

**EUPHORIA, RISK AND CORPORATE SCANDAL:
ENRON AND THE COMMERCIAL CORRUPTION OF
EXPERTISE WITHIN FINANCIALISED CAPITALISM**

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Abstract:

Individual investment decisions are guided by the knowledge that is presented by financial experts about the future prospects of firms. The integrity of the financial system depends on the expert community maintaining its independence in the face of firms' attempts to impose their own commercial interests as the perspective through which expert assessments of their prospects are undertaken. The dramatic nature of Enron's collapse in the autumn of 2001 was intensified by the fact that it occurred on the back of a three-year period of exceptional growth in its stock market valuation. With hindsight, this period can now be shown to be evidence of Enron's successful 'capture' of expert opinion, such that a post hoc evaluation of the public pronouncements of financial experts appears to reposition them as ostensible company stakeholders. The paper focuses on: the strategies deployed by Enron's senior managers to effect this capture of expert opinion; the reasons why the company had become so dependent on good news propelling stock price increases that its managers felt compelled to adopt such a strategy; and the implications of the commercial corruption of expertise for the sustainability of finance-led growth regimes.

Keywords: Enron; risk society; financial expertise; company watchdogs; financialisation; stock market.

Introduction

There were, in effect, two Enrons. On the one hand, there was the Enron that was visible for all to see. This was the company that was paraded around the financial press as the most notable success story of late twentieth century capitalism (Kulik 2005: 349) and that had a stock price performance to match (Cruver 2002: 124). It was the company whose senior managers won business leader of the year awards many times over (McLean and Elkind 2003: 59) and who rubbed shoulders with high-profile politicians from around the world (Swartz and Watkins 2003: 37). On the other hand, there was also the Enron that could only survive for as long as it could take advantage of the general ignorance of its unseen operations. This was the company that hid its dynamic debt position from its own shareholders (Benston and Hartgraves 2002: 112-3) and that relied on strategic misinformation to legitimise its activities (Trinkaas and Giacalone 2005: 237). It was the company whose senior managers engaged in wilfully neglectful or outright illegal behaviour in an effort to maintain the impression that all was well (O'Connell 2004: 734). Despite public appearances to the contrary, the first Enron generated risks which endangered its own existence, in response to which the creation of the second Enron became functional to the survival of the company as a viable entity.

In order to explore the interaction between these two Enrons, I focus on the attempts of senior managers to create a context of general ignorance about the company's faltering business model. To do this, I exploit the conceptual similarities which exist in the work of economic historian John Kenneth Galbraith (1992 [1954], 1994) and sociologist Ulrich Beck (1992, 1999). These are particularly evident when comparing the explanatory structure which Galbraith uses in his study of financial euphoria to

that which Beck uses in his study of the risk society. Both focus on the way that the events in question arise from individual actions which can be shown, under post hoc examination, to have been based on erroneous assessments of the environment in which they were undertaken. The build-up of tendencies that lead eventually to risk society outcomes occurs in full view of society but is generally unrecognised for what it actually is. The same is true of moments of financial euphoria, which in themselves should be understood as risk society outcomes. The inability to see those tendencies in their true light disguises the nature of the underlying event, and this ignorance enables daily life to continue 'as normal'.

However, such ignorance is not necessarily the result of individuals' unwillingness or lack of capacity to keep themselves informed. They can be misled into believing something that turns out to be false and, in this way, their ignorance can be manufactured. Such was the dynamic in the case of the two Enrons. The company's senior managers had no incentive to allow Enron's increasingly precarious financial position to become common knowledge amongst the investing public. As its business model became ever more dysfunctional over the course of the 1990s, the only thing that eventually kept the company afloat was the dramatic increase in its stock price from 1997 to its peak value in 2000. Enron's future became tied to the euphoric moment associated with the tech-stock bubble and, in such circumstances, it was essential to continue furnishing the investing public with good news about the company's prospects. To this end, senior managers set about the task of capturing the content of the public pronouncements of financial experts. The aim was to persuade these experts to give up a degree of their independence so that their public pronouncements on Enron were consistent with them having internalised the

company's interest in an ever increasing stock price. The managers' success in such a strategy ensured that individual investors were increasingly exposed to financial risks when committing their savings to Enron stock, even though they were unaware of the fact at the time.

The paper is written in four stages. In section one, I establish the conceptual framework based on the critical view of expert opinion developed by Galbraith and Beck. I argue that the Enron affair has all the characteristics of a risk society event, but those risks were hidden by the deliberate construction of an expert community which bought into the euphoria surrounding Enron's rapid stock price rise. In section two, I explain why Enron's senior managers felt that they had no choice but to put together a self-serving expert community of this nature. The overhaul of Enron's basic operations through the 1990s left the company with an increasingly dysfunctional business model, whereby it could no longer function as a going concern unless it experienced a continuous increase in its stock price. In section three, I focus on the characteristics of the in-house expert community that Enron constructed, showing how a number of company watchdogs repositioned themselves in effect as Enron stakeholders. This allowed a context of general ignorance of Enron's real activities to develop, enabling the company to inhabit the image of a highly successful modern corporation, whilst all the time undermining the conditions of its own existence. In section four, I draw out a number of implications of the foregoing analysis for the sustainability of the current macroeconomic regime. Public confidence in finance-led growth regimes relies on the presence and presumed objectivity of a number of experts, in particular government regulators, boards of directors, credit rating agencies, stock market analysts and accounting professionals.

Their objectivity is assumed to follow from their position beyond the firm, external to society's commercial system and acting on behalf of the investing public. However, the Enron affair demonstrates just how easily firms can subvert the position which company watchdogs are supposed to occupy with respect to society as a whole. Enron's self-generated in-house expert community utilised its expertise, not as a check on Enron in the interests of society, but directly on behalf of Enron by helping to sustain a misleading public image of the company. If Enron proves to be merely one instance of a more general corruption of financial expertise, then the sustainability of current finance-led growth regimes is very much open to question.

