

Why Is Wall Street Occupied: A Student-Organized Teach-in at Hofstra Law School

Panel on Corporate Law -- 19 Oct 2011
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Occupy Wall Street & the Crisis of Corporate Law

First, I want to thank Jenelle and the other student organizers for inviting me to participate in this kickoff of an exciting series of panels at Hofstra University's Deane School of Law on topics inspired by the Occupy Wall Street demonstrations.

I'm going to outline a couple of areas I think are critical to understanding the background for the crisis that brings us here today, and I'm happy to go into these, or other areas, in more detail in the Q&A.

We are here today because the American economy is in trouble: completely avoidable trouble. More fundamentally, however, we are here today because we have succumbed to the greatest sin of all: idolatry – the sin of setting our own creatures up over us as our masters, of bowing down before our tools.

The immediate problem, of course, is the Great Recession, triggered by a housing bubble that collapsed, leading consumers to conclude that they were less wealthy than they thought they were and to cut back on their spending. This, in turn, left an enormous hole in demand that neither the private nor the public sector is willing to fill. Business facing fewer customers and state governments seeing reduced tax collections responded by cutting employment, and, of course, fewer employees means even less demand.

According to the BLS website, today unemployment is 9.1% (U-3 official unemployment rate, seasonally adjusted); if you add discouraged workers who remain at least marginally in the workforce (U-6), it is 16.5%. Almost another 10% are underemployed – part time workers who want but can't find full time work. Each of those people unemployed – plus the others who will be added when the Party of Freeloaders succeeds in its next round of school budgets cuts and destruction of the regulatory police who keep our markets honest – has a story of personal suffering and tragedy, lost hopes and dreams. Collectively, they amount to a national crime: pointless and avoidable misery due to mismanagement of our economy.

But we also have a longer term and larger problem. Growth in productivity used to lead inexorably to higher pay. Not any more. Virtually all the benefits of economic growth are going to a tiny part of the citizenry.

Inflation adjusted, median income has barely budged for a generation even as the economy has doubled or tripled in size. The bottom 90% of Americans are making barely 10% more than in 1973, while the incomes and wealth of the top 1%, and especially the top 1/10 of 1%, have soared as they have taken an ever larger proportion of a growing national pie.

It looks even worse when you look at the median or below.

Basically, we have a three decade long pattern of all the benefits of growth going to the very top. Once, we were, by some measures, one of the most egalitarian countries in the world. Today, we have the highest inequality of the developed countries by almost any measure.

At the top, our executives and rentiers pull in double what they would anywhere else. At the bottom we have a percentage of young men in jail that – with the unlamented demise of the Soviet Union and apartheid S. Africa – is unrivaled and, of course, not counted in the unemployment statistics. For the rest, the minimum wage, which sets wages for a good third of American jobs that are either at the minimum or set to be just above it, is lower in real terms than it was when I was in HS and Bill Clinton hadn't even begun to not-inhale.

And in the middle, the successful blue collar worker is a thing of the past. Wages for HS educated men are lower today in real terms than they were in 1973, perhaps because our major industrial corporations waged a successful battle to destroy private sector unions and win the right to ship manufacturing jobs overseas. White collar workers, who used to be able to count on life-time employment on good behavior and steady progress through the ranks, have done only marginally better. And I don't need to tell an audience of law students that the long standing view that a professional degree represented entry in the upper middle class is as obsolete as a rotary Gestetner mimeograph machine (and I bet most of you don't even know what that is or how strangely affecting its smell was, wafting down the corridors of a middle school).

Since the 1970s, we've had wage decline or stagnation for 95% of the country, while the private costs of core middle class necessities – housing, education, health care – have gone up far faster than inflation and our private sector pensions basically disappeared.

Families dealt with it first by sending wives & mothers to work. For a long while, the longer hours women work made it possible for household incomes to stay relatively stable even as individual pay declined. But in barely a generation we went from the shortest average working year in the developed world to the longest. We had hit the limit some time ago: the stay at home mom is basically extinct. When households could no longer maintain their standard of living despite the lack of real pay increases by working harder, they switched to borrowing – first credit cards, then mortgages, then home equity loans and student loans. The upper 15% got a little help from the dot.com boom and the rest of us imagined that it would trickle down, and then the housing bubble fooled homeowners – half the country – into thinking they had solved their pension problems, for a while.

