



Moral Capitalism at Work

2012 YEAR IN REVIEW

From the perspective of the Caux Round Table (“CRT”), with its concern for conditions conducive to a moral capitalism, the distinctive features of 2012 were the fading of strong leadership in politics, business, religion and academia and the emergence of committee management in its place.

G8 and G20 heads of state, finance ministers, etc. did nothing dramatic to re-engineer the world economy after the collapse of credit markets in 2008 or to confront climate change or the needs of the environment at the Rio+20 Conference. Summer Arctic ice was at its lowest expanse and shipping is being considered through once deeply frozen waters. No intellectual leadership of distinction appeared to re-engineer the basic premises of valuation in capitalism after the current model of rational pricing/market efficiency proved its deficiencies in 2008. In the United States, political polarization unseen for generations led to gridlock on fiscal responsibility. Leadership transitions in Russia, China and Egypt have not been inspiring.

But, the committee process of crisis management proved resilient to maneuver around the debt burden threatening financial values in the Eurozone. More importantly, common sense prevailed in Greece, Italy and Spain that excesses in entitlements, just like excesses in private market speculations, are unsustainable. Responsibility, understood as prudence and dynamic balancing of interests without going to extremes, was affirmed by many in Europe.

On the other hand, the claim of sectarian extremism showed its power within the Ummah of Islam, with Sunni/Shi’a differences leading to violence and Salafi fundamentalism promoting more violence in parts of Africa.

Under such circumstances, the responsibility to speak out for responsibility must spread more widely among a potential priesthood of all believers. Leadership should no longer be located among those with positions of bureaucratic authority, but should become a catholic phenomenon, embracing those with vision and the courage to speak and act. Speaking truth to those more timid souls in power makes more and more sense.

If character is destiny, then our common global destiny turns on the character we each bring to ourselves and to our concern for the common weal.

High standards of good governance in markets, private enterprise and in politics are needed if we are to correct behaviors and lower future risks. Such standards are clear and the CRT has chartered the path, but the challenge remains to get them mainstreamed and to challenge the unacceptable leadership behaviors that are all too prevalent and so damaging.

This past year, we were called on to present our vision to the High Level Thematic Dialogue on the State of the World Economy at the U.N. General Assembly. Our very successful Global Dialogue in July at Mountain House in Caux, Switzerland, provided four recommendations for fundamental improvements in global financial governance, which included:

1) FIXING THE FLAW IN ECONOMIC ANALYSIS

Key Issue:

Modern micro and macro economic analysis depends on mathematics for its analysis and its predictions, but use of mathematics, in turn, favors assumptions about human nature that are too simplistic and not in line with emerging anthropological and neurological understandings. New assumptions are necessary to better align economic understanding with human realities.

2) SOVERIGN RESPONSIBILITY FOR SOUND FINANCIAL INTERMEDIATION

Key Issue:

The foundation of economic growth in today's global economy is financial intermediation. The access to spendable liquidity, either in the form of equity investment or repayable debt, permits the commencement of business ventures and sustains operating businesses of all sizes and varieties. Where access to such liquidity is limited, economic growth stagnates; where excessive liquidity is made available, asset prices become distorted, unsustainable price bubbles emerge and financial collapse occurs, damaging economic activity and lowering living standards. Thus, the sovereign responsibility to promote economic growth calls forth a subordinate responsibility to provide optimum conditions for private sector financial intermediation. Institutions of financial intermediation consist of banks, securities underwriters, insurance and reinsurance companies, brokers/dealers, financial advisers, investment banks, accountants and legal counsel.

3) RATING AGENCIES

Key Issue:

Credit rating agencies ("CRAs") have captured the market when it comes to issuing the verdict on the credit-worthiness of countries and corporations. In the process, they have become one of the most powerful organizational groups in global finance. But, this heavy reliance and dependence of the global finance and investment markets on the verdicts of the CRAs proved to be spectacularly wrong in the run up to the global financial crisis and collapse of credit markets. Widespread calls for reform were triggered as a result, particularly relating to the way credit ratings conduct their business, the oligopolistic nature of the ratings market and the lack of accountability of the CRAs for the performance of their ratings. While some reforms have occurred, the power and influence of CRAs remain. As a result, the risk to global financial stability from conflicted and inaccurate ratings has yet to be adequately addressed.

Second, the valuation process needs innovation and reform. The traditional criteria for valuation are too limited and narrow; they consider mostly accounting conventions which only report present consequences of past actions. They do not purport to bring into present consideration

future potentials and risks. These factors are intangible in estimation of the discount rate for equity values and the capitalization multiplier.

4) REPOSITIONING BANKS AND FINANCIAL INSTITUTIONS

Key Issue:

The global financial crisis has exposed severe flaws in the global financial system. Banking and financial intermediation have produced an unsustainable imbalance between ‘paper’ financial claims and real earnings and assets; regulation has been shown to be seriously inadequate; incentive systems have been seriously misaligned, fuelling naked greed; and society has been poorly served as a result. Fundamental reform is urgently needed to: rebuild the robustness of the global financial system, restore its fragile network of trust, and get the finance sector to again make a positive economic and social contribution. But, policy makers seem hapless, regulators are making only slow progress and the industry, itself, is showing little leadership in driving needed change.

Too many financial assets have been created relative to real assets. This is called the “Quadrillion Problem.” World GDP is now 63.12 trillion USD; notional value of global money supply, corporate equities, debt instruments and derivatives is 899 trillion USD or almost a quadrillion USD (global money supply is 60 trillion, global equities are 45 trillion, global debt instruments are 124 trillion and global derivatives are 670 trillion). This amount does not include sovereign, unfunded liabilities for future retirement and health care payments.

