Introduction

SUCCESS, ARROGANCE, PROBLEMS, DECEIT, more problems, more deceit . . . *spectacular failure*. That sequence describes the heady boom and decisive bust of Enron Corporation, the most chronicled and dissected business story in history.

But hubris, dishonesty, and obstinacy were not the exclusive franchise of Enron and its two principals, Ken Lay and Jeff Skilling. This destructive pattern was present in the record bankruptcy of Bernard Ebbers's WorldCom, which came just months after Enron's collapse in December 2001, not to mention other corporate scandals that greeted the new century. Looking back, the virus was also operative in the fall of Samuel Insull's titanic energy-utility empire during the Great Depression, a failure that was in some ways the Enron of its era.

The same failings characterized the 1904 bankruptcy of Houston Oil Company of Texas, which had been capitalized at a princely $30 million just three years earlier. Houston Oil, which emerged from receivership four years later, was a predecessor company to Enron.

History can meet itself coming and going.

The central figures in these three debacles were revered business titans. In the first third of the twentieth century, Insull was the Great Man of the electricity industry, as well as Mr. Chicago. Ken Lay was the Great Man of natural gas for much of the 1980s and 1990s—and Mr. Houston as well. Houston Oil centered on the bigger-than-life John Henry Kirby, the Mr. Houston of his day. Kirby would recover from Houston Oil's early stumbles, but his reign ended with his personal bankruptcy in 1933, a time when Samuel Insull was living abroad to avoid his legal woes. In the end, an extradited Insull was acquitted of his alleged business crimes, but such was not the case for Ken Lay, who in two trials was found guilty on all counts by jury and judge. Yet Lay escaped the prospect of life in prison, receiving what his sympathizers called a pardon from God—death from a heart attack just weeks before his sentencing.

"The bigger they come, the harder they fall," goes an old adage. And yet history mostly remembers the winners: Astor, Carnegie, Morgan, Rockefeller, Vanderbilt. By contrast, the lives of Kirby, Insull, and Lay are riches-to-rags stories, with Enron representing perhaps the *ideal type* of business failure—and thus a near-perfect specimen for lessons and learning.

What was the socioeconomic system within which Enron thrived—and then perished? Why did such a revered company collapse, and just who was responsible? What incentives, ideas, and habits led the perpetrators astray? How did deviations from common sense and standard business practices lead to unintended outcomes, slippery slopes, and such a disastrous finale? Most important, what are the lessons for business and government going forward? These questions are the inspiration for this trilogy. Book 1 examines the capitalist worldview; Book 2 focuses on Insull, Kirby, and Enron's prehistory (including the career of Ken Lay); and Book 3 chronicles Enron's rise, fall, and aftermath.

Bad habits acquired in boomtime, in addition to old-fashioned fraud, go a long way toward explaining dramatic business reversals. But Enron was something more. Ken Lay's company was not the largest bankruptcy in U.S. history (WorldCom's filing, listing $107 billion in assets, was double Enron's claimed amount) or the most overtly fraudulent. What set it apart was that Enron's sins seemed to involve every commandment and every pew. It was what journalist George Will called a "systemic failure," encompassing academics, accountants, boards of directors, consultants, credit-rating agencies, investment bankers, journalists, lawyers, politicians, regulators, securities analysts, and more. Thus, American business, even capitalism itself, was placed on trial, prompting Princeton economist Paul Krugman to declare in the *New York Times*: "I predict in the years ahead Enron, not September 11, will come to be seen as the greater turning point in U.S. society."

George Will was right. Enron shamed professions and institutions, not only individuals. Ken Lay's handiwork made Adam Smith's invisible hand tremble. Still, Krugman missed the boat, as did other pundits, including Robert Kuttner, who declared in *BusinessWeek* that Enron refuted free-market economics. These critics thought that the system that had made an Enron possible was capitalism and that free-market economists from Adam Smith to Milton Friedman had thus encountered their equivalent of stagflation (simultaneous high inflation and high unemployment), which had humbled Keynesian economics a quarter century before. Philosophically, these critics equated Enron Man to Capitalist Man, with one-and-the-same running footloose in an inadequately constrained system. The 2005 movie documentary *The Smartest Guys in the Room* linked Enron to Ronald Reagan, deregulation, and California's alleged electricity-deregulation experiment to make the same point.

