

### **The gathering of the faithful**

As usual at this time of the year, the “believers” made their pilgrimage to the annual meeting of the World Economic Forum in Davos. The theme for this year’s meeting was “The Great Transformation: Shaping New Models”, presumably of global capitalism. The gathering included the usual quota of politicians, central and commercial/investment bankers, business leaders and, of course, journalists. In many ways, Davos has become a symbol of the ascendancy of globalization – of goods, services and capital – and a useful forum for making connections and exchanging ideas.

The mood was somber, and no wonder. The U.S. economic recovery seems halting and uncertain; the European Union is in the midst of a crisis; and Japan stagnating for two decades. The global economy may undergo another recession (both the World Bank and the IMF have lowered their global growth forecasts for 2012). One major risk is of course trade protectionism: Timothy Geithner, the U.S. Treasury Secretary, fulminated against China as a “formidable challenge” to the global trading system because of its exchange rate, and subsidies. And, the Republican presidential contenders in the U.S. have threatened to impose duties on Chinese imports, as a post-election priority. Both Mr. Geithner and the Republican candidates seem to have forgotten that trade protectionism surely played a role in deepening a recession into a depression in the 1930s. (Actually, the Chinese surplus is falling, and may well become a non-issue by the end of the year!)

Income disparity was never part of the Davos agenda – this year, it was second only to the crisis in the euro zone. And no wonder: income disparities have gone up to the 1930s level, if not higher, in the Anglo Saxon world, thanks at least partly to the low taxes on capital gains. (Fiscal policy, instead of promoting social welfare, seems to be furthering social Darwinism!) As the WEF *Insight Report*, “Global Risks 2012”

warned “in developed economies....the social contract that has been taken for granted is in danger of being destroyed”. In an interview, George Soros described the current situation as comparable to the 1930s.

Coming back to the theme of the conference, capitalism does seem to face a crisis: the Financial Times is running a series of articles on the topic and TIME (January 30) had a major piece titled *How to Save Capitalism*. To be sure, nobody is talking about going back to socialism: Mao's China, Indira's India, the Kim dynasty's North Korea, communist U.S.S.R. and erstwhile East Europe are examples that it does not work too well. Cuba too is liberalising its economy.

Capitalism and market economies have changed dramatically since Adam Smith extolled the virtue of the “invisible hand”. One example: ownership and management were not divorced then, and the corporate form for business was almost non-existent. But whatever its form, it remains undeniable that capitalism does lead to income inequality. It is tolerated so long as it is the result of “the creation of new wealth rather than the appropriation of wealth already created” (John Kay, FT, January 18<sup>th</sup>). When the perception is different, the people often turn against capitalism – even Americans, traditionally the most pro-capitalistic culture in the world. A recent poll suggested 40% of the people did not have a positive opinion about capitalism, and only minorities in the U.S. and the U.K. have faith in business to do what is right! Even David Cameron, the Conservative Prime Minister of U.K., has recently accused business leaders of “filling their own boots”, “ripping off” shareholders and consumers! And, the Labour Party leader Ed Miliband described today's Anglo Saxon model as “predatory capitalism”.

But market capitalism is not a single model. We can distinguish between at least four varieties:

⇒ *laissez faire* capitalism of the 19<sup>th</sup> century variety: this is the agenda of the Tea Party and right wing Republicans in the U.S., but seems difficult to go back to in adult franchise democracies;

- ⇒ Finance capitalism of the Anglo Saxon variety which gives the highest reward to speculators, whose contribution to creation of new wealth is questionable. One example: in 2009, a couple of dozen hedge fund managers together earned more than the combined compensations of the chief executives of all the S&P 500 companies taken together (John Gapper, FT, January 26).
- ⇒ State capitalism of the type practiced in China (and some other countries) with major corporations backed/owned by the state but behaving like private sector multinationals. (PSUs nearer home behave more like government departments). The Economist (January 21) argued that the model produces “cronyism (and) inequality”. But surely so does finance capitalism? -- the revolving door between Washington and Wall Street, the income inequalities in the U.S., speak for themselves
- ⇒ Stakeholder capitalism of the type practiced in Germany and a few other northern European countries. Klaus Schwab, the founder of the WEF, himself believes that companies should serve not only shareholders but all the stakeholders in their organization.

My vote? The last variety! But the choice for the global economy is now a question more of politics, than economics.

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