Section 1: Expertise and the Financial Risk Society

The most basic insight on which Ulrich Beck's risk society approach is founded is that human beings are capable of creating a world that they do not understand (Lash and Wynne 1992). The cases that Beck identifies relate to human activities which attempt to harness technological and scientific developments for commercial gain. His main point is that such effects often pose an existential threat. His theory of risk society identifies a stage of modernity in which economic progress both confronts and subverts the process of human development (Beck 1992: 24, 1999: 74). He concentrates in particular in this respect on ecological events. Whilst Beck's ecological risks are demonstrable threats to established ways of life, nobody can be

sure exactly who will be affected by them when they finally strike or, indeed, when precisely that time will be.

In Beck's society of ecological risks, expertise becomes valuable precisely because of the context of unpredictability. Experts are called upon to express a judgement on whether the prevailing structure of risks will cohere into a future existential threat and, depending on their answer to that question, what is the preferred course of action in the present. Yet, none of this can ever be known for sure. Indeed, the definition of the problem itself does not exist outside of the structure of political power within which the expert is located. Competing views of the nature of threats is therefore little more than a reflection of competing political definitions of the good society. In this way, expertise necessarily becomes a relative phenomenon in the risk society, with Beck (1999: 79) talking about the way in which one set of experts is routinely "dethroned by counter-experts".

In addition, expertise often has a commercial price attached to it in today's highly commodified society. Certain groups will commission 'their' experts to describe the world very much to their own liking and in their own interests. The purpose to which expertise is deployed is therefore as divergent as the interests that are evident within society. However, the source of the claim to be treated as holding expert knowledge is always the same. It is always rooted in the cognitive traditions and the discursive practices of a supposedly authoritative scientific rationality (idem: 109). The response to individuals living in a world that they do not fully understand is typically to place their trust in science or, failing that, in anything that comes close to approximating science (Giddens 1991: 88-92). Scientific knowledge is assumed to be

constructed in a rational environment ('is there enough evidence that a build-up in critical tendencies will have a specific impact on human life and, if there is, what is the technical fix that can counteract the initial problem?'), and so the only course of action for the individual is to follow the prescriptions of scientific knowledge ('if that is what science says then I should allow it to guide my behaviour'). However, the psychological comfort that might be forthcoming in such a rational world is immediately invalidated by the recognition that scientific knowledge is today a commodity in its own right (Kuhn 1970; see also Fay 1996: 80-2).

At times it is produced with the sole intention of selling it on to the highest bidder, and at other times it is produced specifically to order (bespoke knowledge, as it were). As a consequence, individuals have no way of knowing a priori whether the supposedly expert claims with which they are confronted are constructed within the textbook world of rationally-formed objective scientific endeavour or within a commodified world where knowledge claims are tailored to meet overtly political aims. In other words, science may well be the primary authority structure within contemporary society, but the individual has no way of deciding whether the knowledge claims embedded in modern science represent the best possible approximation of an external truth or reflect a particular commercial interest. Given such circumstances, Beck (1992: 49) writes of a "commonality of anxiety" that must necessarily afflict every individual as an existential condition of contemporary risk society.

In this respect, there is at least one important difference between the ecological and the financial manifestations of risk society. Beck presents the commonality of anxiety

as an inescapable aspect of ecological risks, but financial risks which are embedded in moments of market euphoria only arise in the first place because of a temporary suspension of investor anxiety. A stock market bubble results from the continual increase of market prices, but this occurs only at the time at which investors' confidence is such that they stop believing that prices will fall (Kindleberger 1989: 28-56). Expert opinion is once again crucial here. Investors may come to the conclusion that the mere possibility of downside price trends has been all but eliminated. But they only do so in a context in which expert opinion – delivered in quasi-scientific language and appealing to quasi-scientific authority – is saying that this is already the case (Shiller 2000: 71-117). Such assumptions rely, for instance, on public policy-makers continually asserting the benign nature of the future economic environment, market commentators highlighting the supposedly unparalleled dynamism of modern corporations, accounting and audit professionals confirming robust company earnings profiles, stock market analysts turning all this contextual information into declarative statements that individual stocks are currently undervalued and, finally, the development of a general perception that rich pickings are there to be made.

Another difference therefore becomes apparent between the ecological and the financial dimensions of risk society. With regards to ecological risks, individuals have a long-term existential interest in believing bad news. Whether that news turns out, over time, to have been based on questionable knowledge claims is largely beside the point: that interest is constant irrespective of how the future unfolds. In order to secure both their and future generations' long-term survival, individuals should act in line with dystopian ecological forecasts, just in case they turn out to be true. By

contrast, with regards to financial risks, and especially in instances of stock market euphoria, individuals have a short-term monetary interest in believing good news. It is again immaterial whether subsequent events show that such knowledge claims had no substance except as a reflection of the bubble environment in which they were constructed. So long as investors can exit their positions and cash in their profits whilst the good news stories persist, that interest will hold.

Galbraith's account of the general conditions for financial euphoria focuses on such concerns for the way in which behaviour is influenced by supposedly authoritative knowledge claims. Despite these two important contextual differences, like Beck he pays particular attention to the submission of the individual to a culture of expertise (Galbraith 1992 [1954]: 99-103). Yet, this is an asymmetric tendency in the context of a stock market bubble. Buoyed by the promises of riches in such a context, investors will only submit themselves to a culture of expertise when expert opinion tells them what they want to hear. They will often deny the validity of knowledge claims which suggest that the stock market is already overvalued and that a period of price retrenchment is overdue. By contrast, they will treat as authoritative any counter-suggestion that the bull market still has life in it. To this end, they will typically care less about the source of the authority on which they rely (i.e., who is speaking) than they do about the content of the allegedly authoritative statements (i.e., what is being said). Indeed, Galbraith (1994: 5) goes as far as to argue that, within the context of a stock market bubble, investors have a "vested interest in error". That is, they are happy for the content of allegedly authoritative statements to be wrong, or even deliberately misleading, just so long as they continue to propel the desired trajectory in market prices.

