The Perverse Rewards of Society

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In January 1990 an insightful and thought-provoking article was published in the *Financial Post* by John McCallum, then senior economist at the Royal Bank of Canada. McCallum argued convincingly that modern Society tends to reward those who measure, divide and redistribute wealth, rather than those who actually create it.

McCallum cited, as examples of the former, lawyers, accountants, tax consultants, investment bankers and lobbyists. The first three professions owe much of their livelihood to the opacity of a cumbersome and unwieldy legal system, to a tortuous set of accounting rules and regulations and to the enormous complexity of tax laws. Investment bankers orchestrate deals that transfer existing assets between parties, and the lobbyist owes his worth to inadequate and inefficient mechanisms for getting information to where it is needed. The professions that actually create wealth, directly or indirectly, include scientists, engineers, farmers, doctors and other health professionals, educators, social workers, etc. With the possible exception of doctors, none of these receive financial compensation commensurate with their contribution to improving the general health, wealth and material well-being of the nation.

McCallum pointed to Japan, with an economy then second in size only to the United States. Japan's astonishing industrial success has been achieved with two to three times as many scientists and engineers per capita as the United States, and with far fewer accountants and lawyers per capita! As a result the best and brightest among young Japanese employees practise professions that directly contribute to the good of society.

I recall reading the article shortly after I had completed my studies for an MBA. In my graduating class, most of the students had, like myself, been out in the world of business and industry for a few years, and were looking to advance their careers in their chosen profession. As many as 30% of my classmates however had gone into the MBA program directly from undergraduate school. When questioned as to their career plans after graduation, many of these young, intelligent and articulate students responded without hesitation that they would pursue lucrative careers in investment banking, or other opportunities in higher finance.

Twenty years ago, words like creative accounting, toxic debts and credit default swaps were not in the popular lexicon. Instead acronymic buzzwords like M & A (Mergers and Acquisitions) and LBOs (Leveraged Buyouts) gave promise of excitement and generous financial rewards. A recent Harvard study shows that those who work in finance earn almost three times more than employees in other professions. About five percent of Harvard's 1975 graduating class work in finance. The figure for the 1990 class is fifteen percent. In recent years a brand new MBA graduate could join a Wall Street investment firm at a starting salary of $100,000!

Today we are surveying the results of this enduring folly. The wreckage of a financial meltdown that started on Wall Street with the so-called sub-prime mortgage caper has gone international with alarming speed. Within the space of a few weeks a small peaceful country like Iceland, that never threatened anyone and which had been enjoying an economic boom, is suddenly facing total bankruptcy. The banks in that country, heavily invested in now worthless paper, have accumulated debt roughly eight times the size of Iceland's entire economy!

Goldman Sachs, a household name among US investment banks, has recently been under investigation for premeditated fraud in connection with selling securities related to dodgy sub-prime mortgages, for failing to disclose to buyers the real nature of their investments and for giving misleading information in testimony to Congress concerning their sub-prime position.

It is clear that the internal checks and balances that are supposed to regulate a free market economy have failed in spectacular fashion. While the legendary "invisible hand" of Capitalism has supposedly been guiding the market, the other hand has evidently been in the till!

The reasons that led to this state of affairs will be debated for years, and will form the basis of case studies for many future MBA classes. Heavily implicated must be the investment bankers, sub-prime mortgage salesmen and purveyors of esoteric debt instruments and other derivatives! Many of these started as bright young business school graduates following the money trail, and using their intellect to dream up ever-more complex and obscure financial investment tools. In effect, Society has rewarded them for ultimately destroying wealth, not creating it!

As politicians and financial experts grapple with the mess and seek a solution on an international scale that will prevent this kind of fiasco from occurring in the future, it is clear that whatever system emerges will have little need for investment banks of the kind that have flourished on Wall Street. The man in the street can have little sympathy for the legions of high flying financial wizards who are now clutching their pink slips as they seek a new career path for their wasted talents. Still less can we empathize with former CEOs and CFOs who have left their failed companies with truly obscene bonuses and stock options!

Possibly the most sobering realization of all is to contemplate what economists call the Opportunity Costs involved. Just suppose that all those young, intelligent MBAs, instead of heading lemming-like for careers in Finance, had selected professions that truly create wealth that benefits society and raises the standard of living of all. By now we could have had more cures for a variety of medical afflictions, the streets would be full of electric cars, alternative non-polluting sources of energy would be in widespread use, the general standard of education of the population would be raised, solutions could have been found to cut hospital waiting lists, and to improve the lot of the homeless and mentally ill, etc.

Perhaps Thomas Jefferson, U.S. President and distinguished Humanist, was not exaggerating after all when he wrote in 1802: "I believe that banking institutions are more dangerous to our liberties than standing armies. If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around the banks will deprive the people of all property until their children wake up homeless on the continent their fathers conquered."

What will the future bring? Who can say with certainty? Meanwhile, my advice for my grandchildren will be this. "With hard work, dedication, honesty and integrity you can be all that you wish to be, as long as you steer clear of drugs, alcohol, biker gangs, investment banks and pernicious mortgage salesmen!"

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