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STAKEHOLDER CAPITALISM DURING AND AFTER COVID-19

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Summary

The COVID crisis has exposed multiple failings within today's economic system, including the precarity of work, high levels of private debt, and weakened civic infrastructure. The dominant corporate governance model - shareholder value maximisation – combined with financialization has led to a neglect of broader stakeholders and societal challenges. 'Just-in-time' business culture has eradicated slack in supply chains, where disruption is now impeding the production of critical health equipment. Meanwhile, the profit-focused model of health innovation has failed to prepare society with a coronavirus vaccine, despite the occurrence of SARS nearly 20 years ago.

To overcome these market failures and urgently mitigate the health emergency, we call for governments to deploy their 'war-time' capacity to steer production and investment towards food and medical equipment, as well as a vaccine that will be accessible, affordable, and distributed to those most in need.

With many private corporations now in urgent need of public financial support, the COVID crisis also provides an opportunity to change the fundamental way that public and private sectors interact to shape a better kind of capitalism. Corporate bailouts should embed strategic conditions in order to align corporate behaviour with the needs of society. In the short term, such conditionalities should focus on preserving employment and maintaining the productive capacity of the economy, whilst avoiding the extraction of government funds by dividends and executive compensation. In the longer term, governments should use conditionalities to promote dignified working conditions, including decent pay, adequate safety, and worker representation, as well as advance longer-term societal missions, not least the need to transition to a net zero-carbon economy. Such mission-oriented public policy should encourage more investment in mission-orientated innovation, as well as supporting worker retraining and transition in sectors that face permanent changes, such as aviation.

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It is now vital to ensure public-private collaborations lead to collectively beneficial outcomes for all of society. By ensuring that public support rewards value creation instead of value extraction, governments will be setting the foundations for resilient businesses, as well as strong, sustainable and inclusive growth in the post-COVID period.

Summary of Proposals:

Proposal 1: Governments must take responsibility for steering economic activity towards the creation of a vaccine, and the provision of protective equipment, testing and community contact tracing where they are most needed

Proposal 2: Coronavirus vaccines should be accessible and affordable on a global scale

Proposal 3: Governments must use conditionalities when bailing out corporations to restructure the post-COVID economy towards sustainable and inclusive growth

Proposal 4: Most immediately, conditionalities should be used to protect employment, promote dignified working conditions, and avoid financialised practices

Context

Dysfunctional Public-Private Economic Relations

The COVID crisis highlights the importance of the relationship between public and private sectors. Governments can provide support to private companies through emergency interventions, but also by subsidising investments and protecting innovation (e.g. via patents). Yet the relationship is too often designed to deliver private value for the corporation rather than public value to society. Thanks to government support, corporate risks are effectively socialised, yet the rewards are all too often privatised (Lazonick and Mazzucato 2013).

The present crisis presents a window of opportunity to reshape dysfunctional public-private relations. When public support enables new value creation in the private sector, governments should ensure that the resulting outcomes benefit society as a whole. This symbiotic relationship must begin with the emergency support currently being extended to businesses.

Corporate bailouts must reward value creation rather than value extraction. It is time to establish **economic relations for public purpose between public and private sectors.** (Mazzucato 2020a)

A variety of approaches are being used to support business and employment continuity. Several countries, including Australia, Denmark, Poland, Singapore, and the UK, are providing wage compensation to firms for maintaining employment. Others refusing to bail out firms that practise tax avoidance. Singapore is subsidising environmentally friendly investments. Some countries are lending to companies with no strings attached, while Germany is ready to take ownership stakes in ailing companies.

Supply and Production Failures

The COVID crisis has affected a number of countries disproportionally due to them lacking preparation, foresight and capabilities to steer economic activity. In the UK and the USA, production systems have revealed significant vulnerabilities, with widespread difficulties ramping-up production and coordinating supply chains of food, medicine, ventilators, protective equipment, and test kits. The inability of corporates to respond to supply chain disruption has been exacerbated by efficiency-focused business cultures. Just-in-time and lean management systems identify slack capacity as inefficient, yet the eradication of such critical buffer zones has left many corporates less able to respond to shocks. Some countries, such as Germany and Korea, have shown **much more resilience in their production systems**. This is partly due to domestic manufacturing capacity but also thanks to the ability of the government to coordinate private sector activity where market forces have become incapacitated.

