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## Redefining Capitalism

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# Redefining Capitalism: an Ethical Rating and its Contribution To Development

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*Le monde  
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d'eux-mêmes.*

Today's world is a world of increasing differences. There are objections to the previous statement, but the World Bank's figures are self-explanatory. They point to a scenario whereby extreme poverty of the world's poorest would have dramatically increased in the past 20 years in Sub-Saharan Africa, whereas South and East Asia have benefited from the phenomenal growth of China and India.

There is overconfidence and a lack of realism in the first world as to how to tackle the situation that worsens day by day. Many individuals in the rich world, who are not directly involved with the difficulties faced by emerging economies, do not realize the depth and severity of the problems the poor encounter, or the degree to which the latter affect the daily lives of millions of people.

No easy solution seems feasible or applicable. There have been, and there are interesting initiatives that, provided their success, could bring first and third world closer together in terms of income, growth opportunities and share of the pie. However although apparently straightforward, these proposals remain simplistic

and hard to implement within the present regulatory framework, even if this may be possible on the long run. This situation is exacerbated by the fact that the individual is greedy by definition.

## **The role of financial economics**

Finance drives the economy in the developed world. The economic policies of rich economies determine the fate of emerging countries. It seems plausible to find alternatives that can be implemented through regulation in the financial markets of the developed countries, and to change some of the basics that permit their existence and operation. Capitalism has always been revisited after major crisis or crashes. The Great Depression in the 1930s, the crash of the stock market in 1987, the burst of the Internet bubble in the late 1990s, or the financial fiasco of Enron, Worldcom and Arthur Andersen in the early years of the twenty-first century, are all examples of situations in which the major players of the game redefined their roles and repositioned themselves. Many people in the first world may not see

Ces chiffres évoquent un scénario où l'extrême pauvreté des plus pauvres a augmenté de manière spectaculaire durant les 20 dernières années en Afrique Subsaharienne, alors que l'Asie du Sud et de l'Est ont bénéficié de la croissance phénoménale de la Chine et de l'Inde.

De même, les entreprises dans le monde d'aujourd'hui essaient de respecter les réglementations en vigueur, mais sont capables d'esquiver les codes de conduite éthique, toujours dans le but de maximiser leur profit.

a crisis in the current environment. Many may be too optimistic, overconfident, true believers in a process we all label globalization that brings good to everyone we know, to all around us. Some people could have misunderstood what globalization really brings to many, wrongly taking for granted that those living in the developing world can access the same sort of opportunities and resources as those of us who live in the rich world.

### **The UN goals will be unlikely accomplished**

As in the past, capitalism may need to be revisited. The current trend does not serve the goals set by the UN, which, given the current state of the world, will be unlikely accomplished by the year 2015.

Jeffrey Sachs, who currently heads the Commission in charge of UN's Millennium Development Goals, points out: 'we can realistically envision a world without extreme poverty by the year 2025 because technological progress enables us to meet basic human needs on a global scale and to achieve a margin above basic needs unprecedented in history'. Jeffrey Sachs is right in the end but he may not have pinpointed the correct means. Vandana Shiva, a writer connected with the participatory economics movement, led by Michael Albert, makes an interesting argument: 'to make poverty history, we first need to elaborate a real history of poverty. And Sachs has totally misunderstood it'.

The present trend of capitalism will be that of increasing differences. Inequality tends to increase not only at global level, but also within developed nations. The system is heading in the wrong direction, but still has the virtue to redefine itself. However this will not happen automatically.

### **Redefining capitalism**

The strong connection between financial markets and the opportunities available to emerging economies plays a key role in the search for practical ideas to redefine current capitalism, and manifests the importance of financial economics in the development of this approach. As previously stated, finance is viewed as the main driver of the first world's economies. Finance has a daily impact on the stability and growth of an economy.

There is already regulation in the financial markets that, through taxation, raises public funds for public spending. If corporations were given an option whether or not to pay corporate or dividend tax, they would definitely choose not to, based on the maximization of the present value of their future cash flows. Or equivalently, they would adopt the one strategy that most benefits their shareholders, the one that maximizes their equity.

Similarly, corporations in today's world tend to respect current regulations, but are able to skip ethical codes of conduct, always aiming at maximizing their profits.