An expert only becomes an expert in these circumstances when he or she says the ‘right’ thing from the perspective of the investor’s short-term monetary interests. To this end, individuals instinctively relativise expertise. They are free to choose whatever expert advice they like, and they are most likely to do so on the basis of what they think will enhance their short-term monetary position. Moreover, that advice is not constructed solely to the liking of the individual investor. As the Enron affair shows only too well, it emerges from within a complex relationship of overlapping interests between the experts who are asked to pass judgement on the prospects for a firm and the firm whose prospects are being judged. This is once again an issue of bespoke knowledge and it adds a further distorting factor to expertise in relation to financial markets.

Such dynamics are worthy of comment in themselves. But they become even more so on recognition of the influence that expert advice, however stripped of true expertise, continues to have on the stability of the financial system. The sustainability of finance-led growth regimes is entirely dependent on individuals maintaining sufficient confidence in the integrity of the financial system as to allow their savings to be directed towards financial markets (see Section 4). In turn, this requires that individuals trust in corporate watchdogs’ ability to preserve their independence from the companies whose activities they oversee. As the Enron affair demonstrates, however, those watchdogs can become ostensible company stakeholders, such is the effect of what is best for the company on the way that they perform their jobs (see Section 3). The financial system is deprived of its integrity as soon as the dividing line becomes indistinguishable between the expert opinions offered by company

watchdogs and the economic interests of the company itself. In the case of Enron, this occurred in the context of senior managers' all-out attempts to ensure the continued expansion of the company's stock market valuation. To see why such efforts were deemed necessary, we must look at changes introduced in Enron's underlying business model, which increasingly tied the viability of the company's daily operations to ever higher levels of the stock price. This is the focus of the following section.

Section 2: Enron's Over-Reliance on the Stock Price

Most accounts of the Enron affair begin by noting the extent of the change in its basic underlying business. It began life as a natural gas pipeline operating company (Fusaro and Miller 2002: xi; Smith and Emshwiller 2003: 4), and moved through successive phases of adaptation to the point at which it saw itself almost solely as a financial trading company (Enron 2001). Moreover, it not only traded a whole host of energy commodities and their related financial derivative instruments. It also actively made the markets in those instruments. Enron stood unchallenged as the primary issuer of over-the-counter derivatives for the whole of the lucrative energy sector (Deakin and Konzelmann 2004: 135).

Enron's business operations had a dual focus and, in this way, they very much mirrored those of the banks that its senior executives so wished to emulate (in terms

of reputation, earnings and, importantly, stock market valuation). On the one hand, it made money out of its market-making activities, offering the same service to other traders as banks offer to investors seeking to hedge the risks embedded in their investments via the over-the-counter derivatives market. On the other hand, it also followed the banks by becoming an active trader on its own markets (what banks call trading on their own account).

This latter activity became a particularly attractive proposition when Enron took all of its market-making activities online. EnronOnline provided its users with instantaneous access to a virtual marketplace in which they could record the price at which they were prepared to buy or sell any particular energy commodity or related derivative instrument (Partnoy 2003: 319). Importantly, though, Enron decided that it was not satisfied with allowing one user to access the virtual marketplace to trade with another user, for this would have limited its earnings potential to the money it could make from users' fees. Instead, it decided that all users had to trade directly with EnronOnline, thus making Enron the counterparty to all trades that were conducted on its multi-billion dollar markets.

The system was consequently set up so that Enron's traders alone could see all the bid and ask prices on any energy commodity or energy derivatives market at any moment of time (McLean and Elkind 2003: 223). This meant that Enron's traders alone could exploit the price spreads that arose from EnronOnline's users having less than perfect knowledge of all other users' intentions. In turn, this provided Enron's traders with endless arbitrage opportunities, from which they could profit by matching pairs of users, one of whom was willing to sell the relevant commodity or instrument for a

lower price than the other one was prepared to buy it for. At first glance, then, there might appear to be no ostensible difference between Enron's trading activities and those of the arbitrage departments of major banks.

However, there was one very important difference. Although banks' arbitrage departments appear in their financial statements as autonomous profit centres, they are very much part of a larger entity. The key to successful arbitrage trading is for traders to be sufficiently liquid that they are able to stay in their positions long enough to ride out unpredictable market disturbances (Lowenstein 2001: 3-4). The spreads between bid and ask prices provide the basis for arbitrage opportunities, but if those spreads move in an unanticipated direction after the trade has been entered it will require successively larger sums of money to stay in the trade until the subsequent price correction occurs (Shleifer and Vishny 1997: 36). A trader who is insufficiently liquid will have to exit the trade before the price correction occurs and, importantly, before the price correction makes the original arbitrage position a profitable one. In general, banks have been very successful arbitrage traders precisely because they have been able to call upon large sums of capital to keep them in their arbitrage positions when price spreads temporarily move against them. This is why it is significant that banks' arbitrage departments are incorporated into a broader corporate structure. For, it is the other core activities of the banks – in particular their investment banking practices which elicit hefty fees – that provide the arbitrage departments with ready access to large sums of money to enable their traders to stay in their positions.

By contrast, Enron was always dependent on flows of banking credit in order to feed its trading operations. In its early days as a trading company, it could rely on its

highly priced heavy assets when it was asked to post collateral on its bank loans (Smith and Emshwiller 2003: 39). All this changed, however, when the company's senior executives decided to press ahead with adopting the stock market analysts' favoured approach of the time: an 'asset-light' approach (see Higson 2001: 4-5). The accumulation of heavy assets involves taking more debt onto the balance sheet and, as the 1990s progressed, favourable stock analyst recommendations were given to those who followed 'new economy' firms in running relatively debt-free balance sheets, rather than those who followed 'old economy' firms in using balance sheet debt to propel earnings growth (Mauboussin and Hiler 1999).