Not surprisingly, these new-era populists championed more regulation in the attempt to plug the gaps in existing regulation. And more than that, a new ethos of corporate social responsibility was urged for business, complete with redoubled efforts to imbue students with business ethics through the academic curriculum, as if the problem at Enron was a lack of philosophical training. In a *Journal of Corporate Citizenship* essay, "Are Business Schools Silent Partners in Corporate Crime?" two university business ethicists asked why Washington policymakers had not investigated business schools in reference to the corporate scandals, given that many of the culpable MBAs were taught from an "approach to business education that elevates narrow self-interest above broader values of community and corporate citizenship."

So rather than rely on invisible hands and old-fashioned virtue, the call had come for New Capitalist Man and the Accountable Corporation. "The wisdom and resourcefulness of regulators, activists, and above all, corporate management itself," concluded a four-volume guidebook for corporate governance in the post-Enron era, "will shape a healthy future for the modern *accountable* corporation."

How did an enterprise that sought to become the world's leading company become the very worst? How did Enron prosper for so long, seemingly achieving one ambitious vision after another? How did Ken Lay gain and command so much trust among vast constituencies? What created an aura of corporate invincibility that fooled virtually everyone—including Enron's own employees—as well as Lay himself?

Part of the answer is the *new economy* mantra (an economy-wide arrogance, in retrospect), which Jeff Skilling, in particular, exploited by positioning Enron as the world's premier dot-com energy company. In the knowledge economy, Enron had a corner on brilliance, he thought. But something more fundamental was at work, quite the opposite of the free-market whipping boy postulated by Krugman, Kuttner, prominent business ethicists, and others.

The socioeconomic framework that enabled Enron—and also contributed to its demise—was political capitalism. Unlike free-market capitalism, political capitalism is a variant of the mixed economy, in which business interests routinely seek, obtain, and use government intervention for their own advantage, at the expense of consumers, taxpayers, and/or competitors. Ken Lay, despite his claimed allegiance to a free-market economy ("I believe in God, and I believe in free markets," he would say), was at the epicenter of America's mixed economy. In fact, the scope and scale of Enron's politically dependent profit centers was unprecedented.

Who was Ken Lay, the architect and chairman of Enron from its formation in the mid-1980s until its bankruptcy? The once-celebrated visionary of the energy industry was not an engineer, as were many leaders in the energy sector. Lay

did not possess an accounting or finance background, as did some senior executives. He never clawed his way up the corporate ladder in various operational divisions, much less built a company from scratch. No, Enron's leader was a Ph.D. economist, interested in the big picture and the ways of political power. His résumé was top-heavy with Washington experience, acquired at three federal jobs, the last two regulating the energy industry.

Ken Lay's interests and skill set dovetailed with the political-capitalist system he found when he became a Washington energy regulator in the early 1970s. Predictably, then, when Lay reentered the private sector after nearly six years of government service, his niche became running federally regulated interstate natural gas pipelines, assets that he knew well from his time at the Federal Power Commission (now the Federal Energy Regulatory Commission).

And when Lay got his own show as chairman and CEO of a Fortune 500 company, he lost little time in applying his academic training, considerable smarts, uncommon energy, keen ambition, and soulful persona to the government-opportunity/government-favor game. He was an extraordinary, mile-a-minute political capitalist (or *rent seeker* in the jargon of economics), eager to deploy the political means to propel Enron to the top of the energy industry—and then the whole business world.

As his career took off, Ken Lay's lofty ambition turned into overambition and then into blind ambition, complete with an almost messianic confidence. Increasingly, he focused externally, playing political cards for Enron's benefit. The Great Man of his industry and hometown, Houston, became a philanthropist and kingmaker, the modern equivalent of John Henry Kirby, who in his day had gathered almost too many awards, connections, and constituencies to list.

For a number of years, Enron did well by supplementing its consumer-driven profit centers with politically derived business opportunities. In particular, Enron scored big under a new regulatory regime, *mandatory open access*, whereby companies were required to open their natural gas pipelines and power transmission systems to outsiders needing interstate transportation services. Such "infrastructure socialism" enabled first-mover Enron to become the most profitable and largest wholesale marketer of gas and electricity in the United States. (Europe was being conquered too.) But other companies followed Enron's lead in the unregulated commodity business, and Enron's margins shrank despite the company's ongoing innovation. That required Ken Lay and marketing guru Jeff Skilling to find the next big thing—the next big *political* thing—to retain their first-mover advantage. The urgency was heightened by bad investments that threatened to take the bloom off Enron's rose, something Ken Lay could not accept professionally or personally.

