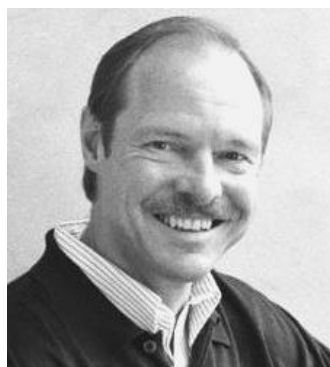


Cavelti

Perspectives



Government and Big Business: Distrusted for a Reason

“In pointing to Europe’s failings, you’re holding up America as an example. But what has America brought us? Big capitalism, big corporations and, as it now turns out, big fraud.” So writes a Danish reader in response to my last issue. It’s an interesting assertion and one that’s highly topical. Now that Enron, Worldcom and others have made the unholy alliance between big business and big government completely transparent, it’s only logical that the merits of American-style Capitalism should be examined.

It’s not capitalism that’s to blame

Personally, I have no difficulty with the concept of capitalism and I readily admit to believing that the American manifestation of capitalism is superior to others. Capitalism’s fullest potential is achieved when markets are free, and in the context of the world’s large economies, there is no freer market than that of the United States. Some use another definition: they say capitalism is most alive when small business flourishes. In small business creation, too, the US has no rival in the industrialized economies.

So where’s the problem? How did American capitalism deteriorate to the point where the management of huge corporations can defraud shareholders by billions, without directors or auditors intervening? The answer has little to do with the shortcomings of capitalism. What we’re dealing with here is crime, and criminals will emerge no matter what ideology reigns. I’m not suggesting that my examination should end—only that the nonsensical debate carried on by the media and the even less rational response by government aren’t leading anywhere. The questions that loom are these:

-Why is this seemingly new class of crime manifesting itself now?

-Why is it being perpetrated in some of the world's biggest companies?

-Why is government having such a hard time resorting to what's needed most: brutal punishment?

I believe there are several reasons. The immense consolidation of corporate and political power during the past twenty years provides an irresistible climate for mega insider crime, while the massive appreciation of equity markets and the resulting excesses in compensation schemes supply the motivation. Finally, dangerously loose campaign finance regulations encourage collusion between government and corporate America. Add to this a justice system in which common-sense fairness and predictability are often woefully absent and you have a volatile mix.

Big business...big influence

Let me concentrate on what I deem to be the central issue—that of unprecedented concentration of corporate power, or “big capitalism” as my friend the Danish reader calls it. I disagree with him when he holds out America as the epitome of big business—corporate wealth is at least as concentrated in industrialized Europe and Asia. But I agree that, without the merger mania of the past decades, we'd be in far less trouble.

“Unless drastic reforms are made, we must accept the fact that every four years the United States will be up for sale, and the richest man or family will buy it,” Gore Vidal wrote quite some time ago. We all know that is what's happened; the only detail Vidal got wrong is it's not individuals or families, but corporations who do most of the buying. And, contrary to popular belief, this is not purely an American phenomenon—it's not much better, and in some cases worse, in other industrialized democracies. Big business has enormous influence over government and frequently gains control over the government's agenda.

You may say that's how it always was, and to an extent you'd be right. History is full of influence-buying episodes, conducted on some occasions with utmost secrecy, on other others with brazen recklessness. But one key element always prevailed: it was a practice seen as sleazy and dishonorable.

Two things are different today. First, the custom of vote buying (or “lobbying” as its sanitized equivalent is referred to) is now accepted as a necessary expense of running a large business; second, the structures of business and politics are far more monolithic. No longer is one administration or Congress less tainted by corporate influence peddling than the one before, and no longer is corporate America closer to the Democrats or Republicans. Both parties open their auction room to all comers (and all large corporations flock to both auctions), primarily because campaign finance laws are so full of loopholes that virtually everything is legal. Tellingly, some of the most scathing criticism about the current system comes from legislators themselves—evidence that specks of honesty can survive in even the most poisoned environments.

The result, as Enron and other scandals since have illustrated, is devastating. People like Kenneth Lay and Jeffrey Skilling escape the harsh treatment that would accrue to small businessmen perpetrating the same acts, simply because they're part of a new corporate super-culture to whose monetary subsidies the politicians have become addicted. To appease the restless crowds, government will talk tough, but meaningful reform is unthinkable. It would end the status quo, to which all in power cling to. By definition, this means that the victims must be ignored; armies of shareholders have lost their individual and pension savings; literally tens of thousands of employees have lost a job. Nothing is being done for them, but Mr. Lay's and Mr. Skilling's rights have been protected with great sanctity.

Does capitalism have a future?

Some pundits have suggested that the era of the corporation is over and that big government will step into the void; others propose that capitalism in the form we know it is finished. To me, both these notions seem wrong. Yes, there will be a lot more government talk about corporate responsibility for a few years, while corporate moguls lay low. While that happens, we citizens would be well advised to remember that the political classes in Washington, Ottawa, Paris or Tokyo are there primarily because the corporate class allows it. No matter what sound bytes we get fed, the fact is that government and big business are completely intertwined. They feed and depend on each other.