Enron's adoption of an asset-light approach required that the company sell off many of its heavy assets in order to eliminate their accompanying balance sheet debts (Deakin and Konzelmann 2004: 135-6). However, this decision had an important knock-on effect when it came to the company's trading operations. Having sold off many of its heavy assets, it could clearly no longer use those assets as collateral on bank loans. But without being able to secure bank credit to feed its trading operations, its arbitrage business would immediately become less liquid, providing the company with difficulties in staying in its positions long enough for them to become profitable in the face of temporarily adverse movements in price spreads. Even though EnronOnline provided Enron's traders with full knowledge of all the bid and ask prices in the marketplace, they were still powerless to prevent sudden falls in trader confidence from disrupting the normal performance of price spreads.

Enron came up with two solutions to the problem of how to maintain sufficient liquidity in its arbitrage business. The first was to try to increase the flows of cash

into its trading operations from other sources within the firm (Kulik 2005: 351). In order to turn its market-making activities into a more robust profit centre, though, it had to leave many of its over-the-counter derivative positions unhedged. This meant that it had to expose itself to the possibility that those positions would turn into big money losers. Yet, to minimise this possibility, it turned to any number of sharp practices designed to manipulate market prices and hence to move its over-the-counter derivative positions 'into the money' (e.g., McLean and Elkind 2003: 271-83).

In addition to this, Enron went gung-ho for the asset-light approach in an attempt to generate further flows of cash into its trading operations from the capital market. At the height of the bull market in the late 1990s, increases in stock prices were closely correlated to reported returns on capital employed (Feng et al 2001: 478-85). The beauty of an asset-light approach from this perspective was that there was almost no capital employed. In such circumstances, high returns on capital employed can ensue from relatively low levels of earnings (Arnold and de Lange 2004: 759). Enron set itself the task of working with what became known at the time as a 'gravity-free' balance sheet (Mauboussin and Hiler 1999), in which its underlying business model would no longer be dependent on employing anything but the most minimal level of capital (Enron 2001). In this way, it hoped to post high returns on capital employed, which it expected to lead to extremely favourable stock analyst recommendations and, in turn, to large increases in its stock price. Given that the company retained substantial numbers of its own shares (Gordon 2002: 1245), Enron's senior managers believed that the adoption of an asset-light approach would lead to the generation of significant long-term flows of cash into the company as the stock price continued to

go up. This new source of cash could then be used, of course, to support a more liquid arbitrage business and to increase the chances that the arbitrage business would be profitable.

Enron attempted to lock-in what it saw as this virtuous circle by increasing the volume of its trading activities and thus increasing the return on its capital employed. However, the initial increase in trading activities could only be supported by taking out additional credit lines from its banks, and it was here that the company's entire future was staked on continual increases in its stock price. In order to secure this additional credit, Enron posted its own stock as collateral. It could only use the current stock price to back the loans and to generate credit, but of course the full cost of the loans was the face value of the credit *plus* an interest payment. If it was ever going to be in the position to pay back the full cost of the loans using its own stock, then the stock price at the time at which repayment was due would have to be higher than it was at the time at which the credit was originally extended. As the company's trading operations became entirely dependent on rolling over an ever expanding pyramid of credit (Baker and Hayes 2004: 772-3), nothing would suffice other than a continued upward trajectory in the stock price. If the stock price faltered for more than a brief period of time, its loan repayments would become due with immediate effect as its banks looked to call in their loans, its arbitrage positions would unwind before they could show a profit and, eventually, its whole trading operation would become untenable. As Enron had increasingly become purely a trading company (Partnoy 2003: 297), a prolonged fall in stock market valuation consequently endangered the entire company (Sims and Brinkmann 2003: 247).

This, then, is the business context in which Enron became pathologically reliant on continued increases in its stock price. I turn in the next section to the extra-economic strategies that the company's senior managers put in place in an attempt to secure the desired trajectory in the stock price. In particular, I focus on their efforts to create their own network of supposed experts, who would continue to place in the public domain optimistic forecasts of the company's potential, even in the face of mounting evidence that less favourable assessments would have been more appropriate.

Section 3: Watchdogs as Stakeholders in the Creation of a Financial Risk Society

When the end came for Enron it came very quickly. On October 16th 2001, the company released that year's third-quarter earnings report, which showed a US\$1.2 billion charge levied against shareholder wealth. This arose from losses accruing to an off-balance-sheet equity fund that Enron's finance officers had established in an attempt to create the impression of a more favourable balance sheet position than its genuine debt holdings warranted (Higson 2001: 1). Less than four weeks later, on November 8th, Enron restated its previous four years' earnings to reveal further losses resulting from its previously secret dealings with off-balance-sheet equity funds. Once more, these were charged against shareholder wealth (Benston and Hartgraves 2002: 105-6; Baker and Hayes 2004: 773-4).

Enron's stock price had, in any case, declined over the previous twelve months. Given such a context, the downward revision of earnings reports triggered substantial short-selling of Enron stock, leading the stock price to haemorrhage in value (Smith and Emshwiller 2003: 102-3). The banks that had lent Enron money against its stock price increasingly called in their loans, drying up the credit which collateralised its trading positions and, in the end, making it impossible for the company's traders to execute their trades. On December 2nd 2001, Enron filed for bankruptcy, with its stock trading at little more than 1% of its peak value less than eighteen months previously (Froud et al 2004: 893).

