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**Transparency and Accountability Network**

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# **Community Accountancy**

**PUTTING ACCOUNTANCY TO  
WORK FOR ALL OF SOCIETY**

# **WEALTH TRANSFER**

**FOR DISCUSSION ONLY**

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# WEALTH TRANSFER

## Wealth transfer is zero sum

The progress of the human race is about wealth creation ... value creation. Wealth transfer is NOT wealth creation and is also value destruction.

Value chain analysis shows who are the winners and losers ... and also where wealth transfer is taking place.

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It can be argued that the most powerful tool that MBA training has given to their students is the mathematics to take a value chain that has its inherent costs and values and optimize the functioning of the value chain for the benefit of the optimizing organization. In other words, these experts know how best to remove value from various other entities and move it into the optimizing organization.

This is a very powerful concept and has facilitated a very rapid and efficient concentration of wealth into large organizations and entities with a minimum of investment.

## Value chain and the market economy

Value chains flow through markets ... but the market is more a fiction than a reality, which is part of why they are so valuable in value chain manipulation and also so dangerous. It is not easy to tell when a market transaction is driven by supply and demand for physical goods, or whether the market is being driven by speculation about future market values, or whether the driver is legitimate hedging against future price movements.

Cost and price determine profit.

Price for the seller becomes cost for the buyer. This next buyer sells for a new price, and profit is again the difference between cost and price.

Where are the big profits? Where are the losses?

How do valuable raw materials create profit with little benefit to the community of origin?

Value chain analysis shows who are the winners ... those that have small cost and high price. But costs are usually based on simple GAAP concepts and not on Community Accountancy analysis.

When cost is based on the consumption of Community Accountancy value rather than the consumption of GAAP cost and value adding and value destruction instead of profit, there are different results.

## Transfer prices

Prices are critical in economic analysis and the determination of profit and value to any entity.

But we know rather little about prices ... often prices are hidden and prices are kept secret.

And even where there is publicity about prices, it is not always clear what the information really means ... price disinformation is as common as price information.

In value chain analysis, the transfer price determines how the value adding is shared between the entities in the chain it is very important.

Because of its importance very little information is available about transfer prices. The idea that the "market" determines the price assumes a high degree of information and this is rarely the case. Transfer pricing serves those that have the control.

# FUND FLOW PROBLEMS

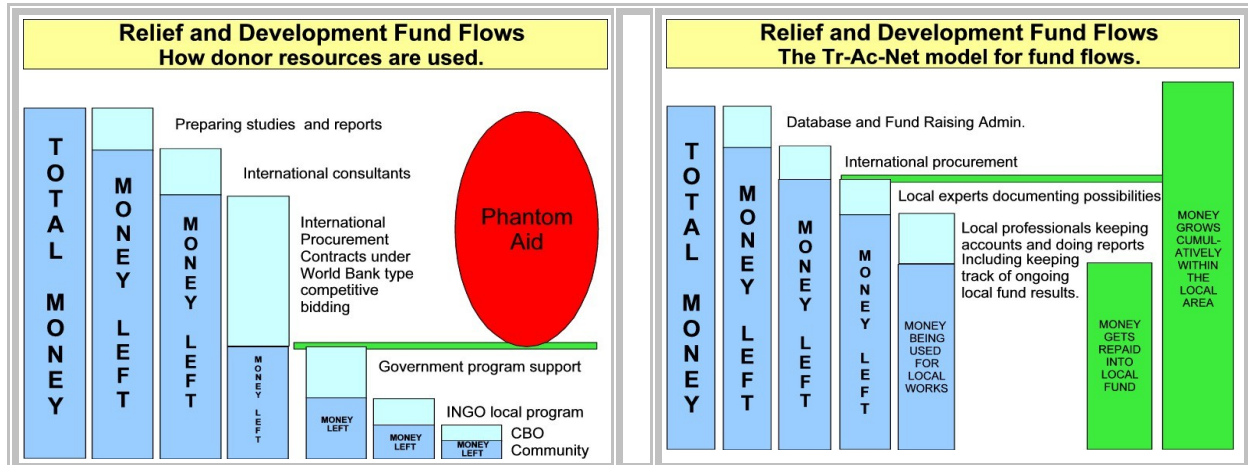
## Phantom Aid

The amount of money being raised for international relief and development assistance is huge.

Fund raising in the aftermath of natural disaster is impressive, and shows how supportive many people are of development initiatives.

But sadly the relief and development industry is less than candid about how the resources are used and what is being accomplished.

In 2003 a well know UK based NGO named this Phantom Aid. Some years before the phenomenon had been described as “Black Hole Development” implying that no matter how much fund flow there was, the results would still be the same!



