ISSN 1759-5894

SRRNet
Social Responsibility
Research Network
www.socialresponsibility.biz

Discussion Papers in Social Responsibility
No 0901
Published 2009

Towards truly global markets

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Published by SRRNet, UK (www.socialresponsibility.biz)
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Introduction

The current financial crisis, much as previous ones, has highlighted failures in governance and failures in regulation. Indeed some writers, in their desire for scapegoating, have argued that the regulators are more guilty even than the perpetrators and should be sanctioned accordingly. There is of course one flaw in this argument and one problem with managing the prevention of future financial crisis (Grabel 2003) and this is concerned with the recognition of and regulation of a truly global market for finance. The liberalisation of financial markets instigated by the Washington consensus has made the free movement of funds a fact of financial life and has encouraged the parcelling together of doubtful debts into mystery parcels to be sold around the world. And of course the operators in all financial markets, always ready to accept a gamble in the hope of ever larger profits and bonuses have been quick to respond.

Regulators inevitably, according to their founders, must focus upon a local market while finance escapes them through its ability to migrate around the world. Effectively this means that any realistic form of regulation does not and cannot exist (Becker & Westbrook 1998). One consequence of this regulatory failure of course is that contamination spreads and the dubious practices developed in one financial market become the norm in other markets. When the inevitable crisis appears this too spreads from one country to another as all economies are affected by both the consequences of dubious lending practices and by the ensuing crisis of confidence. This calls attention to the fact – recognised but mostly ignored in the financial models used to legitimate financial activity – that the financial market is a global market and a corollary of this is that any regulatory regime must also be global. In this paper therefore we highlight the problems with the current regime and argue for a global regulatory authority capable of sanctioning even the most powerful actors in the market, including national and transnational governments.

Failures in governance

One of the main issues which has been of concern to corporate managers is that of corporate governance (Aras 2008). Probably since the mid-1980s, corporate governance has attracted a great deal of attention. Early impetus was provided by Anglo-American codes of good corporate governance[1]. Stimulated by institutional investors, other countries in the developed as well as in the emerging markets established an adapted version of these codes for their own companies. Supra-national authorities like the OECD and the World Bank did not remain passive and developed their own set of standard principles and recommendations. This type of self-regulation was chosen above a set of legal standards (Van den Barghe, 2001). After big corporate scandals corporate governance has become central to most companies. It is understandable that investors' protection has become a much more important issue for all financial markets after the tremendous firm failures and scandals. Investors are demanding that companies implement rigorous corporate governance principles in order to achieve better returns on their investment and to reduce agency costs. Most of the times investors are ready to pay more for companies to have good governance standards. Similarly a company's corporate governance report is one of the main tools for investor' decisions. Because of these reason companies can not ignore the pressure for good governance from shareholders, potential investors and other markets actors.

Good governance is essential for good corporate performance (Aras & Crowther 2008a) and one view of good corporate performance is that of stewardship and thus just as the management of an organisation is concerned with the stewardship of the financial

[1] An example is the Cadbury Report which went through several iterations to eventually become The Combined Code applied in 2003.

resources of the organisation so too would management of the organisation be concerned with the stewardship of environmental resources. The difference however is that environmental resources are mostly located externally to the organisation. Stewardship in this context therefore is concerned with the resources of society as well as the resources of the organisation. As far as stewardship of external environmental resources is concerned then the central tenet of such stewardship is that of ensuring sustainability. Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present (Aras & Crowther 2007a). This necessarily implies such concepts as generating and utilising renewable resources, minimising pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future.

The current crisis, and its effects, has meant that a great deal of concern is being expressed all over the world about shortcomings in the systems of corporate governance in operation and its organisation has been exercising the minds of business managers, academics and government officials all over the world (Spence 2008). Often companies' main target is to become global – while at the same time remaining sustainable – as a means to get competitive power. But the most important question is concerned with what will be a firms' route to becoming global and what will be necessary in order to get global competitive power. There is more then one answer to this question and there are a variety of routes for a company to achieve this. Corporate governance can be considered as an environment of trust, ethics, moral values and confidence – as a synergic effort of all the constituents of society – that is the stakeholders, including government; the general public etc; professional / service providers – and the corporate sector.