But Enron's focus on the political means, rather than on the economic means of profitably anticipating and fulfilling consumer needs, proved challenging and problematic. Some government-created niches were more mirage than moneymaker from the get-go. And shifting political winds could reverse even

the best of opportunities, as Enron discovered during the California electricity crisis of 2000–2001. Enron's supersized paper profits in the Golden State could not be monetized, and the company's power-trading opportunities shrank in the political melee that went national. Enron lost what it once thought was its ace in the hole, hastening its judgment day.

Book 3 in this trilogy details Ken Lay's tireless efforts to profit from government intervention. Government favor propelled Enron's profit centers in domestic power plants, natural gas and electricity marketing, wind and solar power, infrastructure in underdeveloped countries, and unconventional natural gas production. Enron was all about complex federal laws and administrative regulations, such as special provisions within the Natural Gas Policy Act of 1978, Public Utility Regulatory Policies Act of 1978, Omnibus Budget Reconciliation Act of 1990, and Energy Policy Act of 1992—or FERC rulings, such as Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol (FERC Order No. 436: 1985), Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations (FERC Order No. 636: 1992), and Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities (FERC Order 888: 1996). The arcane was pure gold to Enron.

And then there was the legislative reform that Enron could not land. In the 1980s, Lay's company failed to persuade lawmakers to enact a sizable oil tariff to reduce interfuel competition to the company's natural gas operations. Enron also fell short in its 13-year drive to persuade the federal government to regulate greenhouse-gas emissions, particularly carbon dioxide (CO_2), an intervention that promised profit opportunities in no less than seven company divisions. Still, as an ex-Greenpeace official observed, Enron was "the company most responsible for sparking off the greenhouse civil war in the hydrocarbon business."

And despite a desperate eleventh-hour attempt by company lobbyists, there would be no federal mandate for open access (to solve the so-called "last-mile" problem) to jump-start one of Enron's most languishing and fraudulently represented businesses, Enron Broadband Services.

Enron exploited the machinery of political capitalism in still another way. As the company's problems grew, Lay and Skilling's best and brightest manipulated the highly prescriptive—indeed *politicized*—tax and accounting systems to create the illusion of profitability. However clever, such an elevation of form over substance only postponed and worsened the inevitable. Creditors would end up getting only nickels on the dollar from the core assets of a company that was more broke than bankrupt.

Thus, the collapse of Enron was not a failure of capitalism proper. Enron played all sides of the political aisle to make itself an extraordinary company on the way up and on the way down. Public perception aside, Enron was not "a

problem for anyone who believes in markets," as the *Wall Street Journal* editorialized soon after the collapse. It was a logical, albeit grotesque, outcome of the mixed economy writ large.

In retrospect, Enron could have been a sizable, sustainable company without special government favor. There were sound consumer-driven divisions that achieved scale economies through merger. But by the economic (versus political) means alone, it could never have become America's Most Innovative Company, as it was designated by *Fortune* magazine for six years running. Ken Lay himself would have needed to develop and deploy a different skill set to reach the top in a free-market order, where success is less about personality and political connections than it is about meeting shifting consumer demand expeditiously and cost-effectively.

The impressive rise and stunning fall of Samuel Insull's energy utility empire offers a vivid comparison with the story many decades later of Ken Lay and Enron. To be sure, Insull was a far better businessman than Lay. Insull's deep intuition about energy technology, combined with his other business skills, made him a consummate doer and, indeed, the father of the modern electricity industry.

It was Insull who pioneered scale economies by replacing isolated generating plants with large, centrally located power plants that could electrify whole areas. It was Insull who broadened the market for electric appliances in a most exciting way and in so doing became, according to Forrest McDonald, his biographer, "the crucial link between Phineas T. Barnum and Madison Avenue." Insull matched the consumption profile of the city and farm to run his units more efficiently and to promote universal electricity service. And it was Insull who pioneered innovative financing techniques to meet the needs of his rapidly expanding businesses. He was one of the leading business pioneers of all time, doing nearly as much for his industry as Rockefeller and Ford did for theirs.