Il y a une tendance toujours plus forte dans le monde de l'entreprise à adopter un code de conduite éthique qui préconise le respect de l'environnement, des conditions de travail flexibles, un équilibre entre le travail et la vie de famille, etc.

Cependant, une société est totalement libre de se doter ou non d'un tel code, en l'absence de toute répercussion d'un point de vue financier. En bref, la notation financière d'une société ne changera pas selon que celle-ci soit éthiquement responsable ou non.

One of the key strengths of current financial markets is the financial possibilities it opens to public corporations through the issuance of stock or corporate debt. The concept of financial rating is key to a public corporation, because it determines the cost of capital it will incur on whatever funds are borrowed from investors. The rating agencies impose strict constraints in determining certain ratings that are indicative of the financial strength of a corporation, or alternatively viewed, the established financial policies. Additionally, auditors make sure a public corporation's financial statements meet international standards and are trustworthy.

Hence there is a system in place with which the modern corporation has to comply. This system has undergone much evolution over the years, without reaching perfection. A corporation's only approach is to adapt to the regulation and the set of rules established by regulators and rating agencies. Top executives in large corporations work hard to be transparent, to not use confidential information to their own advantage, to immediately communicate whatever news may arise, either good or bad, to the financial community.

There is a growing trend in the corporate world to adopt a code of ethical conduct that includes respect for the environment, flexible working conditions, trade-offs between work and family, etc. However a firm is absolutely free to adopt such codes or not, as these have no repercus-

sions from a financial point of view. Briefly stated, a firm's financial rating will not change whether or not the company is ethically responsible. Today's financial markets only reward the financial manners of a corporation, with the ethical dimension being considered as irrelevant.

### **The need for an ethical rating**

We cannot live in a world governed by multinational corporations that do not have strong codes of conduct, that invest and divest huge amounts of funds as they wish, that outsource the majority of operations to third-world economies where deplorable working conditions reign, and that have no strong established ethical regulations. The rich world has succeeded in building a system that works for the first world, but that does not work globally. The system needs to be revisited, and this time the ethical component needs to be addressed.

Alongside the financial rating, companies should have an ethical rating of similar nature that would affect their financing and success in the consumer market, as much as the financial rating does in the financial markets. Rating agencies would determine the ethical actions of a corporation, whether or not it outsources, how it invests its money, the working conditions of its employees, whether its operating policies respect the environment, what part of its corporate tax is devoted to social action and so on. And there would

Les marchés financiers actuels tiennent seulement compte de la performance financière d'une entreprise, étant entendu que le comportement éthique est sans importance.

La notation financière est devenue une garantie pour l'investisseur parce qu'elle est révélatrice du risque d'insolvabilité d'une société. La notation éthique pourrait jouer le même rôle pour le consommateur. L'investisseur contre le consommateur, voilà la clé de cette évolution.

be (ethical) auditors that confirm whether the corporation complies with the set of ethical criteria established. A globalized economy characterized by the immediate communication of information should not tolerate unethical policies on behalf of corporations.

The statements are strong, since they touch every potential corporation that participates in the financial markets. But if a corporation currently does its homework financially speaking, simply because this is the way to operate within the system, a corporation will similarly do its homework from an ethical point of view, if this is a requirement to remain in the system.

### **The consumer as an actor**

Every potential investor looks at a corporation's financial rating prior to purchasing stock, corporate debt or derivatives that have the corporation's stock as underlying asset. The financial rating has become a guarantee for an investor because it is a definite indicator of the firm's probability of default. The ethical rating would play the same role for the consumer. Investor versus consumer is the key in this argumentation.

Products and services would be labelled with a company's ethical rating. The consumer could therefore know at any given moment whether a company is ethically responsible, and ultimately, consumers would reward or penalize a firm for not complying with the rules of the system. There is research available that links a con-

sumer's ethical values to his or her consumption habits. Therefore and provided that a consumer does have ethical values, he or she would likely purchase products or services that align with his or her values, ethically speaking. This is why the proposed system is sustainable. In order to be successful in the marketplace a firm would have to be ethically responsible. The better the ethical rating, the better opinion a consumer would have of the corporation, and the more likely he or she will be to purchase a certain product or service.