Of equal concern is the question of corporate social responsibility (Aras & Crowther 2007b); although there is an accepted link between good corporate governance and corporate social responsibility the relationship between the two is not clearly defined and understood. Thus many firms consider that their governance is adequate because they comply with The Combined Code on Corporate Governance, which came into effect in 2003[2] (Aras & Crowther 2008b). Of course all firms reporting on the London Stock Exchange are required to comply with this code, and so these firms are doing no more than meeting their regulatory obligations. Many companies regard corporate governance as simply a part of investor relationships and do nothing more regarding such governance except to identify that it is important investors / potential investors and to flag up that they have such governance policies. The more enlightened recognise that there is a clear link between governance and corporate social responsibility and make efforts to link the two. Often this is no more than making a claim that good governance is a part of their CSR policy as well as a part of their relationship with shareholders.

Failures in regulation

One thing which is apparent is that the current financial crisis, much as previous ones, has highlighted failures in governance and failures in regulation. Indeed some writers, in their desire for scapegoating, have argued that the regulators are more guilty even than the perpetrators and should be sanctioned accordingly. There is of course one flaw in this argument and one problem with managing the prevention of future financial crisis and this is concerned with the recognition of and regulation of a truly global financial market. The liberalisation of financial markets instigated by the Washington consensus has made the free movement of funds a fact of financial life and has encouraged the parcelling together of doubtful debts into mystery parcels to be sold around the world. And of course the operators

[2] It was revised in 2006.

in all financial markets, always ready to accept a gamble in the hope of ever larger profits and bonuses have been quick to respond.

Regulators inevitably, according to their requirements, must focus upon local market while finance escapes them through its ability to migrate around the world. Effectively this means that any realistic form of regulation does not and cannot exist. One consequence of this regulatory failure of course is that contamination spreads and the dubious practices developed in one financial market become the norm in other markets. When the inevitable crisis appears this too spreads from one country to another as all economies are affected by both the consequences of dubious lending practices and by the ensuing crisis of confidence. The crisis is of course made much worse by bank lending policy and financial profligacy, with bank lenders being secure in the expectation that there was no risk because governments would step in to rescue them[3] from dire consequences of their irresponsibility. Indeed the government bodies – with press complicity – have sought to disguise that fact that such lending has been completely irresponsible by falling back on semiotics to create the term toxic debt to disguise the reality of complete irresponsibility bordering on lunacy. The language being used from these people tends therefore to be used as a device for corrupting thought (Orwell 1970) by being used as an instrument to prevent thought about the various alternative realities of bank lending policy.

Of course such bank managers – encouraged in their lending policies by their governments – failed to recognise that it was possible to lend too much. Indeed it is scarcely creditable that such a scale of lending was possible but the banks in Iceland succeeded in lending at a level of 7 times the country's GDP. It is unsurprising therefore that the government was unable to rescue their banks from the credit crisis and had to resort to both seeking to pass liability on to individual citizens in other countries[4] and becoming the first developed European country for over 30 years to need IMF assistance. Perhaps the British government protested so strongly as the UK is also at risk with bank lending exceeding twice GDP and a distinct possibility of the British economy similarly imploding.

When considering the antecedents of the 2008 crisis however it is our view that this started to go wrong when the concept of limited liability was introduced for corporations – in my country in the early part of the nineteenth century. The principle of limited liability was introduced to protect investors (ie shareholders) from the potential adverse consequences of the actions of the corporations in which they invested. This paved the way for the attraction of many more investors, thereby enabling the growth in size of business enterprises, with those investors secure in the knowledge that they were protected from any loss greater than the sum they had invested in the enterprise. Thus for relatively small levels of risk they were able to expect potentially great rewards and thereby escape from some of the consequences of the actions of the enterprise. Further actions have been taken since to alleviate corporations (and hence shareholders) from the risk associated with their investments. Buckminster Fuller (1981) describes lucidly the actions of successive US governments during the twentieth century which had the effects of transferring all risk to society in general through taxation, reduced regulation and through acting to bail out failed enterprises. Examples can be found in the actions of most other governments. So without risk corporations were able increasingly to do whatever they wished – and without responsibility anything became possible, even the lies of the present as no-one was accountable for their actions as long as economic growth – and profitability – continued. Thus we arrive at the