Post hoc examinations of the way in which Enron conducted its daily activities have shown conclusively just how much of its supposed success was down to calculated financial manipulation covering up the fact that it had increasingly become unviable as a profitable concern (Sims and Brinkmann 2003: 245; O'Connell 2004: 737). What is more important for current purposes was the failure of corporate watchdogs to signal the contradictions in the company's basic operations. More than that, corporate watchdogs acted as if they had become active stakeholders in the company's continuing success. This is a case study in the wilful creation of bespoke knowledge, in which supposed experts are taken in-house and their expertise, whilst still presented as being in the public interest, in fact is consistent only with the company's economic interest. The Enron affair suggests that it is necessary to focus on five such sources of the commercial corruption of financial expertise: i) government regulators; ii) boards of directors; iii) credit rating agencies; iv) stock market analysts; and v) accounting professionals.

i) Government Regulators

Government regulators are supposed to act at arms-length from the intended subjects of the regulation, so that their detachment can ensure that the regulation works in the interests of society as a whole. In response to such assumptions, however, Enron's senior managers courted extremely close relationships with regulators at all levels of government (Hirsch 2003). The histories of Enron written by company insiders (e.g., Cruver 2002; Swartz and Watkins 2003) tend to focus on the internal division of labour between its three most senior managers. Jeffrey Skilling, long-time Chief Operating Officer, took care of day-to-day activities within the firm, restructuring its basic business orientation in line with an asset-light approach. Andrew Fastow, Chief Financial Officer, concentrated on creating the highly complex structured finance deals which ensured that the company appeared to meet its earnings target and hence demonstrate to the outside world that its asset-light approach was working. This left Kenneth Lay, the Chief Executive Officer, to develop relationships with government officials, in the hope of ensuring that Enron faced a regulatory context in which its asset-light approach could flourish.

Such was the success with which Lay played his role that Enron became a government 'insider' (Froud et al 2004: 886-7) and, as a consequence, government policy increasingly became tied to what was best for Enron. When the prevailing regulatory orientation worked against Enron's interests, Lay was quick to present 'government' in the abstract as an impediment to consumers enjoying lower energy prices. Yet, at the same time, he was instrumental in working with actual

governments to ensure that Enron got what it wanted. Most notably in this respect, the US Federal Futures Trading Commission exempted energy derivatives from government oversight following feverish lobbying activity from Lay (McLean and Elkind 2003: 96). These were the markets in which Enron made most of its money and, once the government decided that these markets would be self-regulating, Enron was free to make those markets in whatever way it pleased. Had greater levels of disclosure been imposed upon those markets, Enron would have been hard pressed to manipulate its earnings figures from its derivatives business in the interests of maintaining upward momentum in its stock price (Benston and Hartgraves 2002: 115). The structure of government was so convincingly captured that Enron's managers were able to set the terms on which they conducted most of their own activities.

ii) Enron's Board of Directors

Lay found the perfect way to reward the outgoing head of the Federal Futures Trading Commission, Wendy Gramm, for the decisions that had provided his company with the regulatory environment it desired: he offered her a paid place on Enron's Board (Partnoy 2003: 302). The same was true of John Wakeham, the UK Secretary of State for Energy who had pushed through a number of deregulating bills for the Thatcher Government, thus allowing Enron to gain a foothold in the European market (McLean and Elkind 2003: 96). Moreover, many other members of the Enron Board were paid additional retainers in lieu of supposed consultancy fees (Deakin and Konzelmann 2004: 139).

One of the founding assumptions of conventional corporate governance theory is that the Board of Directors acts as a check on managerial autonomy designed specifically to protect shareholders' interests (Gordon 2002: 1235). However, Enron bypassed the autonomy criterion from the start by compromising the independence of the Board through its offer of directorships as a return for past favours and through the enhanced payments it made to directors for internalising the company line. Board members' appointments can only serve society as a whole if they are based on an expertise that can be called upon to rein in whatever temptation managers may experience to place shareholders' investments at risk. Yet, this was quite clearly not the basis for the appointment of so many of Enron's Board.

As a consequence, it should perhaps come as no surprise that Enron's Board has been accused of a "lack of fiduciary diligence" (Brennan 2003: 42). It waived the company's own code of conduct to allow Fastow to set up off-balance-sheet equity funds which he himself ran and profited from handsomely, but which were capitalised with Enron's own assets (Partnoy 2003: 303). In doing so, the Directors signed off on complex financial dealings which saw senior managers put shareholder money at risk by constructing ostensible hedges which in truth were nothing more than the company trading with itself (Sims and Brinkmann 2003: 246). They also did not prevent Fastow from transferring assets from Enron to his own equity funds, thus introducing a serious conflict of interest given his official responsibility as Enron's Chief Financial Officer (Smith and Emshwiller 2003: 48-50). An important source of ostensible shareholder control over Enron's senior executives was therefore

neutralised by the managers' success in providing themselves with compliant directors.

iii) Credit Rating Agencies

As Enron increasingly became a trading company in the 1990s, it became ever more exposed to the consequences of a credit rating downgrade (Deakin and Konzelmann 2004: 138). Under the loan agreements negotiated with its banks, Enron had agreed to allow its loan repayments to become due with immediate effect if its credit rating fell below investment grade (Partnoy 2003: 336). Moreover, many of the large institutional investors such as pension funds have a formal requirement to sell all their holdings in companies whose credit rating fails to maintain that standard (Smith and Emshwiller 2003: 70). Institutional investors had become major Enron shareholders towards the end of the tech-stock bubble, when the company came to be seen as a 'quality' stock. Any credit rating downgrade would therefore have led to significant offloading of Enron stock, causing both its price and the value of the collateral it was posting on its bank loans to fall, hence changing the terms on which it received the credit from its banks which underpinned its whole operations. In turn, this would have made future downgrades ever more likely, threatening a complete credit squeeze if its credit rating fell below investment grade.

The credit rating agencies maintain their ostensible detachment from the companies they rate by basing their ratings on clearly stated rules and metrics (Froud et al 2004: 895). Even in its heyday, Enron did not have the capital base, the diversification

away from cyclically-based activities or the stable long-term earnings profile to warrant the high investment grade ratings of major banks. However, although the quarterly earnings reports which Enron filed increasingly showed its enhanced credit dependency, the credit rating agencies did not activate their own metrics to push the company further towards junk status until after it restated its earnings for the previous four years on November 8th 2001. Given Fastow's frequent trips in the intervening period to meet the credit raters face-to-face (Smith and Emshwiller 2003: 63), it appears that the credit rating agencies were prepared to suspend the basis of their own expert judgement (i.e., the automatic application of their own metrics) in order to buy into the Enron story that they were being told (i.e., that the company's stock market valuation was more than justified). In this way, the credit rating agencies acted as if they were Enron stakeholders.

