, motor vehicles, chemicals).

The new information industries meanwhile rely heavily on single operating systems (Microsoft, Google), data gathering platforms (Google; Facebook) or digital market places (Amazon, eBay) where monopoly control can be imposed and competition suppressed.

While the problems of size and monopoly are far from new (oil majors; railroad companies; chemical cartels are all a part of the history of capitalism), the international and often intangible nature of these new industries renders national governments, their regulators and their competition authorities relatively toothless.

The fourth and final strand relates to another longstanding criticism captured in the phrase 'short termism'. As Secretary of State, I like to think that I was able to address this issue through various interventions: the industrial strategy; the Law Commission review of fiduciary responsibilities; institutional interventions like the Business Bank and Business Growth Fund to create more patient capital; changed terms of reference of the CMA and the Takeover panel emphasising long-term responsibilities.

But, as recent hostile takeover bids show, like Melrose's for GKN and the role played in it by short term investors, the attraction of profits from a short-term turnaround invariably transcend long term considerations.

So, what is to be done? As modern liberals we must reject ideas becoming fashionable again on the political left to try to recreate nationalised industries and other traditional forms of state control or, worse, adopting a whack-a-mole, populist, reactive approach to each and every business scandal.

As a pro-business Liberal party, we seek to improve the workings of capitalism through an eclectic, forward-looking and joined-up approach involving:

- more effective competition policy capable of regulating the industries of both present and future;
- encouraging new and different models of ownership that disperse both reward and decision-making;
- reforms of corporate governance, to stem abuse and encourage long-term investment and ethical behaviour;
- and more robust regulation of utilities and outsourcing.

A few words on each:

First, competition policy has to be significantly more aggressive. While it is welcome to see the European Commission take on the big internet platforms, its inquiries are far too slow and the hoovering up of countless small, innovative companies, by Google and Amazon especially, has gone largely unchallenged

A powerful reason for the UK remaining within the EU, a campaign led by the Liberal Democrats, is that the Commission can take on global companies far more effectively than the feeble UK authorities ever could.

I set out in a recent speech how the tech giants, which now dominate the corporate world, could be challenged through stricter takeover rules and forced divestment of their most valuable acquisitions.

And smarter regulation combined with economic ownership of personal data could rebalance the information economy away from monopolistic giant enterprises back towards citizens

Second, Liberal Democrats believe the UK should be a laboratory for different kinds of business and ownership models.

We already have a lot of foreign companies and some – like Siemens, Tata or Nissan - demonstrate a social awareness and long term thinking superior to native companies.

Mutuality has – just – survived in the finance sector and has potential elsewhere. The mutually owned Welsh water company, Kelda, offers a more enterprising alternative than renationalisation of the water industry.

Employee participation in ownership and decision-making too has some demonstrated success stories – Arup and John Lewis – and has helped to make postal workers stakeholders in the Royal Mail.

The great Liberal, John Stuart Mill, was a passionate advocate of workers owning their own companies, predicting that the “relation of masters and workpeople” would be superseded by partnership and “association of the labourers with the capitalist”.

I grew up in York where the Quaker owners of chocolate companies pioneered worker shareholding and other manifestations of social responsibility. They have not disappeared.

Indeed, worker share ownership as a liberal, pro-business response to inequality and workplace apathy, and empirical evidence from across the world demonstrating that employee-owned workplaces are happier, more productive and more resilient in economic downturns, the presence of such companies remains surprisingly small as a share of the economy.

Indeed, the UK ranks near bottom among EU countries when it comes to formal participation and governance rights for employees, rights themselves linked to higher levels of productivity, equality and R&D.

Social enterprise meanwhile operates well on a small scale, but there are also good examples at larger scale like the bus company, HCT, which I happen to chair. And if bus franchises, why not trains?

And those of us who have no doctrinal obsession with privatisation can see that publicly owned enterprises can be both valuable and efficient (like three I helped to set up in government: the British Business Bank, the Green Investment bank and Post Office Ltd, which became independent of the Royal Mail in 2011.).

Policymakers should use the wide range of tools at their disposal to encourage greater take-up of these different forms of ownership, to encourage diversity and promote a fairer distribution of power and wealth.

These tools include tax breaks for specific types of company, increasing lending to such companies either through public institutions such as the British Business Bank or by incentivising private banks, and in the case of employee ownership giving workers stronger rights to request shares, particularly when their companies change hands.

And there other ways of giving citizens a direct stake in the success of enterprises.

My party is actively considering a recent IPPR proposal to distribute financial wealth through a sovereign wealth fund financed by some combination of higher corporation and wealth taxes, taxes on financial transactions; the receipts from future asset sales, as with RBS; and the absorption of the Crown Estate.

The recent experience of the Green Investment Bank (GIB) and the British Business Bank (BBB) shows that it is possible to assemble top quality management teams able to manage large portfolios in the public interest without political interference in operational matters.

The real challenge is to build a political consensus so that such an institution can survive changes of government (as the BBB, but not the GIB, has been able to do).

