Rethinking the Market Economy*

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Abstract
Several socio-economic mutations and technological breakthrough innovations are currently modifying the competitive environment and the functioning of today’s economies. These profound changes create opportunities for rethinking the market economy system. They do not challenge the fundamentals of capitalism, but can contribute to amending the system by opening new perspectives and by controlling or preventing the shortcomings of conventional capitalism. Those changes are still in the making.

Keywords: Societal Market Economy; Global Market; Global Capitalism; Global Competition

1. From a Deregulated to a Regulated Financial Market

The main flaws of the traditional capitalist system that we have seen in recent years (Bower et al. 2011) are well known. The main challenge confronted by socio-economists today is to design and implement a societal market economy model avoiding those flaws, while maintaining the dynamism of entrepreneurial capitalism.

The comparative analysis of the different capitalist models prevailing in the World Economy shows that the capitalist system can indeed take diverse expressions, but there are several permanent characteristics observed in every capitalist model, which I call the seven pillars of entrepreneurial capitalism. The pillars are: (1) entrepreneurship and innovation, (2) private and legitimate ownership of tangible or intangible production means, (3) objective of market needs’ satisfaction, (4) freedom of choice for consumers, (5) privatization of profits, (6) existence of a social security net, (7) active presence of an enabling government.

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contribute to amending the system by opening new perspectives and by controlling or preventing the shortcomings of conventional capitalism. Those changes are still in the making.

A stabilized and regulated financial market is obviously the more structural reform to be achieved by priority. Since the years 1980’s deregulation has led to a free financial international market devoid of any fiscal control and dominated by powerful transnational enterprises and financial intermediaries. What the financial crisis has revealed is the decoupling between the international financial world and the real economy.

In the USA, passed as a response to the 2008 crisis, the Dodd-Frank Act has brought the most significant changes to financial regulation in the United States since the regulatory reform that followed the Great Depression. The first effects of this new legislation are already observed in the US financial market and in particular among banks. For example, the so-called Volker rule prohibits banks operating in the US from trading for their own gain and limits their ability to invest in hedge funds. In addition, several large banks are paying heavy price for their past sins (Admati, Hellwig 2013).

In April 2014, the European Parliament approves laws on banking overhaul (Kanter 2014). In the EU-28, the European Commission has tabled around 30 proposals to improve regulation of the financial system and benefit the real economy. This represents a solid basis for a future banking union.

The initiatives taken by the European institutions demonstrates that the EU-28, and in particular the euro zone, has the political will to draw the lessons from the crisis (Pisani-Ferry et al. 2012). It is clear that these new regulations will not solve all problems, but the direction taken is the good one. Going further today would probably require agreement on sharing sovereignty and risks and moving toward a political union which has deeper implications.

2. From Short-Termism to Sustainable Development

Short-termism refers to an excessive focus on short-term results at the expense of long-term interests. Conventional capitalism, in Europe and in the USA, has privileged short-termism by boosting the quarterly reporting by companies at the expenses of long term value creation while, in most cases, the true performance of a firm depends on results observed over a three to five years period. Businesses need to shoulder greater responsibility which requires a longer time-horizon and mindset. It is time to reassess the relationship between shareholder and societal value and reconnect companies with the long term (Barton 2011).

The purpose of sustainable development is to find a coherent and viable balance between three objectives: economic growth, environmental safeguard and social justice. Sustainability requires the integration of environmental costs or ‘externalities’ in the firm’s information system to properly measure the true added value created by the economic activity (Accenture 2013). Conventional capitalism does not fully conform to its own accounting principles, by neglecting to assign a value to the largest stocks of natural resources and living systems it employs. The rapid deterioration of the planet and the climate change problem have both contributed to stress the importance of the natural capital’s preservation and
conservation (Hawken et al. 1999). The transition toward a sustainable market economy implies the integration within the firm’s information system of all the environmental and stakeholders costs generated by its activities in order to measure their true societal value and not simply their shareholder value (Storm 2009).

