Threatened collapse of WorldCom sends political establishment into crisis

Joseph Kay
28 June 2002

The imminent collapse of telecommunications giant WorldCom is rapidly surpassing even the Enron scandal in its magnitude and implications. After admitting to the biggest accounting scam in American corporate history, the nation's second-largest long-distance provider is on the verge of the largest corporate bankruptcy ever. The situation at WorldCom will exacerbate an economic crisis within the United States that has seen massive layoffs, the precipitous fall of the stock market and a declining dollar. The extent to which the entire American economy is built on rotten foundations of deceit and criminality is becoming clear, with profound political consequences.

WorldCom disclosed on Tuesday that over the past two years $3.8 billion of the company's expenses had been declared as capital expenditure, allowing for an overstatement of profits by several billion dollars. The amounts involved in the scandal are staggering. In order to correct the accounting "error," WorldCom will have to issue the largest restatement of earnings ever announced by an American corporation, dwarfing the previous record set by Rite Aid earlier this month. By a single act of accounting alchemy, the company transformed red ink into over a billion dollars of golden profit.

Only an economic system rotten to the core could create an environment where such a maneuver could pass as good coin for well over a year. It suggests that such tricks are not only widely used; they have formed the basis of the so-called economic "boom" of the past decade.

The crisis at WorldCom has further undermined investor confidence. The steep decline in the stock market that has followed each of the unending scandals has caused a great deal of concern on Wall Street and in the White House. In an attempt to forestall a market sell-off, President Bush interrupted the Group of 8 meeting in Canada Wednesday to publicly declare that the government "will fully investigate and hold people [at WorldCom] accountable..." "There are some concerns about the validity of the balance sheet of corporate America and I can understand why," he added.

Treasury Secretary Paul O'Neill stated, "I think we've got to prosecute people to the full extent of the law. In some cases we need to strengthen the law" so the government can go after executives.

Facing wave after wave of revelations of corporate fraud, the Bush administration has attempted to contain the crisis by blaming individual companies, labeling them as black sheep. The *Wall Street Journal*, not known for its opposition to big business, has called for prosecutions. The Securities and Exchange Commission (SEC) has filed civil fraud charges against WorldCom. Like the government's criminal prosecution of Arthur Andersen, however, any investigation will serve more to conceal than to reveal the extent and nature of the corruption.

The WorldCom fraud is not separate from the general functioning of the American and world economy. The crimes of CEOs and individual companies are subjective manifestations of objective processes with deep roots in the transformation of the capitalist economy over several decades. The SEC charged the company with "falsely portraying itself as a profitable business." WorldCom was able to do this, however, only because it operated within an economy which "falsely portrayed itself as healthy," within an economy based on lies.

As Marx explained, there is an inherent tendency within capitalist society for the rate of profit—extracted from the working class in the process of production—to fall. With the development of the forces of production, an ever smaller proportion of labor is required to set into motion an ever expanding mass of capital. Since surplus value extracted from labor is the sole source of profit, this leads to a tendency for the rate of profit—the amount of profit generated by an equal amount of capital—to decline.

In order to counteract this tendency, capital resorts to a number of different strategies. On the one hand, the individual capitalist seeks to increase his share of the aggregate surplus by increasing the productivity of his own firm: by increasing efficiency, by reducing wages and laying off workers, by developing technology. As all the companies must act in a similar manner to survive, this results in a general increase in the productivity of labor. As the proportion of labor used in the production process declines, however, it becomes more and more difficult to increase the amount of surplus extracted from the small relative amount of labor that remains. It becomes more and more difficult to counteract—by means of increasing productivity—the tendency for the rate of profit to decline.

These contradictions inherent to the functioning of capitalism have reached extreme levels within the international economy as a whole, but particularly within the United States. As a result, the American ruling class has turned increasingly to financial manipulation, speculation and outright theft as a substitute for production as a means to maintain its social position. An important component of this process has been the stock market bubble of the late 1990s. Finance capital—the banks, hedge funds and other big investors—encouraged an environment in which the value of a company's stock has become the sole measure of its worth.

Companies have increasingly engaged in all manner of criminal practices in order to keep share value artificially high. This is why the issue of accounting and accounting fraud has come to the fore. In order to hide the underlying sickness, it became necessary to "put lipstick on the pig." It is through accounting that the internal health of a company is determined. The reports audited by accounting firms—the balance sheet, the earnings statement, etc.—are supposed to express in concentrated form the fundamental infrastructure of the firm. If this infrastructure is decaying, then it is necessary to "cook the books" in order to hide this fact.

The stock bubble has led to an enormous enrichment of a small layer of the population. At the front of this pack are the corporate CEOs and other executives, including former WorldCom chief Bernard Ebbers, who used his company to provide himself with hundreds of millions of dollars in salary, stock options and personal loans before resigning earlier this year. It is not only these executives, however. Aside from the professional financial speculators, there is an entire layer of the upper middle class, in the media and intelligentsia, and the entire political apparatus, who have benefited from the stock market boom.