Yet Insull, like Lay, had a political side and had personality flaws that would transform him from an undisputed Great Man into a national villain. Insull sold his industry on the benefits of the *regulatory covenant,* whereby cost-based rate regulation was accepted in return for franchise protection against would-be entrants. (Such entrants had become a burden to established providers, and no end to their market raiding was in sight.) But public utility regulation proved not to be the safe harbor Insull imagined, and it contributed to a wide-ranging hubris that would bring down the nation's largest holding company, as well as the Babe Ruth of business himself.

Insull failed to overcome success, as it were, in a most dramatic way late in his career. Throwing caution to the wind, and working to create monuments rather than fundamental business value ("I think I'm going to establish a dynasty, and thereby render myself immortal," Insull confided to a friend), America's

most revered businessman became a train off the tracks when the Roaring Twenties gave way to the Great Depression. Insull expanded his investments as the economy contracted, even venturing into areas well outside his core expertise. "He took on greater and greater burdens until it appeared as if he were attempting to carry the entire American economy on his shoulders," McDonald noted.

Insull's crash, trial of the century, and final years provide a climax of Book 2, after which case studies related to Ken Lay and Enron's prehistory are presented for their business and political lessons.

How did the Enron-enabling mixed economy arise?

America's *political capitalism* took root in the nineteenth century and flourished in the twentieth. No sector became more politicized than energy, particularly during Ken Lay's career. Much of this was inherited, but Enron's chairman drove the mixed economy, too. Government intervention, existing and prospective, became core to Lay's business model. Indeed, it would take the new CEO less than a year to turn lightly regulated Houston Natural Gas Corporation into highly regulated HNG/InterNorth, which would soon be renamed Enron.

Unlike Marxism or Keynesianism, political capitalism was not the result of a master plan or ideology. A century and more ago, most business leaders praised free markets but were not principled capitalists. Few people were. Business leaders and others felt little constraint in seeking tariffs, subsidies, entry restrictions, and other species of corporate welfare. To win political support, there was always a high-sounding argument, such as aiding an infant business, promoting domestic security, or stabilizing a cyclical industry. Business lobbying often bore fruit, as a firm or an industry's concentrated effort outdistanced the countereffort (if any) of the less-organized, less-represented taxpayers or consuming public. (Business-versus-business spats were more complicated and less predictable in outcome.) Such intervention begat more intervention, sometimes to address the unintended consequences of the prior intervention and sometimes in the attempt to level a playing field for another party. In the process, the mixed economy became more imbued with interventionism.

Political capitalism hardly started with Ken Lay or even Samuel Insull. But both powerfully advanced the interaction between business and government during their reigns. And the dramatic failure of both men's companies put capitalism itself on trial, leading inflamed legislators to regulate corporate governance in ways far beyond the free society's common-law strictures against force and fraud.

What about America's Progressive Era, when the intellectual class helped to convince politicians to leash capitalism? Didn't this limit political capitalism—and by implication Enron's political machinery to come? Here, many textbooks got it wrong. Much so-called reformer legislation was actually, on close inspection,

by business and *for business*. The fact that much so-called antibusiness intervention had organized support from business constituencies should have tipped off the reformers that their drive for a mixed economy would have unintended consequences—and undesirable outcomes for the public good.

Thus, the intellectual class that loudly proclaimed the imperfections and injustices of free-market capitalism was complicit in the growth of political capitalism, which, ironically, created an environment hospitable to the private-sector excesses they came to lament. However unintentionally, reformers created a framework that enabled further corporate manipulation.

Enron *had been* a favorite of the intelligentsia. The *New York Times* and just about every other media outlet sang its praises. Ken Lay's company was a champion of all things politically correct. Enron was *progressive*, practicing *social corporate responsibility* and *stakeholder theory*. Enron supported racial quotas internally and politically. Ken Lay courted Houston's minority community and cultivated Jesse Jackson—all part of Enron's political machine. Enron even formed a subsidiary to invest in inner-city, minority-owned firms (it was a bust).