The 2013 report of the IPCC is clearly alarming and calls for urgent action. Leading business leaders are lucid that current business efforts are not sufficient to set the global economy on a sustainable track and they are increasingly conscious of the need to establish a constructive, two-way dialogue with consumers and local communities, regulators and policy makers, investors and shareholders, employees and labor unions. If confirmed, this new vision of sustainability is a major change in the traditional market economy’s ideology which opens the door for more concerted and collective actions. There is strong support among CEOs of the most forward-thinking companies for governments to play a leading role in shaping the landscape for sustainability at global, national and local levels.

3. From a Black to a Green Economy

The basis of a sustainable economy is a society with a one-planet footprint where all energy is derived from resources that naturally replenished: this is called a green economy (Lambin 2014). The greening objective is a major progress in economics because it proposes to put a price on the use of natural resources too often considered as free goods and of unlimited stock. The “polluter-pays principle” which emerged from this is designed to make the party responsible for generating pollution, responsible for paying for the damage to the natural or social environment. The goal of a green economy is to align two as mutually supportive objectives: saving the planet and stimulating economic growth or, more pragmatically, making sure that our children and grand children will enjoy at least the same wellbeing as the present one (OECD 2012).

To contribute to the greening of the economy, firms have to adopt new business models which are more sustainable. The business model of conventional capitalism follows a linear process: raw material extraction, manufacturing, distribution, consumption and accumulation of waste. A process summarized as ‘take-make-waste’, which can be described as a ‘cradle to grave’ process. In a circular economy by contrast, this linear life cycle is replaced by a loop ‘from cradle to a new cradle’, by adopting re-using, re-manufacturing, technology-updating strategies, re-cycling used products and the wastes generated for other productions or for other industries (Stahel 2006).

Renewable energies will deeply change resource productivity. Many scientists concluded that halving the use of earth resources is not enough. In many cases, we need to cut their use to a quarter, while at the same time substantially increase wealth creation. The Factor 10 Club is a group of scientists advocating that with better technologies human kind can now strive for a ten-time improvement. Such an increase is needed in the future to achieve long term sustainability (BCG Perspectives 2013).
4. From a Globalised to a ‘Glocalised’ Economy

The advancement of science and technologies has greatly reduced the cost of transportation and communication, making economic globalisation an unrelenting phenomenon. Companies have long taken ‘going global’ to mean having a physical presence at locations everywhere with highly standardized products. ‘Glocalisation’ - a portmanteau word of globalisation and localization - is business jargon for the adaptation of a product or service specifically to each locality or culture in which it is sold (Lambin 2014). The increase of economic freedom in the globalised world combined with the development of the new technologies of information and communication has also led to the rise of democracies, which in turn stimulates and facilitates entrepreneurial projects (Bhagwati 2007). Due to globalisation, the virtuous cycle triggered by the digital economy is reshaping the world’s markets and the digital divide reverses. Developing economies now have easier access to capital, talent, intellectual property and other resources that were unavailable to them in the past. Globalization remains controversial however. Specifically, corporations are accused of seeking to maximize profit at the expense of the socio-economic development of their host countries, as sometimes illustrated by poor work safety conditions, unfavorable hiring and compensation standards and low consideration for environmental implications of their activities.

Economic theory tells us, however, that more economic freedom should result in faster economic development (Brondoni 2002). Globalisation has contributed to increase economic freedom in the world which combined with the development of the new technologies of information and communication lead to the rise of democracies in the world, which in turn stimulates and facilitates entrepreneurial initiatives (Sen 1999). The removal of restrictions to free trade has encouraged privately-owned institutions to flourish. As a result, many countries which previously rejected capitalism are slowly embracing it as a means to be incorporated into the global economy formed under globalisation.

Several factors suggest that the globalisation wave is reversing or at least attenuated. De-globalisation is the process of diminishing interdependence and integration between certain units around the world, typically nation-states.

