THE NEW WORLD ECONOMY

BY JEFFREY D. SACHS

US politics and the Paris finance summit

Barbadian Prime Minister Mia Mottley and French President Emmanuel Macron invited world leaders to Paris on Thursday and Friday last week to develop a new global pact to finance the fight against poverty and human-induced climate change.

All kudos for the ambition, yet few dollars were put on the table. To an important extent, the continuing global failure to finance the fight against poverty and climate change reflects the failings of US politics, as the US remains at the center of the global financial system.

To understand US politics, it is important to start with the history of the British Empire. As Britain became an imperial power, and then the world's leading power of the 19th century, British philosophy changed to justify its emerging empire.

British philosophers championed a powerful state: Thomas Hobbes' *Leviathan*; the protection of private wealth over redistribution: John Locke's right to "life, liberty and property;" markets over government: Adam Smith's "invisible hand;" and the futility of aiding the poor: Thomas Robert Malthus' law of population.

When humanitarian crises arose in the British Empire, such as the Irish famine in the 1840s and the famines in India later in the century, Britain rejected providing food aid and left millions of its subjects to starve, even though food supplies were available to save them. The inaction was in line with a *laissez-faire* philosophy that viewed poverty as inevitable, and help for the poor as morally unnecessary and practically futile.

Britain's elites had no interest in helping the poor subjects of the empire — or Britain's poor at home. They wanted low taxes and a powerful navy to defend their overseas investments and profits.

The US learned its statecraft at the knee of Britain, the mother country of the US colonies. The US' founding fathers molded the new country's political institutions and foreign policies according to British principles, albeit inventing the role of president instead of monarch. The US overtook Britain in global power in the course of World War II.

The lead author of the US constitution, James Madison, was an enthusiast of Locke. He was born into slave-owning wealth and was interested in protecting wealth from the masses. Madison feared a system of democracy in which people participate in politics directly, and championed representative government, in which people elect representatives who supposedly represent their interests. Madison feared local government, as it was too close to people and too likely to favor wealth redistribution. He therefore championed a federal government in a capital far away.

Madison's strategy worked. The US federal government is largely insulated from public opinion. The public majority opposes wars, supports affordable healthcare for all and champions higher taxes on the rich. The US Congress routinely delivers wars, over-priced private healthcare and tax cuts for the rich.

The US calls itself a democracy, but it is a plutocracy — the Economist Intelligence Unit categorizes the US a "flawed democracy."

Rich and corporate lobbies finance the political campaigns, and in return, the government delivers low taxes for the rich, freedom to pollute and war. Private health companies dominate healthcare. Wall Street runs the financial system. Big oil runs the energy system, and the military-industrial lobby runs the foreign policy.

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This brings us to the global climate crisis. The most powerful nation in the world has a domestic energy policy in the hands of big oil. It has a foreign policy that aims to preserve US hegemony through wars, and it has a Congress designed to protect the rich from people's demands, whether to fight poverty or to fight climate change.

The US leaders who attended the Paris Summit for a New Global Financing Pact — US Special Presidential Envoy for Climate John Kerry and US Secretary of the Treasury Janet Yellen — have outstanding ethics and long-standing commitments to fighting poverty and climate change. Yet they cannot deliver actual US policy. The US Congress and its plutocracy stand in the way.

The leaders at the summit recognized the urgent need to expand official development financing from the multilateral development banks (MDB) — the World Bank, the African Development Bank, the Asian Development Bank and others.

However, to expand their lending by the amounts needed, MDBs require more paid-in capital from the US, Europe and other major economies. Yet the US Congress opposes investing more capital in MDBs, and its opposition is blocking global action.

The US Congress opposes increasing capital for three reasons: First, it would cost the US money, and rich campaign funders are not interested. Second, it would accelerate the global transition away from fossil fuels, and the US' big oil lobby wants to delay, not accelerate, the transition. Third, it would hand more policy influence to global institutions in which China participates, yet the US' military-industrial complex wants to fight China, not collaborate with it.

While developing countries need hundreds of billions of US dollars in additional MDB lending each year, backed by additional MDB capital, the US and Europe are instead pressing the banks to lend slightly more with their existing capital.

The MDBs could squeeze out another US$20 billion in loans each year with their current capital, but it is a fraction of what is needed.

