Going Beneath the Surface of Today's Corporate Scandals

By Robert Rabinowitz

Review Essay:

The Divine Right of Capital
by Marjorie Kelly
Berret-Koehler Publishers, 230 pp., $24.95

The Future of Money
by Bernard Lietaer
Century Press, 382 pp.

L. Dennis Kozlowski's $15,000 dog umbrella stand. Jack Welch's expenses paid toilet paper. The Rigas family's private golf course. Gary Winnick's $94 million dollar estate. And, of course, Martha Stewart - mysteriously the target of an intense collective *schadenfreude* so uncharacteristic of America. These are the symbols of the ongoing corporate corruption scandal that erupted with Enron's declaration of bankruptcy on December 2 last year. We are, however, in danger of repeating one of the mistakes that actually contributed to the scandal: a focus on celebrities rather than the broader issues at stake. Just as we once feted Neutron Jack as the uber-executive who raised GE's market capitalization from a puny $14 billion into a hulking $500 billion, so we now glory in pillorying greedy robber barons as they descend into ignominy.

The villains of today's brutal bear market - most of whom were the heroes of yesterday's magnificent bull market - did not appear out of nowhere. They arose in a specific time and place, in response to very specific circumstances such as the deregulation of the financial sector - which helped the banks to indulge in one of their periodic binges of incompetence and greed - and the increasing focus on a limited range of financial indicators, such as stock price and quarterly earnings growth as the only measurements of corporations' financial health. Long-time advocates of improved corporate governance such as Robert Monks are using the current scandal as an opportunity to bang the drum for more fundamental reform measures than simply expensing employee stock options. As Monks points out in his book, The Global Investors, a key problem, long diagnosed, is the separation of ownership from control. Executives have escaped from the control of shareholders, with boards of directors becoming more like personal fiefdoms than forceful instruments of independent shareholder oversight.

Two recent books, Bernard Lietaer's The Future of Money and Marjorie Kelly's The Divine Right of Capital, raise even more fundamental questions about the nature of our financial system without lapsing into vindictive personal attacks on particular individuals or institutions. It is, perhaps, the troubling nature of the questions they raise, especially for those who benefit from the economic status quo in America, that accounts for the lack of public discussion of the important issues they discuss.

Unusually for someone who was once a Belgian central bank executive and who was later identified by Business Week as the world's top currency trader, Lietaer makes some of his key points through fables, not statistics or mathematical models. Perhaps the most important fable concerns a small village which has not yet invented money, leading to prolonged negotiations on market day as villagers attempt to exchange what they need through complex barter arrangements. One day, a stranger shows up in the village and gives ten tokens to each of the ten families in the village to use as a means of exchange in order to do away with the lengthy and inconvenient bartering. The stranger's only condition was that at the end of the year, each family had to return to him eleven tokens as payment for the technological improvement he had made to their lives. Lietaer points out that, assuming that the population and its annual production remain exactly the same during that next year, one of the ten families will have to lose all its tokens, even if everybody managed their affairs well, in order to provide the 11th token to the nine other families. This artificial scarcity would effectively undermine spontaneous cooperation in the village and generate a systemic undertow of competition among all the families (Lietaer, pp. 50-51).

The point of this simple fable is to demonstrate the harmful effects on our society of exclusive reliance on a currency that is based on debt to be repaid with interest. (Lietaer explains how money is created from debt in his lengthy primer on "How Money Works," pp. 301-331.) Lietaer argues that, in addition to encouraging systematic competition among participants in the system, interest continually fuels the need for endless economic growth, even when actual standards of living remain stagnant. It also concentrates wealth by creating an ongoing flow of interest and dividends from working people and their employers to the small minority of people who own the vast majority of financial instruments (p.50).

Prior to reading this book, I had always regarded the Torah's thrice-repeated injunction against lending with interest (Exodus 22:24, Leviticus 25:36-37, Deuteronomy 23:20-21) as a relic of a much earlier period in history in which cash-based transactions were a small part of economic activity. I made the assumption that the Torah referred only to predatory lending to the economically vulnerable and not to paying a fair market price for access to capital. Lietaer's observations about the systemic effects of interest have made me wonder whether there are deeper spiritual insights underpinning this injunction, which was long ago effectively neutered by rabbinic legal devices.

Lietaer's point is not that we should abandon debt-based currencies wholesale, although he does believe that much of the material scarcity we experience is not "out there" in nature and is created by our money system (p. 116). Instead, he challenges the idea that we only need one currency. This is because money can serve multiple functions which can be at odds with one another, as another fable emphasizes.

"Imagine a Martian landing in a poor neighborhood and seeing rundown communities, people sleeping in the streets, children without mentors or going hungry, trees and rivers dying from lack of care, ecological breakdowns and all of the other problems we face. He would also discover that we know exactly what to do about all these things. Finally, he would see that many people willing to work are either unemployed, or use only a part of their skills. He would see that many have jobs but are not doing the work they are passionate about. And they are all waiting for money. Imagine the Martian asking us to explain what is that strange 'money' thing we seem to be waiting for. Could you tell him with a straight face that we are waiting for 'an agreement within a community to use something - really almost anything - as a medium of exchange'? And keep waiting? Our Martian might leave wondering whether there is intelligent life on this planet" (p. 146).

Lietaer urges his readers to take the initiative and to create their own alternative currencies which, he claims, would not have such dysfunctional effects. He provides details of various different types of alternative currency, explaining how they are structured and what the costs and benefits are to each approach (pp. 213-235).