SIGNIFICANT ACCOMPLISHMENTS

1. Published twelve monthly issues of *Pegasus* to provide thought leadership for a more ‘moral capitalism’ and more ethical governments.
2. Presented at the U.N. General Assembly’s High Level Dialogue on the State of the World Economy.
3. Convened a distinguished persons group in The Netherlands to make recommendations on corporate social responsibility (“CSR”).
4. Participated in a Bertelsmann Foundation project to establish an independent, not-for-profit rating agency for sovereign debt using a new rating methodology.
5. Initiated a working group to develop a practice manual for daily meditation and reflection for business executives to deepen their personal capacity for CSR management and decision-making.
6. Drafted a follow-up book to *Moral Capitalism* on lessons learned from the 2008 collapse of credit markets.
7. Expanded our network in Minnesota around an effort to teach character and ethics in public schools to shape future business conduct.

8. CRT theory of moral capitalism as stewardship was endorsed by John Bogle, founder of index funds and the Vanguard Group of investment funds and by John Taft, CEO of RBC Wealth Management, in his 2012 book *Stewardship*.

9. Contributed two chapters on moral government to an edited collection of essays to be published by the International Islamic University of Malaysia.

10. Developed a course in CSR using Theravada Buddhist perspectives on mindfulness.

OUTREACH EFFORTS

Global Dialogue

The 27th Global Dialogue was held at the International Conference Center in Caux, Switzerland. The Dialogue addressed four proposed key reforms to international finance.

Business and Public Policy Round Tables

Four Business and Public Policy Round Tables took place throughout the year at the University Club in St. Paul. They included:

- "A Discussion Between Occupy Minnesota and the Tea Party about Economic Justice in America" with Occupy activists Ben Egerman and Stephanie Brown; Walter Hudson, Chairman of the North Star Tea Party Patriots; and Marianne Stebbins, former Chair of Rep. Ron Paul's Presidential Campaign in Minnesota

- "Which Financial System - American, European or Other - Is Now Most Conducive to Investment?" with Roger Conant, Chief Investment Officer of Magni Asset Management and Louis Hill, President of Rockwood Capital Management

- "The U.N. and How to Ignite Global Growth?" with Steve Young, Global Executive Director of the Caux Round Table

- "The 2012 Election: What Does it all Mean? Does the Republican Party Have Victory in its Future?" with Steve Sviggum, former Speaker of the Minnesota House of Representatives; John Hottinger, former Majority Leader of the Minnesota Senate; and Marianne Stebbins, former Chair of Rep. Ron Paul's Presidential Campaign in Minnesota

Internet Presence and Social Media

The CRT's website was visited by close to 40,000 people during the year. CRT videos were placed on YouTube and new posts on relevant subjects were frequently added to our Facebook and Twitter pages. Mr. K.L. Lam of Cornerstone Ltd. in Malaysia provided the highest quality administrative and technical support for the site.

Publication

Twelve monthly issues of *Pegasus* were published with a global circulation of 2,400 opinion leaders.

Citizenship Recognition Award

The CRT's annual Award for Outstanding Citizenship was presented to Sandra Vargas, President and CEO of the Minneapolis Foundation, for her leadership in the application of values to community regeneration.

PRESENTATIONS

U.N. High Level Thematic Dialogue on the State of the World Economy

The CRT presented its recommendations for more sovereign responsibility for financial intermediation before the United Nations General Assembly in New York.

Convention of Independent Financial Advisors

The CRT presented its views on how to reform debt rating agencies, applying a new approach to valuation of risk through the use of CSR stakeholder relationships, at the Convention of Independent Financial Advisor's annual meeting in Monaco.

International Islamic University Malaysia

The CRT presented four lectures on leadership at the International Islamic University in Malaysia.

Bentley College

The CRT provided a keynote address at Bentley College's annual symposium on business ethics.

Loyola Marymount University

The CRT presented a lecture on the inadequacies of "agency theory" as used in financial theory and modeling, with suggestions for its replacement with financial analysis more open to the moral sense.

Viterbo University

The CRT presented a lecture on moral capitalism.

ORGANIZATION

Global Governing Board

Dr. Noel Purcell, Chairman – Australia
Frank Straub, Vice Chairman, Europe – Germany
The Lord Dan Brennan QC, Chairman Emeritus – United Kingdom
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Fellows

Senior Fellows:

Ronald O. Baukol – United States
Kevin Cashman – United States
Brother Louis DeTomasio – United States
Morihsa Kaneko – Japan
Steve Lydenberg – United States
Robert W. MacGregor – United States
Fred Senn – United States

Fellows:

Prof. Abdullah Al-Ahsan - Malaysia
Lord Michael Bates – United Kingdom
Dr. Thomas A. Bausch – United States
Yury E. Blagov – Russia
Bogdan Diaconu – Romania
Jose Luis Fernandez Fernandez – Spain
Prof. Robert Fleming – Singapore
Prof. David Grayson – United Kingdom
Prof. Dr. Harry Hummels – The Netherlands
Dr. N. Doran Hunter – United States
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John C. Knapp, Ph.D. – United States

Michael Labrosse – United States
Alexandra Lajoux – United States
Jeanette Lehr – United States
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Bernard Margueritte – Poland
Dr. Lester A. Myers – United States
Chris Pierce – United Kingdom
Prof. Recep Senturk - Turkey

Senior Staff

Stephen B. Young, Global Executive Director – United States
Hiroshi Ishida, Senior Advisor to the Global Executive Director – Japan
Jed Ipsen, Assistant Director – United States

We regret the passing of Prof. and former Dean of Harvard Divinity School Ronald Thiemann, a member of the CRT's World Advisory Council.