The exasperation of the developing world was on full display in Paris. Brazilian President Luiz Inacio Lula da Silva and some African presidents said that there are too many summits and too few dollars. Chinese Premier Li Qiang (李強) spoke quietly and courteously, pledging that China would do its part alongside the developing countries.

Solutions can finally be found when the rest of the world moves forward despite the US dragging its feet. Instead of allowing the US to block more capital for the MDBs, the rest of the world should move forward with or without the US. Even US plutocrats would realize that it is better to pay the modest price of fighting poverty and climate change than to face a world that rejects their greed and belligerency.

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The dilemma of breaking down Asia's business giants

Incremental measures might be the best way to break down the dynastic and politically powerful conglomerates in the region

BY SIMON COMMANDER AND SAUL ESTRIN

Turmoil around the Adani Group in India has renewed old debates about inappropriate connections between the country's politicians and its biggest businesses. Similarly, Thailand's election last month revealed widespread frustration toward a regime that appeared to have grown too cozy with the monarchy, the military and business elites.

None of this is new in Asia. When former Indonesian president Suharto was ousted from power 25 years ago, similar concerns bubbled to the surface, if only briefly.

Now, ties between business groups and politicians are coming under scrutiny again. Market concentration has been deepening across the region as big, highly diversified business groups — most of them family-owned — come to occupy the commanding heights of national economies.

In China and India, the combined revenues of each country's top 10 companies accounted for about 10 to 15 percent of GDP by 2018, while in South Korea, Thailand and Vietnam the ratio was 30 to 40 percent.

Samsung's revenues alone make up more than 20 percent of South Korea's GDP.

These ratios appear to have been rising — sometimes sharply — in recent decades. In India, the revenues of the 15 largest business groups grew from about 9 percent of GDP in 2000 to nearly 15 percent by 2019.

Market concentration and corporate conglomeration tend to run together, giving rise to what we call the "connections world."

In our recent book, *The Connections World: The Future of Asian Capitalism*, we show how business groups have come to occupy the apex of this domain across the region.

Politicians routinely look to businesses to make campaign or personal contributions, pay bribes, provide sinecures for family members and associates, and create jobs in regions or at moments that are politically advantageous.

In doing so, they generally prefer working with business groups, whose scale and influence allows for a more simplified policymaking process.

At the same time, business groups are organized so that their owners can respond rapidly to requests from politicians, and thus also to opportunities for acquisitions, licenses, permits and public contracts.

They maintain a capacity to reallocate resources quickly, often using transfer pricing or intra-group loans, in addition to their wider suite of financing options.

As a bonus, the complexity of these groups' ownership and financial structures acts as a deterrent against possible predators, whether political or commercial. Having found a place in the sun, few of these groups get pushed permanently into the shade.

Although new, well-connected companies enter the market, the overall number of top players in Asian economies usually remains restricted.

This is not a straightforward case of corruption or conflicting interests. In recent decades, the connections world has been effective in providing solutions to many problems of economic development, owing to its unique power to achieve close coordination between the state and business.

However, in addition to entrenching market power the connections world has also generated sharp increases in income and wealth inequality, as most of the big players are owned and controlled by a very small cohort of extremely wealthy families.

These issues have increasingly led to calls to break up overly dominant business groups, especially when there is a greater need to stimulate competition and hold down inflation.

Among the measures being proposed, most have been tried before. The US government's 1911 breakup of Standard Oil is the classic example.

However, such radical interventions are generally reserved for the most egregious monopoly cases, or for periods of acute crisis.

Yet there is no crisis across most of Asia — only some underlying discontent. Most local business groups are held up as national champions at the vanguard of economic progress.

Although the region's last major financial crisis, from 1997 to 1998, killed off some larger businesses in the short run, it ultimately reinforced the connections system and the major players that survived.

Today, the key players — business owners or politicians — have very few reasons to support a change, and plenty of reasons to maintain the status quo. An extraordinary amount of wealth and economic influence is at stake.

There are still big questions about what shape reforms should take. Is breaking up business groups desirable or feasible, and are better alternatives available?

In assessing the desirability of breaking up business groups, one problem is that all the available evidence on pricing, profits and anticompetitive behavior remains spotty and inconclusive — owing to the groups' opaque accounting practices.

In some countries, such as the Philippines, some families and their business vehicles dominate much of the formal economy.

Elsewhere, far more competition between groups results in a murkier picture.

Even if national authorities settle on a policy of breaking up business groups, it is not obvious what criteria they should use to determine which ones warrant enforcement action.