5. From an Industrial to a Knowledge-Based Economy

In recent years, market economies have clearly shifted from industrial capitalism and endless material consumption to a knowledge-based economy, where there is no limit in the production of wealth, as it relies on intangibles like imagination, creativity and on new technologies. In the knowledge economy, the output generated by the market economy system is ‘service’ and the service firm is to sell a result that is ‘a solution-of-a-problem’ or to provide a ‘lived experience’ (Rifkin 2000). The knowledge economy is not an economy of scarcity, but rather of abundance because, unlike most material resources that run down when used, information and knowledge (a non-rival good) can be shared, and actually grow through application. In addition, the effect of physical location is diminished. By using appropriate digital technologies, virtual marketplaces and virtual global organizations can be created.
The global transformation to a knowledge economy continues to place an unprecedented focus on corporate intangible assets generally, and specifically on a firm’s intellectual property, its patents, trademarks and copyrights. From the point of view of the firm, intellectual capital can be decomposed in three parts. Human capital is defined as the knowledge, skills, experience, intuition and attitudes of the workforce. Intellectual capital can be increased by increasing the capacity of each worker. Structural capital consists of a wide range of patents, concepts, models, and computer and administrative systems. These are created by the employees and are thus generally ‘owned’ by the organization. In short, it is the knowledge that stays with the firm after the staff leaves. External capital refers to the organization’s relationships or network of associates and their satisfaction with and loyalty to the company. It includes knowledge of market channels, customer and supplier relationships, industry associations and a sound understanding of the impacts of government public policy.

The transformation of the economy deeply challenge basic concepts of industrial capitalism such as: freedom of access versus private property, collaboration versus competition, free versus financial transactions, peers versus hierarchical relationships, hedonism and cognitive game versus wage earning systems (Grant 1996).

6. From an Opaque to an Interconnected Economy

Digital technologies confer a new transparency on everything and create interconnectivity in the world as never observed before. Processes, objects, and events are translated in information (data, text, images and sound) and connected to a wider network, thus making them visible and accessible anywhere anytime. This transparency challenges hierarchical boundaries. Internet creates opportunity for knowledge to be more widely shared. It paves the way for more horizontal forms of social organization as well as methods of distributing authority and power that emphasize coordination and collaboration (Oxford Economics 2011). In a digital economy, the balance of power between the main market players has deeply changed, giving birth to a ‘bottom-up’ relationships system dominated or initiated by consumers. Internet has two unique characteristics: (a) the ability to distribute digital products at close to zero costs to a large number of customers and (b) the ability to network, i.e. to connect large numbers of people.

Network ways of doing business challenge orthodox market assumptions about self-interest: self-interest is subsumed by shared interest. In networks, optimizing the interest of others increases one’s own assets and values. The adversarial relationship between sellers and buyers is replaced by a collaborative relationship. The rapid adoption of the digital technology in emerging markets is reshaping the world’s markets since developing economies now have easier access to capital, talent, intellectual property and other resources that were unavailable to them in the past.

User Generated Content (UGC) refers to various kinds of media content that are produced by end-users, as opposed to traditional media producers such as professional writers, publishers, journalists and licensed broadcasters. The term entered mainstream usage during 2005 after arising in Web publishing and new
media content production circles. It reflects the expansion of media production through new technologies that are accessible and affordable to the general public. These include digital video, blogging, aggregators and mobile phone and social media.

7. From a Centralized to a Distributed Economy

In a distributed economy, ownership, influence and control are distributed across globally dispersed groups of market actors who are networking. A distributed economy could not thrive without the technologies associated with the digital economy, mobile computing, wireless broadband, and related developments in digital and software applications (Lambin 2014). The relations in a distributed economy are much more complex than those in a centralized economy. The whole economy is more stable because each leaf node no longer relies on just one central node. It enables entities within the network to work much more with regional or local resources, human capital, knowledge, technology and so on. It also makes the entities more flexible to respond to local market needs thus generating a bigger innovation drive. Information technology can be shared much more easily and small-scale production facilities are becoming cheaper.