iv) Stock Market Analysts

Most investors do not have the time to familiarise themselves with all the market-relevant information that lies behind their investment decisions and, even if they did, they might well lack the technical competence to read the most important things into that information. As some sort of shortcut, they tend to go with the views of trusted stock market analysts (Bernstein 1992: 61-74). In the absence of trust defining the relationship between the analyst and the investor, investors are placed at the whim of the corruption of supposed expert knowledge. They can be persuaded to place their money in certain stocks, not because that is necessarily best for them, but due to analysts seeking to preserve their relationship with important corporate clients and

prioritising this task over preserving their own reputation as independent experts. In this context, it is worth noting how late in the day it was before most analysts revised downwards their recommendations on Enron stock. Even in the immediate aftermath of the company's third quarter earnings report for 2001 – by which time the game was almost certainly already up – all but one of the seventeen analysts covering Enron for major banks had a recommendation on the company's stock of either 'buy' or 'strong buy' (Froud et al 2004: 891).

The problem in this respect is that the expert culture in which stock market analysts could act for society as corporate watchdogs is immediately compromised by the conflicts of interest that the analysts face. The organisational rules which had once prevented different parts of a bank from colluding for monetary gain have been swept away in the deregulation of the US banking industry (Hirsch 2003: 566). Given this, analysts focused less than they might otherwise have done on the fact that Enron was unprofitable in strict economic terms (Higson 2001: 2). Instead, they sought to foster a context in which their analysis would be looked upon favourably by a company with big investment banking contracts to issue (Unerman and O'Dwyer 2004: 891). Increasingly, analysts go to meetings with corporate finance officials along with representatives of their bank's investment banking arm. As a consequence, they have tended to submit themselves to the investment banker's assumption that the company is their client, rather than to the independent analyst's assumption that it is an autonomous entity on which they are required to pass judgement. In such circumstances, it is easy to see how unjustified 'buy' recommendations arise. Enron's financial officers did much to ensure that those circumstances applied in practice, by making it clear that banks whose analysts failed to talk up the company's stock price

were unlikely to be awarded lucrative investment banking contracts (McLean and Elkind 2003: 233-5).

v) *Enron's Accountants*

When it comes to the corruption of expert systems in the Enron affair, most of the academic focus has thus far been on the actions of Enron's accountants, Arthur Andersen. By signing off accounts that they knew to be both misleading to investors and false, key Andersen staff members have been indicted to answer criminal charges, and the company itself was wound up as its business migrated to its competitors. Andersen's actions represented an important subjugation of accountants' public interest role to the audited firm's commercial interest (O'Connell 2004: 734). A financial system based on modern capital markets can only function if investors trust the reliability of accounting data (Ravenscroft and Williams 2005: 368). But for that trust to arise the accountants must be able to demonstrate their independence from the firms that they are auditing (Unerman and O'Dwyer 2004: 974-5). The financial system is likely to be destabilised if accountants stretch the discretion to utilise their expertise as they see best to wilfully incorporate in their accounts what is in the interests of the stock price of the firm being audited.

However, this is exactly the situation that Enron's accountants placed themselves in. Andersen employees were prepared to go native in their relationship with Enron (Higson 2001: 2), because this paved the way for the company to make as much money from the management advice it sold to Enron as it did from acting as its

auditor (Rockness and Rockness 2005: 42). The continued increase in Enron's stock price prior to its eventual collapse was used to show that the advice it secured from Andersen was money well spent, which in turn provided a disincentive for Andersen employees to present accounting data which implied that the current level of Enron's stock price was unjustified. Compliant auditing standards thus give accountants a better chance of retaining their client base than do rigorous and potentially critical auditing standards (Revsine 1991: 19). Enron consequently benefited from the commercialisation of Andersen and, in particular, from its willingness to treat the audit process as a means of increasing its sales of consultancy services (Grey 2003: 573). Given that audit fees increasingly became used in the 1990s as a loss leader designed to expand accounting firms' consultancy business (Reinstein and McMillan 2004: 958), it is perhaps only to be expected that supposedly expert accounting data came to be manipulated by the firm being audited.

Section 4: The Macroeconomic Implications of the Corruption of Expert Culture

Enron's accounts came under critical scrutiny only after successive downward revisions of earnings statements in the third quarter of 2001. The fact that this did not happen before then implies, in Chris Higson's words, "contributory negligence" on behalf of the financial community. For, even before its admissions of reporting error, "a simple analysis of Enron's return on capital in the years up to 2000 shows a company which was unprofitable in economic terms" (Higson 2001: 1). Irrespective

of subsequent revelations of endemic financial engineering to hide company debt in off-balance-sheet equity funds, the published accounts “clearly reveal Enron was on a trajectory of increasing sales and declining returns” (Froud et al 2004: 892). The failure of the financial community to bring the frailties of Enron’s basic business model to the attention of the investing public is evidence of corporate watchdogs that did not bark (Trinkauss and Giacalone 2005). The previous section focused on what the watchdogs did not say and attempted to give reasons for why nothing was said. This final section analyses the macroeconomic implications of these silences.

Such implications result from the way in which the economy has been increasingly exposed to conditions that are suitable for the development of a finance-led growth regime (e.g., Epstein 2005; Froud et al 2005). This arises when a financial logic of funding activity through capital gains is allowed to penetrate every aspect of economic life. The ensuing process of financialisation, as it is so often called, is currently experienced in different intensities in different countries. But it is a project with powerful elite support, ranging from the international institutions that regulate the global economy to the multinational corporations that provide the global economy with so much of its dynamism, via any number of national governments seeking to accommodate that dynamism within domestic policy.

Like all elite projects, however, this one cannot survive merely on the basis of elite decree. If financialisation is to be free of immanent challenges, it must also provide a means of integrating society into the dominant growth regime, so that the social basis of support for the project spreads ever more widely. In other words, a finance-led growth regime must incorporate society as a means of creating the source of its own

legitimation. The most obvious way of doing so is via increasingly robust asset-based welfare systems. In turn, these depend on the wealth effects arising from a structure of capital gains. In the absence of these wealth effects, generalised consent for a finance-led growth regime is unlikely to be forthcoming. Indeed, in the absence of *expectations* of a stable flow of wealth effects, it is hard to see how a finance-led growth regime could command genuine popular support.