Picking the top five or 10 as measured by size would leave a significant number of other major players who could be expected to pick up any slack. The mandated breakups could trigger recombination of assets under different guises.

The usual response to such concerns is that the process would require political resolve.

However, this is similarly unconvincing, especially in the context of the connections world. Politicians have very few incentives to act, and they also worry about how breakups could affect business confidence more broadly.

Before focusing on alternative models, it is important to comprehend the most compelling reason for circumscribing or eliminating the business-group format.

Aside from their common failings in corporate governance, business groups naturally drive the accumulation and entrenchment of market power, largely because they are effective vehicles for leveraging relationships with politicians and access to power.

Considered in this light, the route to a more competitive landscape becomes easier to discern.

There are some precedents for what an alternative might look like. In the early 1930s, then-US president Franklin D. Roosevelt's administration targeted business groups with policies limiting the number of corporate tiers allowed, imposing higher taxes on inter-group dividends, eliminating consolidated group tax filing, constraining financial institutions from acting as controlling shareholders and barring business groups from controlling public utilities.

These measures reined in overly powerful business groups in the US.

After Japan's defeat in 1945, US general Douglas Macarthur, the administrator of the US occupation, adopted a similar approach to dispose of the *zaibatsu* — business groups that had become integral to the country's militaristic regime.

Holding companies were banned, and the practice of tying family assets to business groups was prohibited.

As in the US, these measures proved effective not only in advancing market deconcentration and dismantling the business structures behind it, but also in unleashing Japan's subsequent economic resurgence.

Why not revert to Roosevelt's ambitious playbook? There is no political consensus or trigger that would sanction such a wide-sweeping strategy today.

Even more limited attempts to rein in business groups — for example, by banning crossholdings and limiting the number of tiers or subsidiaries — have failed.

Dominant business groups are highly skilled at circumvention. Measures carved from antitrust policy, as well as changes to corporate governance rules — such as those designed to protect minority shareholders — are unequal to the task of unbundling business groups and limiting market power.

There are some measures that could work. Inheritance or successor taxes could drastically reduce the incentive for maintaining family control, as happened in Japan after it adopted a 55 percent top rate for inheritance tax in 1946.

South Korea recently introduced a 50 percent top rate, and there are already indications — for example, with Samsung — that control of business groups is unlikely to remain dynastic.

Another promising option is supplementary corporate taxes that target the business-group model. Businesses that persist in operating as affiliates of groups would incur tax costs above and beyond the standard corporate rate.

Such policies have the advantage of not penalizing the corporate sector as a whole, and they can be calibrated over time to achieve maximum effect.

However, they need to be accompanied by parallel measures to limit family business groups from taking their holdings abroad through trusts and other tax-avoidance vehicles.

When it comes to antitrust and competition policy, regulators across Asia are right to stick with the approach of focusing on the market share in specific industries.

However, they have so far failed to address concentration at the level of the economy as a whole, and they are generally prevented from doing so by a lack of technical capacity and political clout. With market concentration high and rising, this needs to change.

Israel offers a precedent for targeting overall concentration. Starting in 2012, Israeli authorities took aim at business groups with a suite of policies that included limiting the number of corporate tiers and prohibiting financial and non-financial companies from being held within the same group.

They also revised regulatory and privatization policies to account for the problem of economy-wide concentration.

This multipronged approach led to a sharp decline in pyramidal business groups.

Building on this example, policymakers in Asia could set tighter limits on market shares when business groups are involved, as this might limit their ability to leverage resources and market power in other sectors.

However, the question is whether today's authorities would have the technical capabilities and the political clout to mandate divestment once some threshold has been reached. In most countries, it seems they would not.

Asian economies are likely to remain dominated by powerful business groups with close ties to politicians. The latter have invested massively in their relationships with preferred businesses, which in turn can leverage and allocate resources to achieve greater scale and market concentration.

Many account for large chunks of the economy, leaving little doubt that the problem of market power needs to be addressed.

However, breaking up large business groups might create more problems than it solves, and the political preconditions for doing so are largely absent.

The best chance for improving the situation lies in trying to break down the business-group model through incremental measures.

This approach allows policymakers to target the main redoubt of the connections world — the family-owned business group.

Until such policy changes have been implemented and given time to erode incumbents' power, traditional competition and antitrust policies are unlikely to function effectively.

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