But the underlying problems remained. Corporations that used to recycle consumer spending into the middle class jobs that allow consumers to spend, shifted to sending their surplus to top executives and Wall Street speculators. Corporate profits, top executive salaries and the cut of the financial intermediaries all increased rapidly even as wages stagnated: from the 70's until the dot.com bust, the

stock market averaged close to 18% per year compounded, while CEO salaries increased at a similar rate – and kept increasing even after the stock market hit the wall.

Politicians who used to think of the national interest as good jobs for Americans support, instead, a high dollar that ships jobs overseas; ever lower taxes for corporations and the 1%; and so-called de-regulation that allows sharp and dishonest operators to drive out better practices, much as Sayers Law predicts that bad coins will drive out the good.

The process has many causes – to explore them all, you will need to keep this series going for many weeks. I want to point out a few today.

I. From the New Industrial State to Shareholder-Centrism

First, the rising power of the stock market. We are here to discuss Occupy Wall Street, after all. The greatest change is old news, perhaps even obsolete news: in the early 1980s, stock market operatives using junk bond financed hostile takeovers (and later, private equity funds), broke down the post-New Deal coalition of top executives, middle management and unionized labor. By a combination of sticks (the threat of takeover) and carrots (an almost inconceivable increase in executive pay, in the range of 18% per year for several decades!), stock market operatives convinced top executives to betray their erstwhile allies.

Steady promotions, job security and wage/salary gains in line with productivity quickly disappeared. Money that used to go to ordinary Americans, shifted instead to profits. Leaders who used to live more of less like ordinary people but just a bit more so, instead built themselves the privilege and gilded ghettos that we used to think existed only for the aristocracy of Louis XIV and the Party-based *nomenklatura* of the USSR. Moscow party officials had black cars and special lanes on the highway – our elite now had gated communities and limited access high rises, private jets and their own police forces.

This process is near its end, and one ray of hope in a dimly gloomy day is this: top executives and finance, having beaten everyone else down, have set upon each other. While the dinosaurs are at war, perhaps there is room for the tiny mammals to find a space to grow.

II. Self-reinforcing Inequality

Second, the rising power of concentrated wealth. Markets inevitably shift wealth upward: those with the most bargaining power will always get the best of any unregulated deal, until, left unrestrained they—like Joseph in Egypt—bargain the weaker into slavery. Then bargaining, markets and prosperity stop. Successful economies use law to reverse the process: laws to assure that individuals get the education they need to have some chance of competing, laws to prevent insiders from lying and cheating customers, laws to prevent companies from growing so large that they can appropriate all the gains from trade, laws to ensure that the weaker party always retains enough alternatives to decline the offer of slavery, and especially laws to prevent the rich from translating money into laws that hand them more money or allow them to escape paying for the common costs or permit them to use their market power to win more market power still.

But money is easily translated into power. In our country, as in so many earlier failures, as inequality increased, the newly wealthy began to use their money to buy power to give them more money still. As the rich got richer, they were able to fund a new network of think tanks, media and public intellectuals who argued for destroying the rules that had prevented economic incumbents from using their incumbency to seize more wealth still. Advocates for CEOs and the stock market taught

- that markets are always right and always fair;

- that if the guy at the top seems to be making off like a bandit it is only because he has created the wealth an naïve observer might have thought he merely took;

- that the only way to convince the powerful to share is to give them more;

- that upper-class tax cuts and union busting don't redistribute wealth but, instead, create jobs, the evidence of your lying eyes notwithstanding; and

- that a high dollar is a sign of "strength" and not a deliberate policy to strengthen mobile capital against inevitably less mobile labor, sending jobs abroad in return for the thin gruel of cheap t-shirts.

Politicians and voters alike were convinced to allow money to replace democracy, to accept the unwavering upward redistribution of wealth by approving law that allow the powerful to use their power to outbargain the rest of us. Citizens United is only the latest step in a process that is still epitomized by Ronald Reagan's "government is the problem" and "trickle-down" Reverse Robin Hood campaigns.

Here too, we have reached the limit. Our massive upward redistribution of wealth cut growth in half – 2% per year since 1980 as opposed to the 4% in the post-war period. But now, more wealth to the wealthy can only come at the direct cost of a shrinking pie for all: a capitalist economy cannot survive if the capitalists seize so much that they no longer have anyone to sell to, any more than evil King John or the ancien regime could demand that the peasantry work only for their overlords. Even Joseph had to feed Pharaoh's enslaved subjects.