Marjorie Kelly addresses another part of our society's financial infrastructure that she believes creates inequity and other social ills. The book, which models itself on the writings of Thomas Paine, is animated by a single metaphor that likens shareholders to the landed aristocracy. In economic terms, the aristocracy was that segment of society whose income did not derive from their own work, but from the "rents" derived from the hard labor of the tenants of their estates. Kelly, co-founder and publisher of Business Ethics magazine, argues forcefully that shareholders are in a similar position - their legal status as owners of corporations allows them to reap what others have grown.

According to standard theory, the goal of financial management is to maximize shareholder value, i.e., income from dividends and capital gains from growth in a company's value. The standard economic justification for this view is that these returns on investments are justified as compensation for the risk taken by shareholders when they provide capital to companies to finance their growth. Perhaps the most significant empirical evidence that Kelly cites to undermine the standard justification are the Federal Reserve figures showing that less than 1%

of stock market transactions are related to the issuing of capital and that, over the last twenty years, companies have bought back $540 billion more in shares from stockholders than stockholders have provided to companies in new capital (Kelly, pp. 33-34). Kelly concludes that stockholders are not actually providing any new net capital in exchange for the dividends and capital growth from the stocks they own.

If shareholders are aristocrats, then their peasant tenants are employees whose productivity has risen three times more over the last decade than the rise in their compensation (p. 37). It is they who create the wealth reaped by the stockholders. Kelly points out that employees are treated as assets of the corporation rather like the peasants who were in effect owned by the aristocracy. She also emphasizes how job security has diminished with every passing decade, evoking the plight of peasants who were thrown off the land at the time of the Enclosures.

Kelly's striking metaphor leads her down some very interesting avenues of thought. One logical corollary of her argument is that the current arrangements for control of corporations are highly undemocratic. Stockholders, the landed gentry, have all the voting rights, while employees who actually create the wealth have little control over their destiny. Kelly does us a major service by insisting that corporations be brought into the field of political science. Given the power of corporations - both for-profit and not-for-profit - in public life, we ought no longer to regard them simply as private contractual arrangements. They are public or semi-public bodies which only operate with the permission of the citizenry.

Kelly makes a number of interesting proposals to remedy failures of corporate democracy. The simplest is that financial statements should include a supplemental line comparing the income earned by employees with the income earned by stockholders. This stratagem would transform employee income from a cost on a company's income statement, which as such needs to be trimmed to increase profitability, into a measure of profitability (pp. 101-102). Perhaps the most audacious proposal Kelly makes is for the establishment of a bicameral system of governance for corporations with an employee "House" that must approve all major corporate decisions (p. 156).

Kelly's metaphor does get a little overworked by the end of her book and some of Lietaer's speculations about the future give the book a somewhat dated feel now that the dot.com bubble has burst. In addition, their proposals do seem somewhat puny in comparison to the vast money system that they portray and dissect so vividly. But the major service rendered by The Future of Money and The Divine Right of Capital are not to generate new policy. Rather, both books open their readers to new possibilities for understanding the world. Reading these books, I was reminded of the Talmudic story of Joseph the son of R. Joshua. "He had been ill and fell in a trance. [After he recovered], his father said to him: 'What vision did you have?' He replied, 'I saw a world upside down, the upper [classes] below and the lower [classes] above.' He said to him: 'You [actually] saw the world clearly' " (Babylonian Talmud, Baba Bathra 10b, Pesachim 50a). R. Joshua, in effect, urges his son not to accept the current economic reality as the only possible or viable vision of the world and to view our world instead as a distortion of the world he viewed in his trance. Lietaer quotes Edgar Cahn, a Washington lawyer who created the "Time Dollar" alternative currency, who makes a similar point: "The real price we pay for money is the hold that money has on our sense of what is possible - the prison it builds for our imagination" (Lietaer, p. 146).

These two books offer particular challenges to the Jewish community. Jewish business ethics has tended to focus on personal conduct, dealing with issues such as honesty in business negotiations, fair pricing and ethical treatment of employees. A recent lengthy article in the Baltimore Jewish Times, for example, leads off with a discussion of whether the protagonists in recent scandals were Jewish and then focuses on the morality of particular individuals or actions. There is relatively little consideration of the individual's responsibility to address what might be called "systemic" ethical issues, the moral challenges that are inherent in the very way that our economic and financial system is organized.

There are two reasons for this. The first is that such systemic issues are not explicitly addressed in rabbinic legal texts. For example, the very concept of a corporation is unknown in all of the classical Jewish texts (Kelly points out that American law faces a similar challenge, p. 165). The lack of consideration of systemic issues in rabbinic legal texts is probably due to the fact that Jews in the Diaspora rarely, if ever, had any responsibility for the creation of the economic, legal and political systems of the countries in which they lived. Rabbis therefore focused on creating rules and norms that addressed the challenges that Jews actually faced. Of course, American Jews play a central role, as individuals if not as a group, in our nation's civic life. There is therefore a need for new "Talmudic tractates" that bring together diverse sophisticated Jewish views on such issues with the freedom to craft new fields of Jewish thought.

A second and more disturbing reason for the lack of consideration in Jewish life of these issues is the economic success of American Jews. We, as a group, and especially our communal leadership, have tended to benefit from the very imperfections in the economic structure of our society that Lietaer and Kelly describe. However, as Kelly notes, it is not clear that such imperfections continue to serve Jewish self interest. "Physicians applaud when their portfolios rise in value, yet wonder why insurance companies are ruthlessly holding down medical payments. Employees cheer when their 401(k) plans post gains, yet wonder why layoffs are decimating firms. Their own portfolios hold the answer" (p. 5). If the icons of corporate malfeasance serve no other purpose, they may at least help to open our eyes to considering new possibilities for achieving both greater prosperity and economic democracy.