

A Corporate Crime Wave?

Or a search for political scapegoats?

BY GEORGE GILDER

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Crime may have declined in the streets but, by the recent inflammation of the pundits, you would think there has been an outbreak of corporate criminality. The Internet, communications and stock-market booms of the 1990s, it seems, were based on a pervasive series of felonious acts. A wide array of businesses, from Global Crossing to Loral, from General Electric to Enron, artfully inflated the worth of their shares through the creation of Potemkin businesses. If you believe the news coverage, corporate leaders are racing to despoil, mulct, defraud, poison, pillage and ruin their own businesses, their nation's soils and waters, their retirement funds, and the world economy.

This flood of factitious crimes, this parade of snaffled fat cats and scapegoats, happens every recession. Rather than ruing economic reverses as effects of public policy errors and miscalculations, public officials turn the tables and treat bankruptcy and crash as culpable schemes of particular white-collar criminals.

Some of these alleged crime lords are familiar. Gary Winnick was party to a previous potlatch at Drexel Burnham, where he played a key role in financing the communications infrastructure through MCI, Telecommunications Inc., Turner broadcasting and McCaw Cellular. Then he and his associates were alleged to have ravaged savings-and-loans by inducing some of them to buy those companies' high-yield securities before a government ban briefly destroyed their value. Finally Mr. Winnick boldly launched the world-wide fiber-optic networks of Global Crossing, with, it is implied, the intention of bilking investors and crashing bandwidth prices in what Fortune calls "perhaps the greatest executive ripoff in the history of enterprise" but what is better described as the most efficient global build-out in telecom history.

Jeffrey Mohammad Skilling, Osama Ken Lay, Mohammad Atta Gates, Mad Mullah Welch. The names stream together, the rap sheets blur, but the statistics mount along with the unemployment numbers, the bankruptcies, the environmental cleanup costs. Behold these corporate predators wrecking vast pension plans, sowing deadly cancers in the Hudson River, monopolizing the computer market, blighting the steel industry with dumped scrap, wantonly disrupting energy markets, insidiously subverting the global climate.



Recessions, however, spring chiefly from government mistakes. Compared with these policy errors, crime in the suites is never a significant factor. That was true of the savings and loan and Mexican crises of the early 1980s and of the global crisis today, reaching from Japan and Indonesia to Turkey and Argentina.

After a decade and a half of favorable policy, from the capital-gains tax cut of 1978 to the general tax reductions of the 1980s, from the deregulation of transport and communications to the collapse of inflation to the downfall of global communism, politicians began taking prosperity for granted. They allowed tax rates to drift back up to record levels. They transformed telecommunications rules into a regulatory sclerosis that wreaked a telecom depression. They ignored the implications of the global reign of the dollar at a time of steady dollar appreciation

and growing Third World debt. They embarked on a crusade against chemical industries vital in both war and peace.

In the face of this long siege of policy blunders, politicians today charge Enron with concocting subsidiaries to conceal debt and self-dealing. But company structure is almost always chiefly a response to kaleidoscopic tax and regulatory law and the resulting threat of litigation. Launching innovations in arenas as diversely regulated and taxed as natural gas and broadband communications, Enron inevitably contrived a complex structure of subsidiaries and financial instruments difficult to explain under Securities and Exchange Commission rules that require simultaneous disclosure (or, more safely, nondisclosure) to all.

A trading company such as Enron or a long-term infrastructure play such as Global Crossing is no stronger than the confidence of investors and customers in its solvency. In an environment of SEC-enforced ignorance, mere rumors of crime and default can bring a company down.

The key to the debacle, though, was the debacle of money. Buffeting the Enron staples of fuels and bandwidth and afflicting all commodity prices--from coffee (at an all-time low) to cotton (at 15 year bottoms) to scrap steel (down 55% in four years)--deflation crashed the stock market and stifled every large company and every Third World country with its debt denominated in dollars.

Kmart, Pacific Gas & Electric, Exodus, Globalstar, Enron, Argentina, Turkey, Indonesia--all made serious and unique errors from time to time; all countries and companies do. But what these cases had in common was heavy debt. Taking 40% of incremental income from investors through tax hikes, and tightening monetary policy until entrepreneurial debtors have to repay 40% more than they borrowed, is a sure route to ruin.



When all debtors are afflicted, the scientific method points not to a hunt for particular infractions but to the isolation of a common source. And that common source is a dangerously deflationary monetary policy in the U.S.

While the dollar has been surging since 1996 against the deflated yen, the euro, commodities, and gold, the Federal Reserve adhered to its view that dollars were too numerous and sucked them out of the most fertile frontiers of the economy. The dollar dutifully rose, and strangled the Third World countries with dollar denominated debt, the telecom infrastructure projects supported by debt, the car and computer-leasing companies funded by debt, the farmers, the steel producers, the energy prospectors who rely on debt finance and a stable standard of value.

Rather than addressing the fundamental problem of deflation, the administration enacted broad protection for the steel industry, thus spreading the damage to all companies that use steel and all companies dependent on trade. Rather than lowering tax rates on investments afflicted with deflation, policy makers obsessed about such rearview figments as "consumer confidence," an utterly meaningless statistic from the demand side.

A supply-side crisis requires the supply-side remedies of a stable currency, lower marginal tax rates, and deregulation of technology. These measures offer the only way to raise the tax revenues that will be needed to fund a war against terror and support a wave of retiring workers.

Money is a standard of value, a code for transmitting information about the supply and demand for goods and services. For a decade, Alan Greenspan seemed to adhere to a fixed standard of value, guided by a price rule based on gold and commodities. But since 1996, he went astray, citing as policy guides the "irrational exuberance of the stock markets," the productivity explosion, the Internet bubble. Without guidance from gold, currency markets lack any objective means to differentiate the "news" (a change in monetary conditions) from the white noise of a thousand clamorous markets. When the standard of value itself becomes a commodity, traded like any other on currency markets, the most vital investment information is lost amid the froth.

In essence, Mr. Greenspan blamed business for the errors of government, including his own. He created the context for the "crime wave." To save his exalted reputation, he must now return to a price rule.

Meanwhile politicians must stop tinkering with the structure of law and regulation under which entrepreneurial plans play out. Businesses find themselves operating amid the turbulence of constant legal and monetary change. In extremis, caught in a baffling web of often conflicting bankruptcy, tax, regulatory, and securities laws, many executives make decisions that in retrospect can be interpreted as incriminating.

Bankruptcy, though, is not a crime but a punishment. Virtually no one plans for its concussive effects or expects them at all. The real source of the "crime wave" is the undulation of policy and the Babel of alibis from politicians and bureaucrats searching for scapegoats.

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