III. Financialization

Third, the growth of finance. As the middle class declined, it became harder for business to make money selling to them. The government may be the problem, but for most Americans, as states shifted their priorities from middle class necessities to paying for privatized prisons, the lack of government became a bigger one. As the high dollar and trade deficit became a fixed policy, we effectively subsidized companies to send well-paid jobs overseas. By now, so much has been skimmed that once a middle class family has finished paying for housing, transportation, medical care and education, or picked up the tab for relatives who cannot do so themselves, not much is left to support employment elsewhere. And, of course, the beneficiaries of the skimming -- top executives and the financial markets -- can only spend so much on consumption before reaching even their elevated levels of satiation.

Today, the most profitable sector of the economy is finance, recycling the wealth of the wealthy without producing much for it beyond fees for the servicers. At its core, of course, finance is essential. A

capitalist system can prosper only if it has some mechanism for moving capital from those to have it but don't need it now to those who can put it to work but don't have it. Finance – borrowing and lending, insurance and investment – make it possible for consumers to buy cars and houses they could never manage otherwise, and for entrepreneurs with ideas to grow businesses faster than their own money would allow. Insurance and financial markets can spread risks that no one could comfortably bear on their own, making us all more secure.

But that kind of finance is only a small part of what this bloated sector does today. Our needs for risk spreading or long term investment did not suddenly soar in the last decades; neither the dot.com nor the housing bubbles nor their predecessors were examples of financial markets efficiently reducing risk and funding the most productive investments.

Vast sectors of finance exist simply to take from the unwary and give to the well-situated without creating any value at all – transferring risk from those who understand it to those least able to bear it. Other parts simply move money around in circles, charging a percentage each time it circulates – companies go private buy borrowing money to pay off their shareholders and then go public sell shares to repay their lenders, while lenders and shareholders, public equity and private capital, bond holders and bank funders are all the same diversified pots of finance capital restlessly moving from one vehicle to another in an endless race to beat the averages.

Worst still, the most profitable parts of finance are little more than organized law evasion: products designed to allow companies or their employees or investors to create the appearance of profit regardless of reality, to evade law or internal regulations by replacing regulated or restricted instruments with functional equivalents that evade scrutiny, or to exploit known weaknesses in rules-of-thumb or computerized valuation algorithms. This type of finance, that is, profits by helping others to reduce social value.

Predictably enough, as finance grows, it too learns that power and wealth can buy power, and it too uses its power to influence politicians and voters alike. In the manner of the old aristocracies, and the rich generally, it buys the public opinion makers to convince us that we need to allow them to take an every larger share of our harvests because otherwise – they'll take an even larger share of our harvests. But we can no longer afford finance's demands.

Going forward, our big questions are these:

1. How do we change corporate law and culture so that the corporate decisionmakers – top managers – place jobs ahead of their own bonuses.
2. Can we rebuild the barriers between economy and democracy that allow us to assure that regulators will be able to create the invisible hand that makes markets work for the common good, instead of simply allowing the most powerful to abuse their power to take still more.

3. The classical political philosophers thought democracy would always fail due to corruption – we must find a way to prove them wrong. We must recapture our government from the malefactors of great wealth; and recapture our regulators from the revolving door and the lobbyists; and recapture our media and think tanks and public discourse from propagandists who put the Comintern to shame.

Our current disaster is not inevitable. We were seduced by idolaters of the wealthy and powerful – ideologues who would have us worship economic incumbents instead of the system that created them.

In the end, however, markets self-destruct without strong regulators. Finance has demonstrated that when it controls its regulators, it not only causes unnecessary economic crises every five years, but requires ever larger government transfers from us to it to get going again. The corporations have demonstrated that left to their own, they will press wages down to the point where they have destroyed their own customers, even as they seek to repeal the very laws that stop them from poisoning our natural ecosystem.

But we are many. We have controlled them before, and we can do it again. In the spirit of our Declaration of Independence we must proclaim, “That whenever any Form of Corporate Governance becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its foundation on such principles and organizing its powers in such form, as to them shall seem most likely to effect their Safety and Happiness.”

The corporations and the securities markets and their regulators are institutions created by us and for us – not the other way around.

■ Daniel JH Greenwood