Meanwhile, the pharmaceutical sector has failed to supply society with proven treatments or vaccines for coronavirus, despite the fact that these types of virus seem to spread once a decade (SARS in 2002 and MERS in 2012). This is due to the ‘monopoly model’ that dominates health research, where innovation is incentivised by granting patent monopolies to drugs companies. In practice, this results in the pharma industry chasing maximum returns rather than public health priorities. With the revenue potential for infectious diseases considered limited (Bloomberg 2020), there were only six potential coronavirus vaccines in clinical trials before the current pandemic, and all were dependent on public support (Rizvi 2020). This neglect has left us ill-prepared for developing the urgently needed vaccine.

The Unfolding Corporate Debt Crisis

Private corporations are under severe financial pressure globally. Various financialised practices have left many corporations hamstrung with a heavy debt load. Such practices include taking on debt to pay dividends, buying back shares, or conducting leveraged takeovers of firms. As a consequence, the corporate sector has become more fragile and sensitive to income and credit downturns.

Amidst the pandemic fallout, highly leveraged companies are suffering the dual blow of falling income and increasing interest rates, due to higher perceptions of risk. Billions of dollars' worth of corporate bonds will soon mature (Forbes 2019). Repayment often requires issuance of new bonds. Yet with significantly worsened credit conditions, refinancing will increase the risk of bankruptcy.

Companies rated 'BBB' are deemed just safe enough to be 'investment grade', an important criterion for large institutional investors to hold their bonds. Yet the economic crisis is already heralding a spate of ratings downgrades, which will push many companies across the threshold into 'junk' status. Debt costs will soar as large institutional investors are forced to sell their bonds. The cascade of bankruptcies that follow may trigger further public bailouts.

As described below, some central banks have taken measures to support the financing conditions for companies who were in the 'investment grade' category before the crisis. Nevertheless, large amounts of unsupported 'high-yield' debt and rising debt servicing costs continue to present significant risks.

This dismal outlook for global corporations signifies the need for a plan to use strategic conditionalities as companies ask for public support.

Public Bailouts Programme

Globally, government support for corporations has ranged from direct cash grants and equity stakes, to tax breaks and loans at favourable terms or with a government guarantee. Monetary policy has also been deployed to support corporates by purchasing corporate bonds on a massive scale.

A wide range of countries have authorised direct payments to firms to subsidise wages - including Australia, Denmark, Poland, Singapore, Saudi Arabia, and the UK – in order to preserve productive capacity whilst maintaining household incomes. Some countries have included additional conditionalities. The EU has banned dividends, share buybacks, M&A activity, and bonus payments as part of a temporary extension to its state aid rules. Denmark, Poland, and France have stipulated that public funds will not go to companies headquartered in tax havens.

The worst-affected sectors have needed more extensive support. US airlines have been granted up to $46 billion in loans and guarantees, with strict conditions including 90% workforce retention, pay-cuts for executives, and bans on outsourcing and offshoring. Germany is set to acquire significant equity stakes in airline companies to ensure strategic infrastructural capacity, whilst France has attached environmental conditions to its support of the sector.

However, large portions of government support are also being operationalised through central bank operations. After public pressure, the Bank of England has now imposed conditions limiting dividends and excessive executive compensation for companies seeking to borrow for more than a year. In the US, however, conditionalities remain limited. The extension of the Federal Reserve's bond purchases into risky high yield bonds has also fuelled fears of 'moral hazard' by rewarding dubious practice. For example, the US shale oil sector was highly leveraged and mostly unprofitable even before the pandemic. The significant financial and policy support it stands to receive from now, will shield the sector from its perhaps inevitable 'creative destruction' amidst the transition to a sustainable economy.