Multinational corporations would not determine a consumer's choice. Consumers will rather determine a corporation's set of operating policies. It's about reversing the rules of the game. It's about giving the consumer the power to believe that his or her actions truly affect the state of the world. It's about only allowing those players that respect the rules to participate in the game. It's about consumers pushing those corporations that are not ethically responsible out of the market.

### **Contribution to a development fund**

There is a success story in certain European savings banks that are required by regulation to devote a high percentage of their net income to social action. And these banks do so because they have to, in order to comply with the regulation. And the effects of their social policies are noticed locally.

Les produits et les services seraient étiquetés avec la notation éthique de la société. Le consommateur saurait donc à tout moment si une société est éthiquement responsable, et en dernier lieu, il récompenserait ou pénaliserait une société qui ne se plierait pas aux règles du jeu.

Dans cette perspective et dans le but d'atteindre la meilleure notation éthique, une entreprise devrait réserver un certain pourcentage de son revenu net à un fonds de développement.

On these lines, and in order to reach the maximum ethical rating, a corporation would have to give away a certain percentage of its net income, funds that would end up in a development fund. A company may choose not to do so, although by doing so it may obtain the maximum ethical rating and the corresponding consumer reward. It is a trade-off, since what a firm loses by giving away part of its funds is earned through consumer reward. The money accumulated in the development fund would be managed by a public entity that would only invest in companies that are ethically responsible. Companies that are ethically sound, besides being financially driven, would see their financing opportunities increased. This idea follows from the ethical ratings presented above.

### **Towards a global sense of justice**

It is possible to picture a world with strong multinational corporations that are ethically responsible. It is feasible to imagine a development fund converted into the largest fund of human history, that only invests in companies with strong ethical codes of conduct, that devotes the rates of return of its investment strategies to development aid, and by doing so fosters ethical operating policies within corporations.

Going one step further, let's suppose that by regulation, the wealthiest are required to devote a tenth of their wealth to a development fund. If this fund's principal were to be

compared with other large funds, it would be the largest of any funds in the history of financial markets. Personal wealth over a certain amount should be taxed. The current regulation taxes income and gains on assets, but does not tax personal wealth. Ultimately, nobody should be eligible to possess more than a certain amount of money without being taxed for the monetary resources held. In terms of a global sense of justice, it is simply not sustainable. And this can and should be accomplished through regulation, with changes to the tax code.

Corporations would be entitled to invest 10% of their net income in a development fund over a certain time horizon, say 5 years. After this period expires, the corporation would get the invested money back, and this would be done on an annual basis. The fund would keep the profits linked to the investment strategies, and devote them to development aid.

Rich economies would issue as much as the equivalent of 10% of their GDP in public debt and devote this money to the investment fund. Again, only the profits from the investment strategies would be used as development aid. Therefore the fund would have a principal to invest in securities that would not decrease over time. Surplus of rich economies of the world would feed the development fund, whose rate of return would become development aid for third-world economies. Personal wealth over \$1 billion would be ini-

On peut se représenter un monde où les entreprises multinationales puissantes seraient éthiquement responsables. Ce n'est pas non plus impossible d'imaginer un fonds de développement devenu le fonds le plus important de l'histoire, qui investirait seulement dans les sociétés dotées de solides codes de conduite éthique, qui consacrerait le rendement de sa stratégie d'investissement à l'aide au développement, encourageant ainsi les comportements éthiques dans les entreprises.

En allant encore un peu plus loin, on peut imaginer que selon la loi, les plus riches doivent consacrer un dixième de leur richesse totale à un fonds de développement.

tially asked to contribute 10% to the development fund.

And last but not least, individual investors would be welcome to allocate part of their savings to the fund over a certain time horizon, after which they would get the principal invested back. Many of today's individual investors with certain savings on their accounts, either do not invest them and hence keep them in a checking account with either no return or very low return, or invest them in funds that yield small returns that are mostly kept by the investment managers for actively managing the funds (management fees).

These individuals could alternatively invest their savings in the development fund that could have indexed investment strategies in exchange, and would not charge management fees. The individuals would get back the principal invested after the time horizon they chose, the rates of return being kept by the fund, and devoted to development aid.

### **From the rich to the poor**

The fund would become a redistribution instrument, from the rich to the poor. With an annual budget equal to the profits of its investment strategies, the fund would distribute the profits competitively among projects proposed to a central committee. The committee would be in charge of allocating the funds. Proposals would be submitted and analysed by the committee year round. In an annual summit, the committee would announce which propos-

als have qualified for funding. The projects that get funded would be monitored and audited by the development fund's auditors, who would travel to emerging countries to follow up the development of a project.