[3] Consider for example the British governments nationalisation of Northern Rock before the crisis had really started. Consider also the even more surprising *volte face* of the US government in acquiring stakes in struggling financial institutions – lots of evidence of the risk free environment in which banks have been operating…

[4] The Icelandic government policy seems to have been to indemnify their own citizens while refusing to do so for citizens of other countries – not a popular policy in the UK where many people had accounts with Icelandic banks…

present excesses. The link between rights and responsibilities had been severed and forgotten. So it is reasonable to argue that the current state is an inevitable consequence of the increasing laxity regulation of markets just as the Enron debacle was an inevitable consequence of the increasing laxity in accounting and reporting standards. The unfolding of the details regarding bank lending policy[5] and the consequent effects upon the world economy parallel the unfolding of the Enron affair. This time also the casualties are becoming apparent but they are more than banks which are profligate with their lending; countries have also been shown to be profligate and are also paying the cost. Thus Iceland has been shown to be problematic with its banking regulation laxity and has had to seek an IMF rescue. No doubt more problems with continue to appear, including possibly the UK.

To a certain extent this too is a consequence of the reality that what is becoming more important than governments and nation states is the multi-national company, operating in a global environment. Some of these multinationals are very large indeed – larger than many nation states and a good deal more powerful. The exercising of this power, coupled with the desire of politicians to court the favour of these multinationals is one of the significant causes of the crisis. Many governments throughout the world have behaved as if they recognise this reality and have responded to the veiled threats from these corporations to relocate their operations by granting concessions of various kinds. Even the government of the United States – the most powerful nation on earth – has behaved in this way and continues to do so[6]. For them however the problem is that all their politicians are funded by these corporations and so they must behave as if they are on the payroll and must do as they are told. Needless to say these corporations are concerned with their own interests rather than with altruism and so American domestic and foreign policy is dictated by the needs of multinational corporations. And where America leads others must follow – or suffer the consequences – economic or physical.

We have of course all witnessed the effects of the actions of some of these global corporations. Recently we have seen the effects of the actions of some of these corporations within the United States itself – the champion of the free market. First we have seen the collapse of the global accounting firm Anderson; we have seen the bankruptcy of major corporations such as Enron and World.com with thousands of people being thrown out of work and many people losing the savings for their old age which they have worked so long and hard to gain. More recently we have seen many people lose their homes because they were deceived into taking out mortgages they could not repay – with this sub-prime lending being the start of the 2008 crisis. One of the arguments supporting the Free Market which allowed this to happened is the doctrine of *caveat emptor*. But the myth of the free market is grounded in classical liberal economic theory, as propounded by people such as John Stuart Mill in the nineteenth century, which, briefly summarised, states that anything is ok as long as the consequences are acceptable. And there is no alternative – at least if you listen to many. Indeed Francis Fukuyama (1992) argued that with the collapse of the Berlin Wall liberal democracy had triumphed and the end of history had arrived. Many people are familiar with this argument of Fukuyama – and have challenged the assertion – but most are less clear that he lamented this end of history.

[5] That is if indeed there was any lending policy other than greed and a naïve belief that the good times were here forever so risk could be ignored!

[6] At the time of writing the US government seems to have abandoned its Free Market principles (at least for large corporations – individuals can still go to the wall – and has poured money into the black hole of bank finance and is even supporting its car industry – surely a case of throwing good money after bad!

The Free Market system

The Free Market system is of course based upon the philosophy of Utilitarianism, which was a development of Classical Liberal Theory. This theory started to be developed in the seventeenth century by such writers a John Locke as a means of explaining how society operated, and should operate, in an era in which the Divine Right of Kings to rule and to run society for their own benefit had been challenged and was generally considered to be inappropriate for the society which then existed. Classical Liberalism is founded upon the two principles of reason and rationality: reason in that everything had a logic which could be understood and agreed with by all, and rationality in that every decision made was made by a person in the light of what their evaluation had shown them to be for their greatest benefit. Classical Liberalism therefore is centred upon the individual, who is assumed to be rational and would make rational decision, and is based upon the need to give freedom to every individual to pursue his / her own ends. It is therefore a philosophy of the pursuance of self interest. Society, insofar as it existed and was considered to be needed, was therefore merely an aggregation of these individual self interests. This aggregation was considered to be a sufficient explanation for the need for society. Indeed Locke argued that the whole purpose of society was to protect the rights of each individual and to safeguard these private rights.