Recommendations

1 Steering Production and Distribution of Urgently Needed Equipment

In an economic downturn, the primary challenge is to restore valuable activity. However, the current pandemic has revealed that the coordination of private production is also critical to mitigate the health crisis. Governments should be driving a huge redeployment of resources towards areas of the economy most in need, especially the health sector. Manufacturing firms should be supported to switch to making essential equipment in short supply, such as ventilators. To manage the social and economic impacts of sustained lockdowns, major investment into online teaching, entertainment, and socialising technologies is also warranted. Together this demonstrates the concept of the 'war-economy': the state redeploying resources on a massive scale to achieve collective missions.

Throughout the 20th century, many countries – both developed and emerging – actively steered economic development using strategic industrial policies and credit guidance (Bezemer et al. 2018). The US government, for example, spearheaded the mass production of penicillin in order to fulfil medical need during WWII. History has shown that states can rise to the challenge and coordinate the production and distribution of essential equipment needed to mitigate crises.

To address the present pandemic, there is an urgent need for states to ramp-up production and coordinate supply chains for the production of food, medicine, ventilators, personal protective equipment and test kits. Where market forces become incapacitated, government support can enable urgent production at unattractive price points and can then ensure scarce goods are distributed according to public needs. With bidding wars for protective equipment emerging both between and within nations, concerted efforts are now needed to ensure enough is produced, and that those most in need are protected.

The distributional aspect is crucial, since a lack of public intervention will lead to excessive profiteering by producers and middlemen, as well as too few essential resources ending up where they are needed most: frontline workers in the health and food supply sectors

2 Governing Risk and Rewards of COVID-19 Research

Products resulting from public research and development (R&D) funding should be available at reasonable prices, rather than at excessive monopoly prices due to granted patent rights. This is especially true for the health care and pharmaceutical industries, who benefit from value-extracting business models enabled by lenient public regulations and lack of conditionality (Mazzucato et al. 2018).

With the global community now investing heavily in vaccines, tests and medication for the coronavirus, it must be ensured that the results will be available to all. There is a threat that the eventual COVID-19 vaccine ends up as an expensive monopoly product, despite significant public investments in research (Mazzucato and Momenghalibaf 2020). A number of involved companies have stated willingness to make a successful vaccine accessible, but governments should ensure that this is the case.

The US National Institutes of Health (NIH) has been significantly supporting COVID-related R&D. Since the SARS outbreak in 2002, the NIH has been spending nearly $700 million on coronavirus R&D, leading to a number of promising drug candidates, including Gilead's Remdesivir. In a sector that receives so much public funding, states should govern the drug innovation process, using their market-shaping capacity to steer innovation, negotiate fair prices, and ensure appropriate patents and competition, whilst setting conditions for reinvestment, and safeguarding medicine supply.

To ensure the delivery of social value, public funding of health innovation should embed conditionalities with four key aims: access and affordability, international knowledge sharing, reinvestment, and transparency of R&D costs. In the context of COVID-19, the first two aims are particularly paramount. Governments must ensure that vaccines and treatments developed through public funding do not fall prey to price gouging and that adequate supplies are produced for countries without manufacturing capabilities.

3 Bailouts for Public Missions

Financialised practices are widespread in both developed and emerging economies. The financialisation of corporate governance has turned many companies into tools for channelling as much cash as possible to their shareholders on increasingly short-term time horizons. As we are currently witnessing, this has left many corporations without financial cushions to weather a shock. Moreover, the ideology of shareholder value maximisation has inflicted critical casualties upon society. This can be seen in the poor treatment of workers and the environment, as well as a lack of much needed investment in innovation and high-value-added manufacturing capacity.

Corporate priorities must shift from the needs of shareholders to a more holistic view encompassing the needs of all stakeholders (Mazzucato 2020b). A mission-oriented policy approach can help coordinate the various policy tools to achieve the public's grand challenges (Mazzucato 2019). The COVID crisis is an occasion to change the landscape of corporate behaviour through the application of strategic conditionalities. If done right, this can be the start of a move away from corporate value extraction through various sources of economic rents such as patents, lobbying of legislators and squeezing of the employees. On the new path, it must be more profitable to produce the solutions for our common challenges.

What to promote?