With this in mind, two issues in particular emerge from the Enron affair. For a start, the revelations which emerged about Enron's accounting practices in the aftermath of the company's collapse sent already faltering stock market prices into something of a tailspin. Yet, it is through the stock market that most individual investors secure the capital gains that can then be used to pay for private insurance cover in those instances in which public markets for welfare provision are no longer complete. Private pension funds, for example, channel substantial investments into the stock market in an attempt to ensure that capital gains will provide individuals with sufficient savings for their old age. In his important book on the pricing structure of contemporary stock markets, Robert Shiller calculated (2000: xvi) that, as stock market valuations surged on the back of the tech-stock bubble, if the Dow Jones Industrial Average had suddenly fallen from 10,000 to 6,000, then "the loss would represent something like the equivalent of the entire housing stock of the United States". The frenzied selling that followed admissions of systematic earnings manipulation at Enron and elsewhere actually *did* propel an already falling Dow Jones into the kind of decline that Shiller had used to illustrate his argument. From its peak in excess of 11,700 in 2000, the Average haemorrhaged value to fall below 7,300 in 2002 (www.wallstreetcourier.com).

In short, the events surrounding Enron and similar cases destroyed shareholder value, and it did so on a dramatic scale (Friedrichs 2004: 114). According to Michel Aglietta's model of finance-led growth dynamics, this was perhaps not wholly unexpected. The precise trigger for the destruction of wealth could not have been anticipated, but Aglietta suggests that a financialised economy is necessarily susceptible to cyclical pressures that lead to the creation of speculative bubbles which suddenly burst. Financialisation is predicated upon asset price appreciation, which occurs most rapidly in the context of highly leveraged investment positions, but when leverage effects kick-in in a falling market, liquidity dries up and stock prices fall steeply (Aglietta 2000: 155).

Yet, if this is to present Enron as a manifestation of the normal dynamics of a financialised economy, I wish to emphasise a second implication of the Enron affair which has much more specific implications for the future of a finance-led growth regime. This relates not to the effect that revelations about Enron's earnings manipulation had on the actual structure of stock market prices, but to the effect on investors' broader perception of the stock market environment as a whole. It is certainly the case that Enron's calculated misdemeanours activated a reverse wealth effect in stock markets around the world, impacting adversely on investors whose portfolios did not even contain Enron stock. But the most profound implication of the Enron affair, I argue, is the extent to which it revealed the distortion of the expert culture that sustains the trust of individual investors in the stability and the integrity of the entire financial system. In other words, it has undermined arguably the most important support structure ensuring the incorporation of society into the finance-led

growth regime. It is in this respect that the significance of the arguments about risk society outlined in the opening section become most apparent.

To illustrate this point, let me briefly return to Galbraith's explanation of the conditions that feed a moment of financial euphoria. Looking at this from the perspective of the individual investor, Galbraith pinpoints the significance of instances in which investors lose sight of what they actually know. In order to capture the sense of this generic ignorance, he pictures a social scene that typifies the context which led to the run-up of stock prices immediately prior to the 1929 Wall Street Crash (Galbraith 1992 [1954]: 100): "At luncheon in downtown Scranton, the knowledgeable physician spoke of the impending split-up in the stock of Western Utility Investors and the effect on prices. Neither the doctor nor his listeners knew why there should be a split-up, why it should increase values, or even why Western Utility Investors should have any value. But neither the doctor nor his audience knew that he did not know."

Moving beyond Galbraith's observation, it is necessary to note that ignorance per se is not the problem for investors. Investors' ignorance is likely to be relatively benign so long as their 'not knowing what they do not know' can be offset by taking genuinely detached expert advice which makes clear to them what they need to know about the operation of the financial system. In such circumstances, the risks that are embodied in their ignorance are likely to remain latent. However, if all that is available to them is not genuinely detached expert advice but supposed expertise that is corrupted by an overlapping commercial interest, then the fact that they 'do not know that they do not know' immediately exposes the risks that are embodied in their ignorance. In these

latter circumstances, they will not be able to suppress the potentially adverse effects of their own ignorance through relying on supposed expertise to bridge their knowledge gap. As soon as this fact is exposed, though, it becomes apparent to investors that they have very little understanding of the basis on which they make their investment decisions. They are consequently sensitised not only to what they do not know, but also to how what they think they might know is susceptible to overt manipulation. What they do not know now matters, because to stake their savings on what they think they might know clearly contains the risk that those savings could be lost.

Turning specifically again to the Enron affair, we can thus begin to comprehend how the ensuing revelations of corrupted expert knowledge expose investors to the full effects of a financial risk society. During the period in which Enron's stock price rose so steeply, as Jeffrey Gordon puts it (2002: 1236), "No one on the outside really understood Enron's financial conditions". Julie Froud et al concur (2004: 892) that "many people were willing to believe in something that few actually understood". Their ignorance would not have been damaging for their financial prospects had the expert opinions on which they were relying – most particularly from Enron's Board, credit rating agencies, stock market analysts and Andersen staff accountants – proved to be untainted by Enron's ability to create a coincidence of interests between itself and these supposed experts. The one thing that investors did not know *but that truly mattered to their financial prospects* was the extent to which these supposed experts were acting, in effect, as Enron stakeholders. Had they retained their independence from Enron and commented on the company's financial structure from the perspective of genuinely independent experts, they would surely have been alerted by expert

warnings to the possibility that all was not well at Enron and they would have been able to reorder their investment priorities accordingly. Their ignorance only became a factor given the conspicuous silence of the corporate watchdogs, which they perhaps understandably took as a signal that all remained fine.

