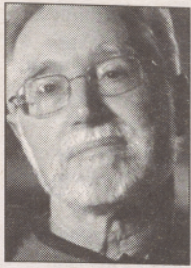


How corporations, banks are cheating with our money

BY ROBIN HAHNEL
CONTRIBUTING WRITER



Robin Hahnel

Robin Hahnel is a political activist and retired visiting professor of economics at Portland State University. He is a co-creator of the post-capitalist economic model known as participatory economics, along with Z Magazine editor Michael Albert. He is also Professor Emeritus at American University in Washington, D.C.

There are two kinds of cheating going on in our economy, every moment of every day, that few people are aware of. One is named "corporation" and the other is named "bank."

Cheat No. 1 Corporations: The defining characteristic of a corporation is that it enjoys limited liability, the owners of a corporation are anonymous and untouchable, and only the assets belonging to the corporation can be seized by its creditors. What does this mean?

If you engage in some behavior that damages others they can sue you for everything you own. They can go after your bank accounts, stock portfolio, house, car, furniture, or anything else they deem of value including your wages. But if a corporation engages in some behavior that damages others their liability is limited to the value of assets owned by the corporation. Mind you, the corporation has owners who are people just like you and me, with bank accounts, stock portfolios, houses, cars, furniture and salaries. And it is these people who are ultimately in control of their corporation's behavior. But victims cannot go after the assets of the owners of corporations. All assets of the owners of the corporation are protected. What this means is that corporations can cheat those they damage whereas the rest of us cannot.

For most of capitalist history the limited liability cheat was disallowed. A system in which the most powerful players enjoy the advantage of limited liability denied to the rest of us is relatively recent. The first modern limited liability law in the world was enacted in 1811 by the state of New York. However, the limited liability cheat proved so advantageous that by the late 1800s all state governments and most countries in the world found it necessary to grant corporations limited liability in order for them to be able to compete successfully against cheaters licensed elsewhere.

The limited liability cheat clearly encourages risk taking. The question is if this is socially beneficial or harmful. Supporters argue that without the limited liability cheat wealthy investors would be too disinclined to participate in large risky ventures, slowing the pace of socially useful risk taking. Critics argue that limited liability promotes reckless risk taking at others' expense. After a decade of observing limited liability in action in England, Edward William Cox, a lifelong member of the Conservative Party, had this to say in 1855:

"There is a moral obligation, which it is

the duty of the laws of a civilized nation to enforce, to pay debts, perform contracts and make reparation for wrongs. Limited liability is founded on the opposite principle and permits a man to avail himself of acts if advantageous to him, and not to be responsible for them if they should be disadvantageous."

Whether socially useful or damaging, I'm sure every one of us would like to avail ourselves of the limited liability cheat that corporate law awards only to corporations.

Cheat No. 2 Banks: Banks have been with us longer than corporations with limited liability. Banks accept deposits, which depositors are free to withdraw at will. But in fact only a small percentage of the deposits are kept on hand because banks lend most of the deposits to borrowers who are only obliged to pay off their loan on a schedule specified by the loan agreement. In other words, banks are bigamists: They have a legally binding marriage with first wife depositors and a legally binding marriage with second wife borrowers. Only if first wives are lenient and fail to exercise their full marital rights of withdrawal are banks not insolvent – caught like bigamists in the act – every day.

If banks were required to keep all deposits in reserve to eliminate any possibility of becoming insolvent (should first wife depositors chose to exercise their full marital rights), they could make no loans and therefore they could make no profits. In other words, "bank" means reserves will be only a fraction of deposits, which means there is always some risk of insolvency.

Worse still, the easiest way for any bank to increase its profits is to keep less deposits in reserve, and thereby increase the risk of insolvency. Unless the rate of interest a bank charges borrowers, on average, is higher than the rate it pays depositors, on average, it cannot make a profit. But a bank must compete with other banks for depositors and loan customers. So it can only reduce the rate it pays on deposits so much before it would lose depositors, and it can only raise the rate it charges borrowers so much before it would lose loan customers. On the other hand, while the "spread" between the rate charged for loans and paid for deposits is limited by competition among banks, a bank can increase profits by increasing the fraction of its deposits it loans out by decreasing the fraction it keeps as reserves. If a bank cuts the fraction of deposits it holds in reserves in half it will double its profits.

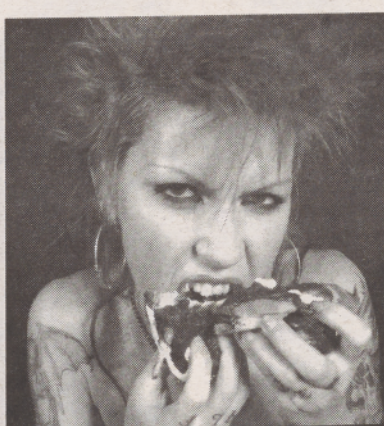
The bigamy cheat is that the bank is

betting its first wives' money, not its own, when it makes loans. If the loan pans out, the bank keeps the profits. But if the loan is not repaid, for whatever reason, it is the first wives who lose their money.

The bigamy cheat proved so lucrative that historically banks could not resist driving one another to keep less and less reserves on hand in their stockholders' lust for profits, which led to frequent, severe runs on banks where innocent depositors bore the brunt of the damage. Public outrage ultimately gave rise to a minimum legal reserve requirement and government deposit insurance. However neither of these "regulatory reforms" eliminates the dangers inherent in the banking industry. Reserve requirements prevent banks from running reserves down to the point where there is so little on hand that even a small increase in withdrawals leaves them insolvent. And deposit insurance reduces the probability of depositors panicking at the first sign of trouble at their bank, leading to a run. But short of a 100 percent reserve requirement – in which case there would be no banks – and fully funded deposit insurance – which no government can afford – the risks inherent in a bigamist industry remain, even if somewhat diminished.

Just as in the case of the corporate limited liability cheat, the bank bigamy cheat has its defenders and its critics. Defenders argue that if we did not allow banks to be bigamists there would be too little socially productive lending. Critics have long argued that unregulated banking is an accident waiting to happen. Some critics, myself included, now argue that because banks have proven so adept at plying politicians to remove regulations after financial crises have passed, we only fool ourselves if we think we can subject them to competent regulation, and therefore private banking for profit is a luxury we can ill afford. Better to have public banks not driven by stockholders to increase profits in ways that create unnecessary social risks. In any case, I'm sure we all would like to avail ourselves of the bigamy cheat and bet other people's money, keep any winnings, and have any losses be theirs.

Some critics, myself included, now argue that because banks have proven so adept at plying politicians to remove regulations after financial crises have passed, we only fool ourselves if we think we can subject them to competent regulation.



VOODOO DOUGHNUT

THE MAGIC IS IN THE HOLE!

22 SW 3RD & BURNSIDE
1501 NE DAVIS

SUPPORTING STREET ROOTS SINCE 2003

OPEN 24/7!

Welcome

... to the health care you know and trust.

Working in partnership with providers, community health centers and social service agencies to serve people on the Oregon Health Plan, Health Share is building a more accessible and coordinated care system throughout the Tri County area.

503-416-8090 | www.healthshareoregon.org

Together we are **health share**

Health Share of Oregon

Vendors are regular contributors to Street Roots content, as columnists, poets and artists. Look for your favorite vendor's writings in each edition of the paper.