Employment

There is an urgent need to use conditionalities to maintain employment to protect the productive fabric of business organisations and the income security of households. While demand is low, workers can be trained and re-skilled to create more value after the health crisis. Where some sectors face permanent changes, e.g. in the aviation industry, governments should actively facilitate the transition into new occupations.

Better Work Conditions

Conditionalities should also foster enduring changes in the work conditions to reflect the value and dignity of work. This includes adequate safety, decent wages and inclusion in firm management, as is prevalent in Germany. The pandemic has highlighted the need for sick pay to allow people to stay home when ill to protect the public health. These improvements need to include the currently excluded workers, such as independent contractors and informal labour, in both developed countries and the Global South. This requires support for union organisation rights so working communities obtain the independent voice to demand and enforce humane standards at work.

Smart Conditions

When relevant and possible, governments should use conditionalities to advance longer-term missions. Businesses and financial institutions have not been investing sufficiently in productive capacity to provide solutions for our needs while lowering our impact on the environment. We therefore need more investment in sustainable innovation, ensuring such new technologies are also made accessible for the wider society. For carbon-intensive firms, smart bailout conditions must also be used to balance the need to maintain employment with the longer-term mission of transitioning to a low-carbon economy. Governments should consider taking equity stakes in particularly climate-exposed firms, in order to manage business transitions in the interest of workers.

What to prevent?

Corporate Closures

Companies are sometimes framed as black boxes where capital and labour are combined. However, they are social endeavours where the continual organisation of resources forms the foundation for prosperity. Viable businesses must therefore be protected, even in case of bankruptcy procedures, to avoid a collapse in the productive capacity of the economy. In the case of widespread insolvencies, governments could consider taking equity positions (as was used during the Great Financial Crisis) or supporting the shift to alternative organisational structures, such as worker cooperatives.

Financialised Practices

Bailouts for public purpose must avoid subsidising and validating extractive business models and financialised practices. Conditionalities should prevent our productive firms being depleted of funds through untimely CEO bonuses, excessive dividends, share buybacks, unnecessary indebtedness, use of tax havens, and political lobbying.

Furthermore, the conditionalities should be used to prevent ‘price gouging’ – the excessive pricing of essential goods, especially COVID-related medicine and vaccines.

When conditionalities are effective, they align corporate behaviour with the needs of the public. In the short term, this revolves around preserving employment during the crisis and maintaining corporate solvency whilst preventing firms from funnelling public funding to financial markets.

Denmark has been at the forefront during the crisis by offering generous wage compensation for firms conditioned on no layoffs for economic reasons. The Danish government is also supporting corporate solvency by funding fixed costs, while excluding companies in tax havens and disallowing the use of funds on dividends and share buybacks for larger recipients for two years. This is the right mentality, although the conditionalities could easily be tightened.

In the US, the Federal Reserve is delivering significant support to the private sector through its Main Street Lending and bond purchasing programmes, but without requiring that firms must maintain payrolls ahead of dividends. This is framed as maintaining ‘market-neutrality’. Yet a bailout can never be neutral, as such support risks validating previous financialised practices.

The COVID crisis is an opportunity to change the fundamental way the public and private sectors interact to shape a better kind of capitalism. This is the time to ‘walk the talk’ on the recently rekindled idea of stakeholder capitalism.

Conclusion

The COVID crisis has emphasised the need for national governments to act as market shapers not just market fixers. The failure of markets to provide essential equipment, tests, and medicines during this health emergency requires governments to deploy their ‘war-time’ capacity to steer production and investment towards societal need. As private corporations increasingly seek state aid, it is time to ensure that government support for businesses is driven by public not private interests. This applies to the emergency pandemic bailouts as well as longer-term public-private collaborations. The use of smart bailout conditions can help to secure employment whilst ensuring the transition to sustainable business practices.

The COVID crisis presents a unique opportunity for governments to rebuild positive symbiotic relations with the private sector. By addressing dysfunctional corporate practices, such as financialisation, and rewarding collective value creation, strategic conditionalities can lay the foundation for a more sustainable and inclusive model of capitalism for the post-COVID period.

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