

Corporate Reform



READING 1

“Editorial: The System Needs Fixing, Mr. President,” *BusinessWeek*, 15 July 2002, 148.

-- Discussion of Reading 1 -----

1. Why was July 2002 a crucial moment for the United States? (The nation was at a tipping point. Americans were starting to bail out of the equity culture that made the U.S. so prosperous and powerful over the past two decades. Many no longer trusted Corporate America.)
2. What model has broken down, and what caused the breakdown? (The model of a high-risk, high-growth economy based on honest financial numbers and arm’s length transactions has broken down and needs repair. The breakdown was caused by major defects in accounting, corporate governance, and Wall Street behavior.)
3. What did the editorial writer want President Bush to do concerning corporate crime? (He thinks that President Bush should convince Americans at home and people abroad that the U.S. is cleaning its corporate house and help restore the trust that millions of

small investors need before they risk putting their money into equities again.)

4. If President Bush doesn't help restore the trust of investors, what will happen? (Americans will retreat to safety, and flows of overseas capital will dry up. Stocks will stagnate, economic growth will slow, the budget deficit will soar, the dollar will tank, and America's prestige and power on the world scene will erode.)
5. List two radical steps that were proposed to restore public confidence in Corporate America. (One step is to have all publicly listed corporations contribute to a fund that pays for accounting firms to audit their books. Another radical step is to separate the roles of chief executive and chairman of the board.)
6. Describe the three other proposals the President could support. (He should support tough accounting reform by creating a new oversight board, make CEOs legally liable for their companies' financial statements, and back Wall Street reform by replacing insiders on boards of directors with independent members.)
7. What does the U.S. free-market system depend on? (It depends on the flow of credible information: transparent and reliable reports prepared by honest CEOs and independent boards; certified by accountants who adhere to the highest standards; and studied by Wall Street analysts free of conflicts of interest.)
8. Write a one-sentence statement in your own words of the main idea of the article. (The U.S. system of market-driven economic growth was endangered by corporate scandals, so the U.S. President should support tough accounting and Wall Street reforms, which will restore the confidence of investors in Corporate America.)
9. How convincing is the argument by the author of this editorial?
10. The U.S. Congress passed the Sarbanes-Oxley Act soon after this editorial was written. Investigate what this Act mandates.

Susan Ariel Aaronson. "Broadening Corporate Responsibility," *The International Economy*, Fall 2002, 46–47.

-- Discussion of Reading 2 -----

1. Why does the author believe that it is not enough for corporate reform to focus on reporting requirements and auditing rules? (Capitalism today is global as well as local, so the U.S. must work with its allies to write international corporate governance norms. We need to think more broadly about how to reassure global economic confidence long term. The ultimate reform would encourage corporations to also act responsibly toward their workers and the environment.)
2. How does the author define global corporate social responsibility? (It can be defined as business practices based on ethical values and respect for workers, communities, and the environment.)
3. How may markets penalize responsible firms that work harder to ensure that workers or the environment are treated well? (These firms could have higher costs, which may allow other competitors to gain market share.)
4. What is the purpose of the two codes promoted by the State Department—the Voluntary Principles for Security and Human Rights and the OECD (Organisation for Economic Cooperation and Development) Guidelines? (These codes are designed to help business protect human rights in nations with poor human rights records.)
5. What do EPA (Environmental Protection Agency) regulations require? (They require corporations to report on their global environmental liabilities.)
6. Which U.S. public policies undermine global corporate social responsibility? (These policies include tax policies that encourage firms to shift production or their headquarters to nations with weaker fiscal or regulatory systems, corporate welfare [subsidies to business], and agricultural protectionism.)
7. Describe the efforts made by the French, British, and Canadian governments to promote domestic and global corporate social

responsibility. (The French government overhauled French corporate law and mandated the disclosure of companies' social, environmental, and profit performance. The British require pension funds to report on the social, environmental, as well as profit performance of their investments. The Canadian government is examining a wide range of public policies to promote CSR. A commission issued a report with 25 policy recommendations on promoting domestic and global CSR.)

8. What examples can you give of corporations that promote global corporate social responsibility?

Vocabulary

Fill in the blanks with the correct words. Use each word only once.

consensus	equity	oversight	mandates
sham	undermine	stakeholders	liabilities
accountability	capitalistic	indicted	fraud

Corporate reform has emerged as a key issue in the world of global business, and particularly in the United States. U.S. corporations that faced investigations into their dishonest accounting practices, false information, and excessive executive salaries were in the news in 2002. These business scandals embarrassed American business leaders, and the Enron, World-Com, and Global Crossing bankruptcies led to an increased awareness of the need for renewed corporate accountability. The call for corporate reform is a recognition that unethical policies and practices could damage the economic health of the capitalistic system.¹

The most serious problem that came to light in the investigations of the bankrupt corporations was accounting irregularities. It was a common practice for the financial officers of these corporations to overstate their assets and understate their liabilities in order to reassure their stakeholders that their companies were strong. In other words, their financial reports were a sham, and many of these executives were indicted on charges of fraud and conspiracy. Naturally, the discovery of this illegal activity resulted in investors losing confidence in corporations and thus decreasing their equity investments.²

1. "The System Needs Fixing, Mr. President," *BusinessWeek*, 15 July, 2002, 148.

2. *Ibid.*, 148.

Therefore, in July of 2002, the U.S. Senate passed the Sarbanes-Oxley Act on corporate governance and accounting, which mandates strict accounting procedures, more oversight of company auditors, and the independence of company directors who choose the auditors.³ However, Gary S. Becker, 1992 Nobel laureate and economist, is critical of the new law. He is concerned that this legislation will undermine entrepreneurial risk-taking and “hinder the efficiency and world leadership of the U.S. business sector.”⁴ He believes in the fundamental strength of the U.S. economy and argues that “corrupt companies are a small fraction of the approximately 16,000 publicly owned companies in the U.S.”⁵

Today business ethics are being reinforced by business and government leaders, but there is not a general consensus on how to apply moral standards to profit-making enterprises. Perhaps more than just a reform of auditing practices is necessary. In June 2002 President George Bush asked for “greater corporate involvement in the community.”⁶ He was referring to a broader approach to corporate reform, corporate social responsibility (CSR), which means companies must consider the health and welfare of their communities, employees, and the environment. CSR encourages businesses “to do well by doing good.”⁷

3. “Enron: Corporate America’s Woes,” *The Economist*, 30 November 2002, 60.

4. Gary S. Becker. “What the Scandals Reveal: A Strong Economy,” *BusinessWeek*, 30 December 2002, 30.

5. *Ibid.*, 30.

6. “Special Report: Corporate Social Responsibility,” *The Economist*, 14 December 2002, 62.

7. *Ibid.*, 62.