The above process guarantees that the development aid is used as efficiently as possible, that through submission, only strong proposals get funding. Furthermore, the audits would also ensure that an organisation does not receive funding again if it has previously been declared corrupt by auditors.

### **A transparent and fair project**

This global mechanism departs from the accumulation of resources through the introduction of a development fund. The mechanism does not only raise the required funds, it also allocates the money from a global perspective of fairness. The process is transparent, and all projects are given an equal chance to get funding. Projects are not only funded, but a follow-up audit makes sure the money allocated is properly used for the purpose in hand.

Within a time frame of five years from inception, the development fund would represent annual funds exceeding the aggregate budget of four of the most representative non-profit organizations worldwide, such as Unicef or the American Red Cross. If, as previously claimed, we assume that the 500 wealthiest individuals devote 10% of their wealth to the

Après un laps de temps de cinq ans à partir de sa conception, le fonds de développement représenterait un montant annuel supérieur aux budgets cumulés de quatre des organisations à but non lucratif les plus significatives, telles que l'Unicef ou la Croix Rouge américaine.

Si, comme mentionné plus haut, on part du principe que les 500 personnes les plus riches consacraient 10% de leur richesse au fonds, les bénéfices annuels dégagés par les investissements s'élèveraient à 20 milliards de dollars.

La mondialisation ne peut pas se concentrer sur un seul objectif en mettant tout le reste de côté.

fund, total annual profits of the investment strategies would yield \$20 billion per annum.

Similarly, let's consider a national economy like that of Spain, issuing the equivalent of 10% of its GDP in public debt. Spain's economy has a current public debt level as a percentage of GDP of 44% and a GDP (2004) of roughly \$891 billion. The principal of the development fund would accordingly increase by \$89 billion and the profits from the investment strategies devoted to development aid would rise by approximately \$13 billion if we apply two basic investment strategies.

### A virtuous circle

Ethical ratings would affect a corporation's financial status, from the sales figures to the market share, mainly because ethical ratings would have a direct impact on consumer behaviour and the choices made when purchasing products and services. By adapting to a set of ethical constraints a firm could directly or indirectly influence third world economies where the firm or one of its suppliers may conduct operations. This in turn would affect, among others, a poor country's workforce and its quality of life. Furthermore it would encourage policies that promote the stability of poor countries' economies, including the fight against money laundering and illegal money transfers.

A development fund, conceived as presented above, would substantially increase the amount of fund-

ing available for development aid in third world countries and therefore have a direct influence on the causes of poverty.

Wealth redistribution has enabled modern economic societies of the twentieth and twenty-first centuries to reach a quality of life that would have been unimaginable after the two world wars. The progressive nature of the tax code is certainly something that those who earn most dislike. A wealthy individual would be better off managing that part of his or her wealth on his or her own. The progressivity of the tax code benefits many low-income households to the detriment of a lesser number of higher incomes. This represents the concept of solidarity in countries with established advanced economic systems.

### Globalization is about redistribution

Globalization cannot serve one goal and deny others. Globalization is not only about destroying trade barriers to sell internationally. It is also about redistribution from the rich to the poor. And if we think of the world as a common and integrated economic system where everybody is interconnected, there should be income redistribution from the rich to the poor globally, just as there is at a national level.

Susan George makes an interesting remark regarding the allocation of the funds raised through her taxation proposal: 'suppose that in-

La mondialisation ne se résume pas à l'abaissement des barrières commerciales pour pouvoir vendre dans tous les pays. Il y va aussi de la redistribution des richesses, du riche vers le pauvre.

ternational taxation of international transactions, corporate mergers and acquisitions and industrial pollution is accepted; that genuine debt relief is granted and a pool of fresh funds is thereby constituted. Is that the end of the story? The most important part remains to be invented and it concerns managing and using the money. [...] Probably the best

option would be a new, small UN body made up of personnel chosen from the UN specialised agencies plus a corps of roving auditors. [...] After forty-plus years of largely unsatisfactory development aid, we've had an opportunity to learn at least one thing: you can't just hand over funds to a government and hope for the best'. •