There is however a problem with this allowing of every individual the complete freedom to follow his / her own ends and to maximise his / her own welfare. This problem is that in some circumstances this welfare can only be created at the expense of other individuals. It is through this conflict between the rights and freedoms of individuals that problems occur in society. It is for this reason therefore that de Tocqueville argued that there was a necessary function for government within society. He argued that the function of government therefore was the regulation of individual transactions so as to safeguard the rights of all individuals as far as possible.

Although this philosophy of individual freedom was developed as the philosophy of Liberalism it can be seen that this philosophy has been adopted by the Conservative governments throughout the world, as led by the UK government of Thatcher and the US government of Reagan in the 1980's. This philosophy has led increasingly to the reduction of state involvement in society and the giving of freedom to individuals to pursue their own ends, with regulation providing a mediating mechanism where deemed necessary. It will be apparent however that there is a further problem with Liberalism and this is that the mediation of rights between different individuals only works satisfactorily when the power of individuals is roughly equal. Plainly this situation never arises between all individuals and this is the cause of one of the problems with society. This problem will be returned to periodically throughout this book in the context of the role of accounting in maintaining this inequilibrium in power relationships.

While this philosophy of Liberalism was developed to explain the position of individuals in society and the need for government and regulation of that society, the philosophy applies equally to organisations. Indeed Liberalism considers that organisations arise within society as a mechanism whereby individuals can pursue their individual self-interests more effectively that they can alone. Thus firms exist because it is a more efficient means of individuals maximising their self interests through collaboration than is possible through each individual acting alone. This argument provides the basis for the Theory of the Firm, which argues that through this combination between individuals the costs of individual transactions are thereby reduced.

The concept of Utilitarianism was developed as an extension of Liberalism in order to account for the need to regulate society in terms of each individual pursuing, independently, his or her own ends. It was developed by people such as Bentham and John Stuart Mill who defined the optimal position for society as being the greatest good of the greatest number and argued that it was government's role to mediate between individuals to ensure this societal end. It Utilitarianism it is not actions which are deemed to be good or bad but merely outcomes. Thus any means of securing a desired outcome was deemed to be acceptable and if the same outcomes ensued then there was no difference, in value terms, between different means of securing those outcomes. Thus actions are value neutral and only outcomes matter. This is of course problematical when the actions of firms are concerned because firms only consider outcomes from the point of view of the firm itself. Indeed accounting as we know only captures the actions of a firm insofar as they affect the firm itself and ignores other consequences of the actions of a firm. Under Utilitarianism however if the outcomes for the firm were considered to be desirable then any means of achieving these outcomes was considered acceptable. In the nineteenth and early twentieth centuries this was the way in which firms were managed and accounting information was used purely to evaluate actions and potential actions from the point of view of the firm itself. It is only in more recent times that it has become accepted that all the outcomes from the actions of the firm are important and need to be taken into account.

The development of Utilitarianism led to the development of Economic Theory as means of explaining the actions of firms. Indeed the concept of Perfect Competition is predicated in the assumptions of Classical Liberal Theory. This is a problem because it encourages selfish and exploitative behaviour. So we can either believe that the market will mediate in an optimal way – which is complete nonsense – or we can suggest that ethical understanding will compensate – also nonsense. Or we must look for an alternative.

Gambling the future

The proposed solutions to the crisis are themselves problematic. Firstly the Free Market system upon which much of the current economic system is based has been abandoned as governments have sought to support ailing banks, thereby signalling yet again that there is no cost to profligate irresponsibility as far as financial markets are concerned. For institutions therefore the cost of irresponsibility must be born by society at large and particularly by future members of that society who must repay the enormous amount of government borrowings, or at best must service that debt. So the cost of irresponsibility now has been conveniently externalised into the future. While this public spending is in accord with the Keynesian economics which are the alternative to the deregulated economics of the Chicago school, Keynes himself actually advocated that the public spending should be utilised on the provision of public goods and infrastructure as an investment in the future. This time the spending has disappeared and the future has been mortgaged without any discernable benefit.