With this bubble's collapse, the means used to keep the money flowing into the hands of the rich has come increasingly to light. All of this has had and will continue to have a devastating impact on the majority of the population. The basic infrastructure of production has been undermined, and in the process social services like education and healthcare have been opened up for plunder. As the economy crumbles, the "downsizing" will continue at an even more rapid pace.

Under these conditions, Bush's cynical calls for accountability merit only contempt. It is upon this criminal layer that the Bush administration is based. The Republican president owes his rise in politics in no small part to the funding provided by Kenneth Lay and Enron. The secretary of the Army, Thomas White, was once an executive at Enron. Vice President Dick Cheney, was once the CEO for oil giant Halliburton, which has itself come under scrutiny for irregularities carried out on Cheney's watch. Treasury Secretary O'Neill recently called for corporate criminals to be "hanged from the highest branch." He should be careful. If taken seriously, his words could be interpreted as a threat against the life of the president and his entire cabinet.

The Democratic Party is attempting to denounce Bush for his close connections with big business. Yet it is itself implicated in the whole process. It was under Clinton that the speculative frenzy reached a pinnacle. Democrats received a greater share of WorldCom's campaign contributions than did the Republican Party. As Stephen Hess of the Brookings Institute noted, "there are too many hands, dirty or not, involved in this for one party to get away charging the other with corporate greed."

WorldCom is a particular expression of this general trend. Like Tyco, WorldCom was a business based not so much on production as on acquisition of other companies financed by high stock prices. Under the leadership of former CEO Ebbers, it acquired more than 70 companies over the course of two decades, including MCI. In the process, the company transformed itself from a small telephone firm into a telecommunications giant surpassed only by AT&T.

Loans needed for each acquisition were financed with corporate stock, and each acquisition led to a further increase of the value of this stock, which then became the basis for further acquisitions. WorldCom's stock reached a peak of over $60 in June 1999 before collapsing. It traded at around 25 cents yesterday.

WorldCom's acquisition binge took off in the mid-1990s. The $37 billion buyout of MCI in 1998 was at the time the largest merger in corporate history. Costs at acquired companies were cut and workers laid off to boost short-term earnings, and accounting books were cooked in order to maintain the appearance of profitability and keep share prices high. The acquiring company added nothing—neither experience, nor greater efficiency, nor any other improvements—to what it acquired. Rather the opposite was true: it bought up companies in order to parasitically extract short-term earnings from the assets at the expense of any long-term improvements in the process of production.

During its binge, the company built up nearly $30 billion in debt. It compensated for the overpriced acquisitions by accumulating on its balance sheet over $50 billion of goodwill, which is used to cover the difference between the price paid and the actual value of the assets. Like capital expenditure, goodwill is not subtracted from earnings.

With overproduction plaguing the telecommunications industry, and its stock price falling, the basis of WorldCom's operations collapsed. The company was forced to write off its earnings over $15 billion worth of this goodwill earlier this year. It then came under investigation for accounting irregularities and insider dealing, had its bond ratings reduced to junk and has finally collapsed in upon its rotten foundations.

It was only after its collapse that the scale of the fraud became clear. The manipulation that came to light on Tuesday—one of the many means the company used to inflate its earnings—was quite simple. Beginning in the first quarter of last year, billions of dollars worth of routine expenses began to appear in WorldCom's books as capital expenditures.

Capital expenditures generally include investments in machinery and other long-term asset purchases. Since capital expenditures constitute a purchase of assets, the cost is not immediately subtracted from the corporation's earnings. The balance sheet merely indicates a transformation of the form of corporate assets—for example, from cash to machinery. Over the next several years, the cost of the machinery is gradually deducted from earnings as depreciation, which is supposed to take into account the gradual deterioration of the asset.

By classifying what were routine expenses as capital expenditures, WorldCom could artificially prop up short-term earnings and increase cash flow. The company purchased and used $3.8 billion worth of goods and services that it simply declared were still in its possession in the form of capital. It is like someone selling a used car and including in its value all the gasoline he pumped into the vehicle since he bought it. The car is suddenly worth twice as much. By the same method, a company in crisis is suddenly performing above expectations!

WorldCom's fraud was a straightforward lie that would not have been possible without the connivance of entire groups of different actors. It was a trick that could have been detected easily if there were anyone who cared to look. What had this $4 billion—an enormous sum even for WorldCom—been used to purchase? On what was this money spent? Anyone with the slightest knowledge of the company's operations should have been able to notice a spotted elephant of such magnitude.

However, no one—not WorldCom's auditor Arthur Andersen (also Enron's auditor), nor the corporation's supposedly independent board of directors, nor the SEC—really cared to pay too much attention. They were all benefiting in one way or another from the process.

Like every one of the corporate scandals, the consequences of the collapse of WorldCom will be catastrophic for its workers. Already the company has begun laying off some 17,000 workers, almost a quarter of its worldwide workforce. The collapse of the stock market as a whole is devastating 401(k) retirement plans. Moreover the whole process of deregulation, speculation and fraud has been bound up with a decimation of the social safety net in the United States and an unrelenting assault on the living standards of the working class. All the wealth generated by means of corruption and fraud has, in the final analysis, been stolen from the vast majority of the population.