Corporate governance reform has been historically undramatic and modest in scope, drawing on business consensus. But precisely because it commands wide support it can affect genuine cultural change.

For example, the reforms to executive pay, strengthening shareholder rights and responsibilities, which I and my successors have introduced have checked the more egregious pay awards and made remuneration policy more transparent and professional.

The voluntary approach to greater diversity – women on boards – has produced results.

In both respects, however, there is a long way to go.

There are other useful incremental changes identified, inter alia, by the Institute of Directors and prompted by the Carillion collapse: greater transparency over share buy-back arrangements, which benefit top managers and inflate stock prices and dividends at the expense of real investment, and over clawback provisions for bonuses when companies fail.

I believe we should go one step further and consider sharply restricting or even outright banning share buybacks, as was the case in the USA before 1982, and where Democrats in Congress have recently introduced a bill to do so once again. As former US Labor Secretary Robert Reich argues “there is no reason buybacks should be considered anything but illegal manipulation of stock”.

Another valuable step would be the implementation of the concept of the Tomorrow’s Company project which incorporates the idea that companies are not just the property of their shareholders but have explicit obligations to a wider range of stakeholders.

To achieve this, the Liberal Democrats have called for large companies to be required to set up “stakeholder advisory panels” to represent interests of employees, customers, communities and the natural environment.

As the leader of a party that believes strongly in involving workers in decision-making, I want to see progress on the Prime Minister's promise to put workers on boards as part of a move towards a fairer, more German model of capitalism.

I confess that this proposal was looked at when we were part of the Coalition but we made little headway, not least because of political resistance from the Conservative Party.

The Corporate Governance Code and Stewardship Code are the current means by which responsible companies seek to strengthen standards within a framework based on the 'comply or explain' principle.

Given ongoing concerns about corporate misbehaviour, we must explore ways of further strengthening the corporate governance framework.

If the evidence shows that the Corporate Governance and Stewardship Codes are failing to improve behaviour, the Government should establish an independent body to ensure standards are adhered to, with robust investigative powers and the threat of fines or legal remedies where necessary.

And while the Government has announced a voluntary code for private companies, I believe the code should be made mandatory for the largest of these and enforced by the same independent body responsible for listed companies.

A more challenging problem has been executive pay: designing a mechanism which prevents top executives from enriching themselves at the expense of the companies they work for while not undermining the principle that good performance should be rewarded.

The current arrangements are failing: egregious pay awards unrelated to performance; examples of remuneration committees and board chairs being 'captured' by executives; a malfunctioning market in which all chief executives aspire to be in the top quantile.

The first step to reform introduced by the Labour Government was of (voluntary) votes by shareholders.

I strengthened the policy by making it mandatory for forward looking pay policy to be determined by shareholders coupled with a legal requirement to produce a simple number capturing all the components of pay.

The result is that more awards are now challenged and occasionally pay policy is rejected as excessively generous. Nonetheless serious discontent continues.

As part of its corporate governance reform package, the Government put forward several proposals.

One is to improve the metrics by measuring and publishing the ratio of top to median pay. This has been delayed but still appears likely to happen. This can produce anomalies and is a minor change, but still worth adopting.

A second more robust proposal involved further strengthening shareholder voting rights by extending mandatory annual votes to current, agreed pay. There are legal problems of retrospectivity but they are not insoluble.

However, we must also look at reshaping the structure of executive compensation itself so that no longer encourages short-term, often damaging behaviour.

The Purposeful Company Taskforce (chaired by Will Hutton) recommends linking executive compensation to longer time horizons, so that shares are released on a phased basis over periods of up 5 to 7 years with at least half of the shareholding requirement applying for two to three years after executives have left the company.

I believe this would be a positive change that would retain a link to performance but force executives to think more long-term and prevent them wrecking companies without facing personal consequences.

Rule changes are unlikely, by themselves, to create a business culture more conducive to long term investment and R&D. At present managers are often judged by short term returns. And – almost by definition – new investment depresses the return on capital in the short run.

I fully understand the argument for a competitive market in ownership. But the economic analysis on takeovers suggests that on average there is no overall gain in efficiency and the process is driven primarily by professional fees, senior management windfalls and short-term share price movements.

So, we should shift the balance of proof and have a stronger public interest test for takeovers involving the country's science base and R&D in particular.

Reforms are also needed to reverse the rise in short-term shareholding, with the average length of UK shareholding falling from six years in the 1950s to just six months today.

On top of voting restrictions for short term shareholders, I believe shareholders should be allowed to designate part or all of their holdings as a "stewardship stake" granting enhanced voting power in return for a minimum "lock-in" period of ownership.

Such changes would have prevented the Kraft-Cadbury and the Melrose-GKN takeovers and perhaps others.

The time is right to strengthen protections against short termism further through disenfranchisement of speculative investors and empowerment of long-term ones.

Good companies like Unilever should not have to flee to Holland to keep predatory takeovers at bay.