This shift not only changes the basis of competition for companies but also blurs - and even removes - the boundaries between entire industries, along with those that have existed between producers and consumers, as illustrated by the concept of virtual market. Distributed capitalism encompasses the myriad ways in which production and consumption increasingly depend on distributed assets, distributed information, and distributed social and management systems (Zuboff 2010). The development of digital economy is shaping a dual-trading arena with two types of market: Global Traditional Markets (GTMs) and Global Digital Markets (GDMs).

The motives and expected benefits for participating in this dual-trading arena are different for each participant.

8. From a Not-For-Profit to an Hybrid Social Business Model

Can entrepreneurial capitalism contribute to meet and solve social problems like poverty in the world, while operating as a capitalist firm? Does social business make sense? A social business operates like a profit maximizing firm within the highly regulated marketplace, the only difference being that shareholders and investors re-accumulate their initial investment, as opposed to receiving dividends. Thus, a social business is a non-loss, non-dividend company created to address a social objective in the market place. It is distinct from a non-profit organization because the firm will seek to generate a profit to be used to expand and subsidize the social mission. Several economists observed that the most interesting experiments take place in the middle ground, where hybrid organisations pursue new forms of blended value, where better-off customers sometimes subsidise less well-off customers. Corporations are realising the positive social and environmental impacts of their work can increase (or at least not compromise) shareholder value, while simultaneously addressing the concerns of wider stakeholder groups.
Many of the best and brightest young people around the world are shunning employment in the traditional capitalist economy and in government, in favor of working in the not-for-profit sector. The reason is that the distributed and collaborative nature of the social sector makes it more a more attractive alternative for a generation that has grown upon the Internet and is already engaged in similar collaborative activities. This new generation is also somewhat disillusioned by the rampant materialism and greed of the economic world. The core value in the social economy is the conjunction of member users’ interests and general interest.

9. From Extreme Inequality to a More Evenly Balanced Society

Unlike poverty, which concentrates on the situation of those at the bottom of society, inequality shows how resources are distributed across the whole society. This gives a picture of the difference between average income, and what poor and rich people earn, and highlights how well different Nation States redistribute or share the income they produce.

The philosophy underlying the market economy system clearly does not support the philosophy of egalitarianism, a social philosophy advocating the removal of all economic inequalities among people. If full equality is not the goal, it remains that extreme inequalities can have harmful social, political and economic effects: concentration of wealth in few hands, risk of speculative investments, abuses of political influence, increased indebtedness, frustrations and feeling of unfairness of the less affluent.

The debate of income inequality has received recently increased attention with the publication of the Thomas Piketty’s book ‘Capital in the Twenty First Century’ (Piketty 2014), for whom, the main destabilizing force at work in the capitalist system is linked to the fact that the rate of income growth generated from capital is several times larger than the rate of income generated by economic growth, meaning a comparatively shrinking share going to income earned from wages. With wealth accumulation, income inequality is quickly gathering pace, with a return on capital of 4 to 5 percent a year and rates of economic growth around 1.5 percent a year. In other words the return of patrimonial capitalism would be enduringly higher than the return generated by entrepreneurial capitalism. As a remedy, Piketty favors a progressive global tax on real wealth with the proceeds redistributed to those with less capital.

To create a more evenly balanced society, progressive taxation is however not good enough. The income inequality frame tends to demote complex cultural, social, behavioral and economic problems into strictly an economic problem. One of the most pernicious forms of inequality relates to inequality of opportunity, reflected in a lack of socioeconomic mobility, condemning those born into the bottom of the economic pyramid across generations (Stiglitz 2014). If we’re going to further social equality, we should focus on the real concrete issues: bad schools, no jobs for young men, broken families, neighborhoods without mediating institutions. The problem of social inequality should be attacked at its core that is it should start with families (Warner 2014). High-income people are able to make investments in their children that lower-income people aren’t able to make.
The key sources for growing inequality around the world: the lack of access to high quality primary and secondary education in many countries; public health problems, like chronic disease, that exacerbate income gaps; and social inequalities such as gender discrimination.