Moreover, those within the financial community who did attempt to maintain their independence were subjected to a mixture of vitriol and ridicule by others who would tell them that they simply did not get what was ‘special’ about Enron (e.g., Fusaro and Miller 2002: 79; McLean and Elkind 2003: 230-1; Arnold and de Lange 2004: 753; Trinkaus and Giacalone 2005: 238). In Galbraith’s terms (1994: 11), this is just another generic condition of a moment of financial euphoria: “The euphoric episode is protected and sustained ... by the will to ignore, exorcise, or condemn those who express doubts”. In other words, the attempt to maintain expert independence in moments of financial euphoria potentially involves being cast out by the expert community as so many of its members succumb to the private interests which become embedded in the euphoric dynamics. Beck says the same more generally about the conditions in which risks are allowed to remain uncovered by deliberate distortions in expert knowledge. He notes (1992: 31) how bespoke knowledge – what he calls a strategic “local misdiagnosis” – can be used to silence the experts who challenge the current orientation of common opinion. In the Enron case, people asking whether the company was both cause and manifestation of an unsustainable speculative bubble were generally drowned out by those who said that: i) in the ‘new economy’ phase previous models of corporate finance no longer applied (see Feng et al 2001: 469-75); and that ii) it was Enron in particular that was at the forefront of rewriting the rules of the game (see Kulik 2005: 349).

But this in itself was only evidence that financial expertise has increasingly come to be incorporated into society's commercial system. To put it simply, financial expertise has become a commodity, to be given a monetary value so that it can be traded just like any other commodity. However, as Sue Ravenscroft and Paul Williams point out (2005: 370), the incorporation of financial expertise into society's commercial system is conditional on it first being removed from society's justice system. Genuine financial expertise enables individuals to invest their savings in good faith and with the minimum of systemic risk. Yet, when financial expertise becomes nothing more than a tradeable commodity, those savings are immediately endangered by the commercial interests that are embedded in the supposedly expert advice.

For the individual to be shielded from the full effects of the risk society, Beck assumes (1992: 27) that expertise has to be enacted in a pristine manner. If experts within the financial community act as if their expertise is part of society's justice system and, importantly, if society in general has no reason to doubt that this is the case, then the individual's experience of financial risks is mediated in such a way that their full effects are not apparent. However, if experts within the financial community act as if their expertise is part of society's commercial system, or even if investors only have reason to suspect that this is so, then the individual is immediately sensitised to the full potential of financial risks. In such circumstances, the risk society is uncovered and must remain so, at least until the time at which financial expertise is re-embedded into society's justice system and society in general comes to believe that this is the case.

It is here that we can identify what might turn out to be the most important long-term macroeconomic implication of the Enron affair. The reproduction of a finance-led growth regime requires a functioning system of asset-based welfare if it is to sustain societal consent. Functioning systems of asset-based welfare are dependent on financial markets that produce predictable capital gains, but these in turn rely on a structure of untainted financial expertise if they are to receive the trust of ordinary investors. Yet, the Enron affair proves just how easy it is for financial expertise to be compromised as it is shifted from society's justice system to its commercial system. At this point, contradictions are revealed in the macroeconomic foundations of the political project of financialisation (e.g., Boyer 2000: 133; Williams 2000: 10). A finance-led growth regime and a financial risk society are therefore likely to be two sides of the same coin.

Conclusion

One of Beck's key insights on the nature of risk society (1992: 22) is that the continual exposure to risks serves to radicalise the society which has that experience to seek radical new social formations. However, despite the fact that the Enron affair uncovered the extent to which ordinary investors are susceptible to financial risks, the political conditions for the move beyond a financialised society are not yet in view. Indeed, after two years of a severe bear market in the wake of the tech-stock crash,

stock prices rose steadily once again in the following four years before slipping back after the onset of the world credit crunch in the summer of 2007. The touchstone Dow Jones Industrial Average regained its peak bubble valuation before credit crunch dynamics spread contagiously from the inter-bank lending market to the stock market and activated a new period of value-shedding. This pattern of pricing is not consistent with investors seeking a radical response to the revelation that financial expertise has been thoroughly compromised. It might, of course, reflect the extent to which ever more people believe that they simply have no choice but to channel their savings into the stock market in order to replace diminishing public welfare provision with individualised asset-based welfare. If this is true, then it is likely to create a structural impediment to the radicalisation of financial risks. At the very least, it shows that genuine societal consent is not necessarily required for the reproduction of a finance-led growth regime. In such circumstances, the compromised status of financial expertise might have little macroeconomic bearing, save for the short-term consequences of speculative booms and busts. Bubble dynamics of this nature might therefore simply be something that the investing public has to get used to as a precondition of life lived within a financialised society (Aglietta 2000: 155).

Galbraith's work contains the seeds of an alternative explanation for the lack of financial radicalisation that has followed the fall-out from the Enron affair. He argues (1994: 5) that, so long as distorted financial knowledge causes stock prices to go up, investors have a strategic interest in financial expertise *failing* to provide true representations of the market environment. Moreover, the observed pricing trend on the post-Enron stock market is certainly consistent with investors believing that their 'vested interest in error' overrides their concerns for the extent to which financial

expertise has been compromised by commercial interests. If this is indeed the case, then there are strict limits on the sanctions that society is likely to impose on those who deliberately compromise their financial expertise for commercial gain. As such, there are unlikely to be concerted demands from the investing public for financial experts to be genuinely detached from the stock market effects that their pronouncements help to propagate. To turn this conclusion back specifically to the Enron affair, it requires that we entertain the possibility that, whilst Enron's investors were most certainly misled by the corruption of expert knowledge, to some extent they also acquiesced in a process through which they allowed themselves to be fooled (Higson 2001: 1-2). The lack of obvious evidence that events at Enron have led to systematic behavioural change on the part of ordinary investors means that those events are unlikely to become a significant structural break in the history of financialisation. In these circumstances, finance-led growth regimes might very well continue to be pushed, despite their evident contradictions and crisis-prone nature. As such, the Enron affair is most likely to be merely a glimpse of the repeated patterns of the future.

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