As well as encouraging shareholders to think long-term, we should also explore ways of empowering individual savers so that they are able to influence the large-scale shareholders – pension funds and other institutional investors – that manage their money.

UK pension funds alone already control £2.9 trillion in assets, while automatic enrolment is bringing 10 million more working people into the nation's private pension system.

It is crucial that savers are able to steer these assets in a socially sustainable direction.

The campaigning group ShareAction have proposed a sensible set of reforms to achieve this, with a focus on greater transparency, enhanced consultation rights and stronger legal obligations so that institutional investors prioritise longer-term considerations – such as the environment and inequality – rather than just short-term profits, and individual savers are able to hold them to account on this. This would certainly be an improvement on the status quo.

Utility regulation needs rethinking in several key respects. Moreover, the concept of a utility itself is dated.

Arguably the most important utilities now are the internet platforms provided by Google, Facebook and Amazon and the clearing of financial transactions provided – mainly - by the banking system, and so they should be regulated as such.

In the former case, the platforms are essentially cross-national and cannot be meaningfully regulated except at the level of major nation states like the USA and China or regional groups like the EU.

But in general, there is no reason why the provision of infrastructure with a 'common carrier principle' should carry more than a utility, low risk, rate of return. The two groups of infrastructure providers above have become accustomed to far higher returns.

What we need is a combination of tough competition policies seeking a break up of monopolistic concerns, like big banks, and regulation of the common platforms.

More generally the regulation of utilities needs to be focused more clearly on the cost of and return from capital.

It is clearly unacceptable that owners of low risk utilities like water companies should be able to extract large dividend payments while making little new investment. But nationalisation is a clumsy and expensive way of dealing with this problem.

Instead, Government should use windfall taxes to claw back ‘excess’ profits and restrict them in future, where the ‘excess’ is not determined by politicians but by regulators acting on pre-agreed metrics (to minimise the probability that regulatory risk will raise the cost of capital).

What about outsourcing?

While Liberal Democrats reject misguided calls following the collapse of Carillion to bring all contracted activity in-house and ban future outsourcing. There are good reasons for government to bring in external expertise on major construction projects for example.

To make those contracts work for the public – who pay for them – we have identified a five-point plan to reform procurement and the operation of private sector contracts for the better.

First of all, we must set clear red lines for sensitive areas in which the profit motive should play no role – such as the rehabilitation of prisoners and ex-offenders and the assessment of welfare claimants – where private multinationals such as Atos and G4S have poor track records.

Secondly, private sector companies which deliver public sector services should be subject to Freedom of Information.

This is an agenda my colleagues pushed in government, but which was resisted by the Conservatives.

Companies with a crucial role in supporting the basic infrastructure of the country must be accountable to the public.

To give an example, the internal machinations about risk and responsibility which must have taken place in the train operating companies prior to introduction of the dreadful "Rail Plan 2020", should be exposed to the light of day.

Thirdly, the government should use procurement to promote social mobility and diversity by reserving a share of public contracts for businesses run by target demographics including women, ethnic minorities, disabled people, ex-offenders and ex-servicemen and women.

It could learn from the United States, where this already happens at both the Federal and State levels through so-called "set-asides" mandated by the Small Business Administration.

While the UK government already has a soft target for spending on small businesses, going one step further by setting-aside contracts and targeting specific demographics would create additional opportunities for groups typically underrepresented in business and entrepreneurship.

Fourth, where projects are outsourced, the public sector needs better trained, better prepared and business-savvy officials who can negotiate and oversee contracts in order to secure better value for money. There is some encouragement to be derived from the creation of a commercial cadre within the UK civil service, though how effective this will be remains to be seen.

Finally, we should consider creating a new legally-defined corporate form for companies that regularly deliver major public-sector contracts, as floated most recently by the IoD.

While operating with shareholders on a commercial basis, such a company's legal framework would require – through duties imposed on its directors – a far greater balance to be maintained between the interests of its wider stakeholders, including shareholders, employees, pensioners, creditors and the public sector.

Though capitalism finds itself in difficulty, it is still the only game in town.

Politicians and commentators across the board use 'entrepreneur' as a compliment, not an insult. Small business is praised and cultivated.

The world's biggest companies – Apple, Facebook, Amazon and Google – have strong brand value and, at least until very recently for Facebook, a – broadly – favourable reputation.

Some of the most visible billionaires – Branson, Buffett, Gates – remain widely admired.

But this goodwill will not be sufficient to prevent a more profound crisis if reform is not forthcoming.

The Karl Marx bicentenary this year (and the extraordinary success of Mr Corbyn) reminds us that some countervailing ideas just don't die, even when pronounced dead and buried.

And the apparent success of the Chinese model combining what its proponents believe to be the best of capitalism and communism, reminds us that the Western model still has much to prove.

From the creation of the welfare state to the breaking-up of monopolies, Liberals have led the way in curbing capitalism's excesses before.

Today's Liberal Democrats will do so again.