On the environmental front, Enron practiced so-called sustainable development by sounding the alarm over man-made greenhouse-gas emissions beginning in 1988, supporting Clinton/Gore's 1993 proposal for a Btu tax, aggressively investing in solar power in 1994, jump-starting the ailing U.S. wind industry with the purchase of Zond Corporation in 1996, spearheading the effort behind what became the nation's strictest renewable-energy mandate (in Texas in 1999), and lobbying the Bush/Cheney administration (unsuccessfully) to regulate CO_2 emissions. Enron received a climate-protection award from the EPA and a corporate-conscience award from the Council on Economic Priorities. The company advanced the interventionist agenda of the President's Council on Sustainable Development, Aspen Institute, Business Council for Sustainable Energy, Pew Center on Global Climate Change, and Heinz Center for Science, Economics, and the Environment, as well as sponsored Earth Day events in Texas, California, and Oregon. Ken Lay's Enron was pointing the way to a sustainable-energy future—or so it was thought.[1]

With dollars and time, Enron was also a philanthropic leader—and made sure that everyone knew it. Ken Lay's private foundation gifted hundreds of organizations in hometown Houston. Such philanthropy (or do-goodism to critics) was part of making Enron the world's leading company, for that required Enron's becoming the world's *favorite* company. Where image was reality, such favor trading (and conflicts of interest) was a way up the stock-price ladder, Lay thought, with each step creating more wealth to redistribute to keep the music

1. Lay, as a director of Resources for the Future and the American Enterprise Institute, pushed the need for government to price CO_2. Lay was not formally associated with any libertarian groups, although he occasionally spoke at their conferences when Enron's agenda involved, to some degree, free markets.

playing. It was a charm offensive not seen since the heyday of Samuel Insull in Chicago, a subject of Book 2.

The many academics, environmentalists, journalists, politicians, and regulators who touted Enron in the boom cast a cold, embarrassed eye upon the company come bankruptcy. Ken Lay's goodwill vanished overnight when thousands of his employees found themselves stranded during the holiday season with a modicum of severance pay. It became a populist morality play with millionaire management on one side and rank-and-file victims on the other. This was thought to be cruel capitalism—despite the fact that Enron was hardly a capitalist-spirited company. This was the unhappy consequence of oil-and-gas Republicanism—never mind that the Texas Republican governor, George W. Bush, had gifted Enron Wind Corporation with his signature on a so-called electricity-deregulation bill, part of which mandated the nation's most aggressive renewable-energy quota.

In all, far too many failed to appreciate how a politicized economy created the conditions that allowed the worst in business to get on top. Along with the accountants, analysts, bankers, executives, and lawyers, the intellectual mainstream was part of that which George Will decried: systemic failure.

The story of Enron is one of the most important benchmarks in the history of mixed-economy capitalism. Books, essays, and movies have told the company's riveting story in myriad ways. But such storytelling has only superficially probed into fundamental incentives and motivations: the *why* behind the why. Political pundits and academics have often jumped to conclusions that missed the underlying causes. So rather than revisiting the regulatory morass that invited Enron's legendary gaming in the first place, more regulation of corporate governance was prescribed, not to mention a new ethics in a quest to reform Capitalist Man.

Challenging the conventional view of Enron's rise, fall, and lessons requires an alternative worldview, which is the subject of Book 1. The sister disciplines of economics, history, philosophy, political economy, political science, and psychology all come into play. And it is here that the story within the story emerges. For the flawed mainstream thinking in the social sciences and the humanities, which resulted in political capitalism (replete with unintended consequences, including Enron), itself suffered from the aforementioned hubris/deceit/obstinacy virus. The smartest fell victim to their own smartest-guys-in-the-room problem when it came to understanding capitalist reality and the political economy of business and government.

What, then, is the neglected worldview that explains Enron's fate in hindsight and offers a best-practices framework for avoiding organizational failure in the future? What time-honored capitalist wisdom might have saved Samuel Insull, John Henry Kirby, and Ken Lay from themselves? And more broadly,

how does the same framework define sustainable enterprise and thus heroic capitalism?

A reconstruction can begin with the works of three leading capitalist philosopher-moralists (Part I of this book). Adam Smith, Samuel Smiles, and Ayn Rand elucidated the character traits, mental models, and interpersonal conditions behind success and failure, while differentiating sharply between free-market entrepreneurship and political rent-seeking. Their concern was less the material outputs of capitalism, however substantial, than the moral inputs of capitalism.

In the eighteenth century (chapter 1), Adam Smith championed the "prudent man" and warned against "over-weening conceit" and "self-deceit" in the pursuit of gain. The Scottish philosopher stressed the need to have an *impartial observer*, a concretized, tell-it-like-it-is confidant capable of giving constructive criticism leading to appropriate change. (Kirby, Insull, and Lay had no such check when they needed it most.) Smith distrusted do-gooders and political capitalists and placed great stock in what he called "sacred rules," the very thing Enron eschewed.