Although there has been much public discussion regarding how the responsibility should be apportioned this is not really significant, although it is apparent that those responsible are, in the main, avoiding sanction and penalty. Similarly many people have discussed the failures in the system which have led to the crisis. Significantly however there does not seem to be any recognition that this is largely a cause of a global environment with national regulation. And the voice of those calling for a regulatory environment to deal with this global environment are very quiet. So we argue that this needs to be solved in order to prevent future reoccurrences. Until this happens we are gambling with the future for no benefit.

Regulation and globalisation

All systems of governance are concerned primarily with managing the governing of associations and therefore with political authority, institutions, and, ultimately, control. Governance in this particular sense denotes formal political institutions that aim to coordinate and control interdependent social relations and that have the ability to enforce decisions. Increasingly however, in a globalised world, the concept of governance is being used to describe the regulation of interdependent relations in the absence of overarching political authority, such as in the international system (Rajan 2008). Thus global governance can be considered as the management of global processes in the absence of form of global government. There are some international bodies which seek to address these issues and prominent among these are the United Nations and the World Trade Organisation. Each of these has met with mixed success in instituting some form of governance in international relations but they are part of a recognition of the problem and an attempt to address worldwide problems that go beyond the capacity of individual states to solve (Rosenau 1999).

To use the term global governance is not of course to imply that such a system actually exists, let alone to consider the effectiveness of its operations. It is merely to recognise that in this increasingly globalised world there is a need for some form of governance to deal with multinational and global issues. The term global governance therefore is a descriptive term, recognising the issue and referring to concrete cooperative problem-solving arrangements. These may be formal, taking the shape of laws or formally constituted institutions to manage collective affairs by a variety of actors – including states, intergovernmental organisations, non-governmental organisations (NGOs), other civil society actors, private sector organisations, pressure groups and individuals). The system also includes of course informal (as in the case of practices or guidelines) or temporary units (as in the case of coalitions). Thus global governance can be considered to be the complex of formal and informal institutions, mechanisms, relationships, and processes between and among states, markets, citizens and organizations, both inter- and non-governmental, through which collective interests on the global plane are articulated, rights and obligations are established, and differences are mediated (Tobin 2000).

Global governance is not of course the same thing as world government: indeed it can be argued that such a system would not actually be necessary if there was such a thing as a world government. Currently however the various state governments have a legitimate monopoly on the use of force – on the power of enforcement. Global governance therefore refers to the political interaction that is required to solve problems that affect more than one state or region when there is no power of enforcing compliance. Improved global problem-solving need not of course require the establishing of more powerful formal global institutions, but it would involve the creation of a consensus on norms and practices to be applied. Steps are of course underway to establish these norms and one example that is currently being established is the creation and improvement of global accountability mechanisms. In this respect, for example, the United Nations Global Compact[7] – described as the world's largest voluntary corporate responsibility initiative – brings together companies, national and international agencies, trades unions and other labour organisations and various organs of civil society in order to support universal environmental protection, human rights and social principles. Participation is entirely voluntary, and there is no enforcement of the principles by an outside regulatory body. Companies adhere to these practices both because they make economic sense, and because their stakeholders, including their shareholders (most individuals and institutional investors) are concerned with these issues and this provides a mechanism whereby they can monitor the compliance of companies easily. Mechanisms such as the Global Compact can improve the ability of individuals and local communities to hold companies accountable.

[7] See www.unglobalcompact.org

Conclusion: the need for action

In this paper we have highlighted some causes of the failure of the economic system and the origins of the 2008 financial and economic crisis. Part of the problem is caused by failures in regulation and governance brought about by the nature of global markets but more local governance. So attention needs to be paid to the development of a truly global system of governance. This is the immediate need for action.

In the longer term further action is needed. We have also argued that a significant part of the problem is predicated in the underlying political philosophy upon which market economics is based – namely its basis in Utilitarianism. This too will result in future problems unless addressed and so in the longer term attention must be paid to addressing this and developing an alternative philosophical underpinning to economic activity – one which is not amoral as is Utilitarianism but one which has built into it a sense of morality. This is a more difficult but more important task.

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