10. From a Materialistic to a Humanistic Economy

Humanistic capitalism is a concept that seeks to marry humanism, specifically the safety and health needs of people and the environment, with an embrace of market forces. In line with the sustainable development concept, a ‘responsible’ firm operating within the market economy system is integrating the objectives of sustainability in its entrepreneurial business model, while fully assuming its economic, legal, ethical and philanthropic responsibilities (Lambin 2014).

By adopting the posture of societal responsibility, the firm commits itself to an ethical behavior which implies to answer for its decisions and for their consequences by reference to a value system sufficiently universal to guide the decisions and the strategic options of a firm operating in globalised market economy. In a market economy, profits cannot be too high, but rather excessive or unjustified because achieved through unfair competitive advantages, corruption or destructive speculations, misuse of the labor force and of the environment or sale of harmful products. If the firm’s profit does not deserve credit, a fundamental pillar of the economic system is dangerously weakened, thereby questioning its social value and moral legitimacy.

A social system such as capitalism is a system of relationships which cannot be moral or immoral in the sense that a person can be. Only individuals are moral agents. Capitalism itself is only a means - a techno-science - and requires individual participants to decide on the ends to be pursued. It remains, however, that a social system can be moral or immoral in its effects. No economic system can by itself make people good or bad. The best that an economic system can do is to allow people to be good. As a techno-science and abandoned to itself, the capitalist system will do whatever can be done, even if the expected effects are alarming. It has no self-awareness, no feelings and no will (Sisodia et al. 2007).

To equate ‘capitalism’ with greed is a mistake. The tendency is to confuse self-interest in the marketplace with selfishness (Helliwell et al. 2012). At the heart of a market economy system is the idea of exchange between ordinary self-interested human beings, who seek to advance their interests peacefully in the market place. Greed or selfishness, on the other hand, is an excess of self interest and often transgresses on the rights of others.
11. From an Objective of Well-Being to the Desire of Happiness

The objective of happiness is rising on the political agenda in several countries and this call for measures of how well nations perform in creating great happiness for a great number, analogous to measures of success in creating wealth, such as GDP (Lambin 2014). The golden rule in economics has always been that well-being is a simple function of income (Helliwell et al. 2012). In the debate covering the role of economics in society, an often repeated cliché is that money cannot buy happiness. But, if it is true that money alone cannot buy happiness, it is also true that poverty and the lack of money generate misery. Usually higher household income generates an improvement in the life conditions of the poor. As incomes rise from very low levels, human well-being improves. But several researchers have observed that, in rich countries, where the average income is above a threshold level (say €20,000 per year), additional income does not correlate with more happiness. This means that poor people benefit more than rich people from an added euro of income. It also means that other causes than income influence the level of happiness (Layard et al. 2012).

Well-being is a combination of feeling as well as actually having meaning, engagement, good relationships and accomplishment. Life satisfaction is a poor moral guide since people can be happy in mediocrity (Seligman 2011).

Correcting economic and financial inequalities is typically the responsibility of the state’s fiscal authorities. A fair economy is an economy where public authorities equalize the resources allocated to each citizen in such a way that everyone has the means to achieve what is for her/him a successful life. Such an objective requires that public authorities interfere in the distribution of resources by giving more external resources (financial transfers, education financial support, etc.) to offset the personal differences generating inequalities (family origin, handicaps, talents, etc.). Thus, it is up to the state to devise redistributive mechanisms to correct ex-post natural iniquities and those generated by the market. The Universal Basic Income (UBI) is another mechanism that can contribute to improve equality. Happier countries tend to be richer countries. But to create happiness, social factors, like the strength of social support, the absence of corruption and the degree of personal freedom, are more important than income. The objective of the economy is not to make people happy, an objective which is completely out of its reach, but to create the conditions allowing people to develop a successful and happy life.

12. From a Command-and-Control to an Enabling State

As noted above, the role of the state or of the government is one of the seven pillars of any market economy. The government has always a role to play in a capitalist system and no country ‘economy is either a purely state capitalist or a purely free market system. But the degree of government intervention varies within each country and fluctuates over time (Lambin 2014).