Smith recognized a confluence of sentiments, a moral order, based on empathy ("mutual sympathy") among buyers and sellers in commerce. He understood how good business drove out bad, and yet he recognized that the worst case of bad business, financial bankruptcy, was the exception, not the rule, in a system of natural liberty. Smith would have been disappointed—but hardly surprised—by the systemic failure that characterized Enron, given the conceit and self-deceit of the company's leaders, as well as the mixed economy that invited political rent-seeking and gaming and allowed Ken Lay to reach the top.

In the nineteenth century (chapter 2), Samuel Smiles explained the timeless virtues behind productivity and identified the bad motivations and habits that led to failure. Perseverance trumped genius and luck in his book. Smiles chronicled how attention to detail, authenticity, common sense, and integrity won in the marketplace. He exposed deceit in its many varieties and warned against shortcuts and keeping appearances. "How many tricks are resorted to—in which honesty forms no part—for making money faster than others!" he complained in his early day. Smiles's capitalism with character reveals Enron's bad actors to be old vinegar in new bottles.

In the twentieth century (chapter 3), the philosophy of Objectivism, formulated by Ayn Rand, explains how Enron's financial bankruptcy was at root a philosophic one. Enron was the embodiment of subjectivism (or *postmodernism*, in academic parlance), given how the company came to believe that wanting, believing, and saying something to be true could make it so. (Objectivism posits that reality is independent of one's consciousness—and hence is *objective*.) Ken Lay was a second-hander, a *philosophic fraud*, trying to be all things to all people, acting on convenience rather than principle, living a corporate life from the

outside in instead of the inside out. For him, the ends came to justify the means despite his many righteous sermons about Enron's values and public goodness. But business strategy based on pretense is a recipe for failure sooner or later.

Yet Rand, as powerful as her philosophy is for understanding the tragedy of Ken Lay and Enron, was party herself to a blow-up born of arrogance and self-deceit. Events in her personal life, chronicled in appendix A, created a crisis for the nascent Objectivist movement, bewildering and victimizing thousands of devotees.

An Enron can strike in any walk of life.

Smith, Smiles, and Rand did much to frame what can be called *heroic capitalism*, or what contemporary businessman/intellectual Charles Koch has codified as *Principled Entrepreneurship*™, defined as "maximizing long-term profitability for the business by creating real value in society while always acting lawfully and with integrity." In Koch's framework, political rent-seeking is rejected because it redistributes and destroys wealth rather than creates it. Koch's ideal is about the economic means, in the tradition of Adam Smith's *invisible hand*, Samuel Smiles's *great work*, and Ayn Rand's *virtue of productiveness*. It is this rich worldview that has been absent in so much of the post-Enron analysis and learning—and that should be part of the debate in the classroom and the boardroom.

Part II of this book turns from philosophy to economics. Its excursion into the history of business and capitalist thought details how a hearty band of academics advanced their reality-grounded theories only to find that the mainstream was not listening. Each of these academics formulated logical, real-world concepts and challenged their colleagues' entrenched thinking—but to little avail. For example, Ludwig von Mises defended economic realism over mathematical formalism, only to witness the triumph of false assumptions (chapter 4). The remaining chapters of Part II go on to explain precisely what economic realism reveals capitalism to be: a highly competitive environment that requires business to improve or deteriorate—or cheat by resorting to the political means. Real commerce is about entrepreneurship, dealing with risk and uncertainty, economic calculation (profit-and-loss accounting), and the nature of the firm. All four concepts have particular application to the business model of Ken Lay and Jeff Skilling at Enron, as well as to business strategy more generally.

Intellectual realism is also a major theme of chapter 5. In particular, Joseph Schumpeter took the economics profession to task for using a highly idealized theory of competition that misconstrued capitalist reality as monopolistic. That error would keep many historians from seeing how pressured and even desperate business executives embraced the political pursuit of success, both before and during the so-called Progressive Era.

This propensity of business leaders to seek special government favor can be understood in the simple terms of diffused costs (to the public) and concentrated benefits (to the firm or industry). The gains of a few come at the expense

of the many, a bad bargain that grows worse as more play the rent-seeking, wealth-redistribution game. By such political capitalism, in theory and practice, America inadvertently set the table for a Ken Lay and Enron.