The other idea, that capitalism is finished, is equally misplaced. Capitalism and big business are not even related. What government-lobbying, government-bribing and, eventually, government-subsidized corporations stand for is as far removed from capitalism as Al Qaida is from the Koran or the International Olympic Committee from the essence of sport.

And that's why the meltdown of Enron, Worldcom and a dozen others won't make a dent into capitalism. Capitalism is about entrepreneurialism, productivity and excellence and none of those tenets has been tarnished. On the contrary, the investing public is finally seeing the world of the big corporation for what it is: gloss without texture...image without substance. That's good, because it will benefit a universe of small and medium-sized corporations, who are socially responsible and in touch with the consumers they serve. Long live capitalism! □

July 15, 2002

Government and Big Business II

A recent article in the Wall Street Journal reminds us that financial markets look forward. It muses that politicians would be well advised to follow Wall Street closely. If they paid attention to what stocks were saying and changed course in time, they could prevent worse economic damage. At this particular time, the paper argues, markets may be falling so precipitously because investors anticipate that the calamities at Enron, Worldcom and other companies will usher in a new era of government intervention in free markets. It's a thought worth contemplating.

What's on investors' minds?

Are investors really worried about large-scale interventionism, or are they terrified of another fifteen or so Enrons coming along to consume some more of their lifesavings? I agree that a return to interventionism would be the worst possible outcome—on the other hand, I believe a dose of harsh punishment for the miscreants at Enron and Worldcom and tough regulations to prevent more of the same are needed.

Some readers appear to have taken my comments of last week as a wholesale condemnation of large enterprises everywhere. That was not my intention, nor do I think it's what I said—nevertheless, your comments cause me to write this “postscript”. What's needed, and is sadly lacking in the treatment of corporate crime, is consistency.

When airlines get away with minor fines for price fixing on a mega-scale, or when Merrill Lynch Chairman David Komansky states that he did not understand what a bad boy his super-analyst Henry Blodget was and settles with the SEC by handing them a \$100 million check and Mr. Blodget's head on a silver platter, it becomes evident that something is seriously wrong with the system. When it turns out that Komansky nearly tripled his pay on the back of Blodget's illegal money making machine (to over \$30 million), it becomes blatant. When the government goes after Blodget alone, scandalous.

"I am an executive of a large corporation," writes one reader, "and I can unequivocally say that my company has never tried to buy favor with the government." Of course. Many of my friends are executives and they wouldn't be my friends if I didn't think they were honest. Which is not to say that legal lobbying (which I view as a sanitized version of vote buying) is a widespread practice that leads to huge conflicts. Consider SEC boss Harvey Pitt, who is a former lobbyist himself. Most who know him well, say that he is deeply in debt to the accounting industry; it's also a fact that, not long ago, he played a key role in killing precisely the type of reforms which could have prevented the recent scandals. Some Democrats suggest he is the proverbial fox in the chicken coop; Pitt's detractors are out to score cheap political points, but they are nevertheless right. The bottom line: large corporations are with frequency treated differently than their smaller counterparts. As recent history shows, some of the corporate elite are emboldened by this inconsistency.

Is the US still the best?

Another message I've received asserts that US accounting standards, despite the recent scandals, are still the best and cleanest in the world. I wouldn't go that far. To make them the best, a ruthless clean-up would be needed and the bar on both corporate and political standards would have to be raised. In the meantime, US standards are comparable to those in other industrialized countries. The perception abroad, however, is now clearly that US standards are unacceptably low. And as we all know, in financial markets perception counts as much as reality. That, after all, is why the Dow keeps sinking. □

August 16, 2002

Government and Big Business III

The other day, George W. Bush, in one of those black-or-white judgments we've come to expect from him, said companies with "shady" practices had let down the nation. In other words, let's ascribe the whole stock market meltdown to the few criminals which every bubble creates. Bush, who is under scrutiny for his own past corporate behavior, should know better. If he doesn't, let me be among those who remind him who is really to blame for the mess corporate America is in:

Who's at fault?

The Chief Executives and Chief Financial Officers of countless corporations who've allowed the deliberate, albeit legal, misrepresentations of their accounts, bear some of the blame. Alan Greenspan had it right: it's the attitudes and actions of the country's top executives that determine corporate conduct.

But most of the blame should be attributed to the Senate of the United States of America. It rejected a series of changes which would have prevented many of the distortions in corporate accounting, which have since led to a massive crisis of confidence. The changes proposed by the Financial Accounting Standards Board and enthusiastically endorsed by then SEC Chairman Arthur Levitt (who's since written a book on the hidden costs and dangers of investing on Wall Street) were shot down in a vote led by Senator Joseph Lieberman. For the record, the current SEC boss, the incomparably conflicted Harvey Pitt, represented the lobby against change.