Conventional capitalism, operating in a liberal market economy or in a state-led market economy, is basically a democratic capitalism since its objective is to maximize profit for the firm’s board of shareholders, made of private persons or
institutions, where public authorities (the state or the government) are not represented. The new state capitalism by contrast designates a market economy system where the state controls the majority share or the entire capital of strategic enterprises. State-led capitalism is not socialism however, and the objective is not to eliminate markets. State-led market economy embraces capitalism for its own political purpose in line with the national interests and for political gain. The state is using markets to create wealth to maximize the state’s power. It is a form of bureaucratically engineered capitalism particular to each government that practices it, with all the risks of populism and distortions implied.

This hybrid form of capitalism – state support disciplined by the market – gives state capitalism four huge advantages (a) it produces global champions that have quickly risen up the ranks of the world’s top companies; (b) it gives companies the freedom to invest for the long term rather than being obsessed about short-term profits; (c) it smoothes the economic cycle. State capitalist countries were indeed much faster to cope with the consequences of the financial crisis than liberal economies; (d) it can accelerate the investment in or development of large-scale solutions to tackle global issues like sustainable development and global warming.

The presence of active state-owned enterprises in a market economy is tolerable if governments and state authorities respect the principle of competitive neutrality. This principle can be understood as a regulatory framework within which public and private enterprises face the same set of rules and where no contact with the state brings competitive advantage to any market participant. For global issues like sustainable development and global warming an increased role of the state will be necessary in the years to come.

13. From a Social to a Societal Market Economy

Being able to provide a label to characterize this emerging market economy model is important and a different name is required because, in too many quarters, capitalism is a loaded word. The term ‘pig capitalist’ is an insult commonly used to designate a rich business tycoon who only cares about making more money. In traditional capitalism debates, the words capital (both physical and financial), shareholders value, private property rights, stocks and bonds are relentlessly used, but the words: governments, stakeholders, unions, philosophers, ecologists and civil society are often perceived as unwanted intruders. The intellectual and ideological perspectives provided by the capitalist system tend to ignore broader society problems and are too narrow, considering the issues and challenges at stake. Alternatives names are ‘social’ or ‘societal’ market economy (Lambin 2014).

The term Societal (and not social) Market Economy is proposed for two reasons: (a) to differentiate the model from the German social model of the 1930s and (b) to place the emphasis on the new socio-economic challenges discussed in this book which raise issues pertaining to society at large and going beyond the traditional economic analysis. Each of the three words captures something essential. “Market” refers to competition and the constant search for improvement and innovation. “Societal” pays tribute to the human element and the need for economic activity to serve the common, social good of society at large. It is appropriate that “societal” comes first in the title, because the modern economy is a largely a construction by
society and for the people. The transition to a societal market economy requires reforms in the firm’s organization. Three conditions must be met: (a) a societal accounting system; (b) an enlightened board of directors; (c) the adoption of a long term view

Undoubtedly, the objective of creating wealth is fundamental in a societal market economy, as a way to contribute to the well-being of society. Too often the ‘private profit’ goal is presented as principal, while in reality the main constraint for the capitalist firm is to creating wealth (value added) to be shared between three key stakeholders: workers (through employment and wages), society at large and state institutions (through taxes and social security), owners and shareholders (through reinvestments and dividends). A company cannot survive if it does not fulfill these three constraints in that order. Thus, the societal contribution of a market economy is acknowledged and formally recognized.

14. Main Ideas

Thirteen evolutions are identified as required for creating a new balance between business, state and society. They are:

1. From a deregulated to a regulated financial market
2. From short-termism to sustainable development
3. From polluting to green economy
4. From a price-driven to an innovation-driven competition
5. From a globalised to a “glocalised” economy
6. From a mostly industry-based to a mostly knowledge-based economy
7. From an opaque to a transparent economy
8. From a centralised to a distributed economy
9. From a not-for-profit model to an hybrid social business model
10. From a materialistic to a post-materialist economy
11. From an objective of well-being to the desire of fulfillment
12. From a command-and-control state to an enabling state
13. From a social to a societal market economy

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