The mixed economy began with intermittent government favor, as well as reformer efforts in the name of rationalizing and civilizing capitalism. But because business support was crucial to many of these reform efforts, America's mixed economy soon became a creation of political capitalism first and outside reform second. Chapter 5 shows how two early American political economists, Simon Newcomb and William Graham Sumner, as well as the father of modern political science, Arthur Bentley, interpreted the legislative process as proceeding from specific lobbying pressure rather than from feel-good ideas (what Bentley dismissed as *idea ghosts*). Alfred Chandler undermined the muckraker narrative by interpreting business change as proceeding from market resources and entrepreneurial strategy rather than Marxist dialectic and capitalist greed (chapter 6).

Part III provides the foundation for understanding Enron's modus operandi in the 1980s and 1990s. Whereas chapters 4, 5, and 6 delineate the true nature of business enterprise under capitalism and the mixed economy, chapters 7 through 11 present a history of energy and sustainable-development thought against the backdrop of real-world political-economic developments. Capitalism and political capitalism, energy and fashionable notions of sustainable development: These are the stage upon which the drama of Enron played out.

Chapter 7 takes an in-depth look at the foundational, errant thinking of Thomas Malthus on population and W. S. Jevons on energy supply. Chapter 8 shows how Erich Zimmermann challenged the assumption of fixed, known, and depleting mineral resources in favor of a *functional* theory capable of explaining why mineral stocks grow even as record quantities are extracted. Chapters 9 and 10 relate the story of neo-Malthusianism—Malthusianism applied to natural resources—and its apotheosis in the 1970s. Finally, chapter 11 narrates the crusade of reformed Malthusian Julian Simon, who turned neo-Malthusianism on its head by demonstrating that human ingenuity can allow a rapidly expanding population to find and use ever more resources, without crises and without the need for government planning.

Mises, Schumpeter, Bentley, Chandler, Zimmermann, and Simon, in their different ways, are intellectual father figures of the business case studies examined in this trilogy.

The celebrated Enron whistleblower Sherron Watkins alerted Ken Lay to the accounting coverups that would soon bring down the company. Though less celebrated, the six social scientists named above were also whistleblowers in their disciplines. Each had, as Thomas McCraw wrote of Joseph Schumpeter, a "radical" message "indicting his own profession for what amounts to a capital crime": a neglect of observable, theory-driving reality. So did others in this book, such as M. A. Adelman, James Buchanan, Allan Nevins, Simon Newcomb, Colin Robinson, and William Graham Sumner.

Well known or obscure, each of the preceding realists challenged intellectual fashion with better theories about the social world. If their insights had been better understood and integrated into the core of the social sciences and humanities, free-market capitalism might have played a greater role than did political capitalism in twentieth-century America. And just maybe, a Ken Lay would not have ascended to the heights of the energy world, and Enron would have been unknown to history.

That is the major conclusion from Book 1. *But why did inferior thinking in the social sciences and humanities prevail?* Why was sounder, on-the-shelf theory neglected—even purposely ignored and deprecated? Why did the majority choose form over substance, opting for methodological and political fashion rather than a sober, truer understanding of the underlying social world? Why did these *intellectual Enrons* occur?

The answer is the by now familiar one: *arrogance*. Yet such academic failure did not lead to an unavoidable meltdown or judgment day. Immune from profit-and-loss accounting and lacking the verdicts of laboratory experimentation, errant social theory could survive and perpetuate itself as orthodoxy—even *consensus*—for two reasons. One was the perverse incentive structure under which the perpetrators were rewarded in academia, in the media, and in the halls of political power. A second was simply the bandwagon effect. Understanding and correcting such institutional failures must be part of the Enron postmortem—if the systemic failure identified by George Will is to be undone.

Capitalism proper—*free-market capitalism*, in both its moral and practical dimensions—deserves a new look in today's debates over corporate governance. Ken Lay's grand play in political correctness, corporate social responsibility, stakeholder theory, and second-hander strategies ended tragically. Sustainable wealth creation for a business and society requires a strict adherence to rational self-interest, sacred rules, like-it-or-not reality, and consumer-driven change, as well as allegiance to the economic rather than political means.

The fundamental lesson from Enron is this: Capitalism did not fail. The mixed economy failed. The capitalist worldview is stronger, not weaker, post-Enron. But there is another, deeper lesson that explains Enron and the mistakes of the intellectual mainstream before, during, and after Enron's active life: What in the Enron vernacular is called the *smartest-guys-in-the-room problem* can strike anytime and anywhere. Whether in business or academia—or any profession or association—conceit, deceit, and dogmatism are the bane of personal, intellectual, and organizational success.