In short, President Bush is either unbelievably hypocritical or appallingly ignorant (or both), when he talks as though the whole stock market malaise had been caused by a few miscreants. Or, as Warren Buffett noted in an essay he recently submitted to the New York Times, "They should quit talking about some bad apples and reflect instead on their own behavior." Buffett lauds the CEO's who've stepped forward to adopt honest accounting, but adds that "most continue to spend their shareholders' money, directly or through trade associations, to lobby against real reform."

□□□

In a superb article published in January 2001 by the Harvard Business Review, author and economist Charles Handy metaphorically talks about tomorrow's capitalism as "the age of the elephants and the fleas." The elephants are the large corporations, the fleas the entrepreneurs. Handy argues that capitalism needs both, because elephants "offer efficiency, resources for development, guarantees of reliability and employment for the bulk of the people." That, certainly, is what the elephants have been promising.

In retrospect, those promises look more than a tad hollow. Let's use Charles Handy's four tests to see whether the economy at large has really benefited from the merger-mania of the past two decades. I'll dispense with the most obvious test first: have the nation's large corporations created employment? After all, employment growth is the major engine in an economy. Without employment, consumers can't spend; and without consumer participation, the economy enters nuclear winter. Well, have they? On the contrary, the legacy of the recent consolidation in business has been the slashing of hundreds of thousands of jobs. Whether a large merger takes place in Switzerland, France, Britain or the United States, it's virtually a given that an army of people will be thrown into unemployment. While everyone would agree that this is a detriment and not a benefit to society, a fair follow-up question might be: is it necessary? The titans of industry are often quick to justify mass layoffs as a necessity—if we hadn't merged, they say, both entities would have been too small to compete on a global scale and eventually been eliminated by the forces of competition. In many cases, that is pure nonsense. Much smaller corporations often manage to prosper in the same competitive environment and, better yet, create employment.

What about the hope expressed by Mr. Handy that large corporations would provide resources for future development or, put differently, that they would become big spenders in economic development? Here, too, the past few years have been a disappointment. Capital spending is steadily shrinking--so much so that most economists have given up on it as a contributor to overall growth.

Few efficiencies, little reliability

What about the contentions that largeness offers efficiency and guarantees reliability? Again, the starkness of practical experience differs from the siren-song of theory. Few people dealing with today's mega-airlines, phone companies, insurers or banks find them efficient or reliable—many more would classify them as incompetent and arrogant. The argument here is not whether efficiencies are accomplished; it's whether they're passed on to the consumer. Yet when big corporations defend the need to become even bigger in government hearings, the advantage of the soon-to-be gained new efficiencies to society, mostly through cost-savings, is always touted.

The sad truth is that any benefit of such cost savings is almost invariably retained for the benefit of management and shareholders and not flowed through to the consumer. Some might argue that this is the whole purpose behind running a corporation: to reward shareholders. But good capitalism does more than that, and tens of thousands of small enterprises understand that—it brings advantageously priced or high quality goods or services to consumers and, in doing so, makes its shareholders rich. All too often, large companies manage to protect their markets not by producing excellence, but by creating near-monopolies or by lobbying with government for special favors that smaller businesses can't obtain.

In short, corporate bigness has done little for society. Worse, I attribute much of the blame for the current popular distrust in both business and government to the unprecedented consolidation of corporate America and Europe. “Cronyism” à la Japan is now a prominent feature of the world's two most powerful economic engines, as well. It is the invariably consequence of far too much power being placed in too few hands. In both the corporate and the political world, self-dealing is the guiding tenet, and because big government and big business keep each other supported, it's a self-perpetuating process.

When the Bush administration came to power, public confidence in government had been in free fall for more than a decade. The government was the brunt of jokes and many Americans perceived the federal government as enemy number one. The closer to the center a politician was, the more evil he was perceived to be. Many viewed Washington as the citadel of evil. Corporations, meanwhile, were held in high esteem—business leaders across the ethical spectrum achieved cult-status; the only qualification was their ability to succeed financially, regardless of how that was done.

Public's faith lower than ever

Apparently, Joe Public's faith in corporations is now even lower than in government. A recent article in the Wall Street Journal reported that it's now difficult to find jurors who are not biased against people with a corporate background. A recent poll of potential jurors revealed that more than fifty percent believed that “corporate executives will lie to increase their profits.”

When the population trusts neither the leaders of government nor the captains of business, things get grim. What we're headed for may not be unlike what's been going on for 15 years in Japan. When I ask my Japanese friends why they won't change things, they tell me with remarkable consistency “because politicians and business bosses are supposed to be crooked.” The Japanese model shows us what happens when the middle class adopts such a view. □

Publisher: Cavelti & Associates Ltd., Toronto, Canada.

All rights reserved.