## Value destruction

The amount of money that gets spent and the amount of good that gets done seems to be more and more unrelated. Five decades or more of teaching MBA students about ways to maximize profit without teaching much about society has created a very large community of experts in profit maximization and hardly anyone that has a deep understanding of the social costs and value destruction associated with this economic paradigm. The problem, however, is worse, because the relief and development industry has many people well trained in various other disciplines, but with rather little training in this dimension of economics ... and even less trained in accountancy..

## Focus on disbursement ... on activity

Metrics ought to serve the needs of society ... but the easy metric that has been important in the Breton Woods institutions and their development clones has been disbursement. While there are cases where disbursement is a useful proxy for results, this is not so when it is used to the exclusion of almost anything else. Disbursement serves as a fairly good proxy for activity ... but neither can stand in for result other than in a very controlled and stable environment. Development, when it is successful, is not stable, but progressing ... and the only metric worth having is a measure of the results.

## Sovereignty ... anything goes

The idea of sovereignty that embraces the independence of a people from a foreign power is good ... but the use of the idea of sovereignty to allow a regime of “anything goes” is not. People are being treated abominably by governments and elite leaderships ... and external interference is constrained by the idea of sovereignty. At what point does doing right become the driver of meaningful action?

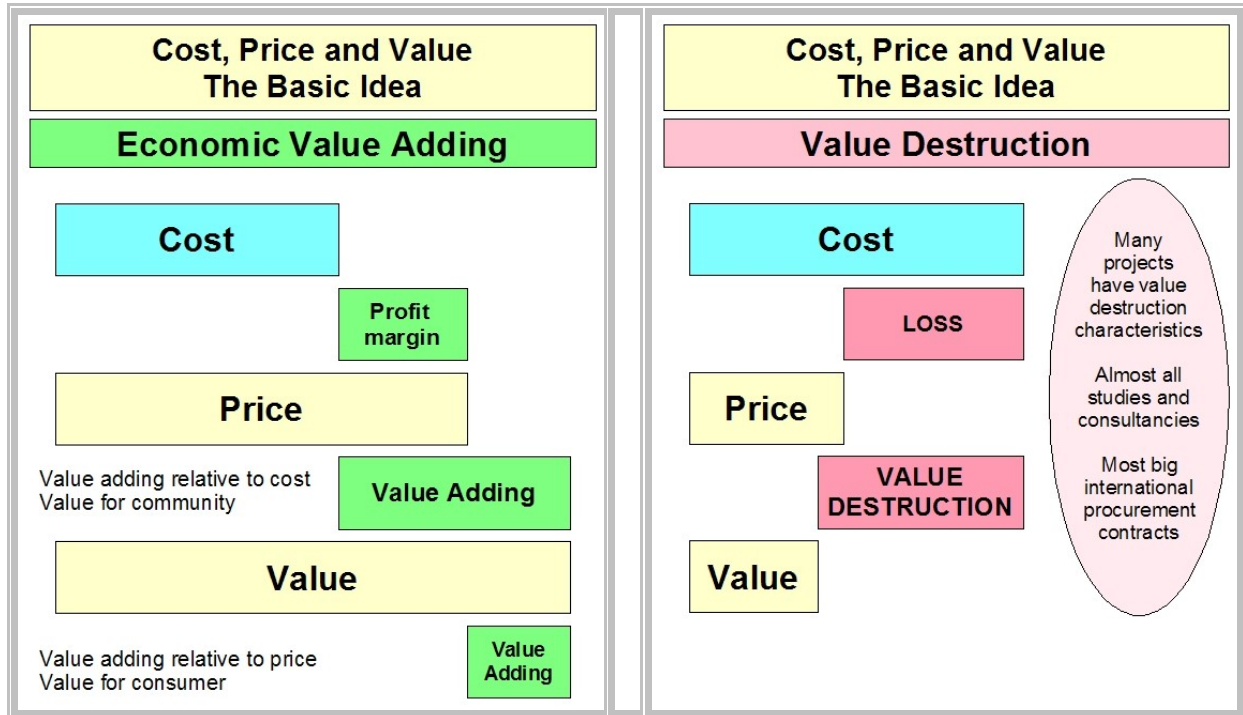
## Weak financial controls

Weak financial controls has been endemic and as a result all sorts of resources have gone missing ... stolen money ... stolen inventory ... over invoicing ... under delivering. Embezzlement of all sorts ... petty corruption and grand corruption.

# UNDERSTANDING COST AND VALUE BEHAVIOR

## COST, PRICE AND VALUE AND VALUE CHAIN

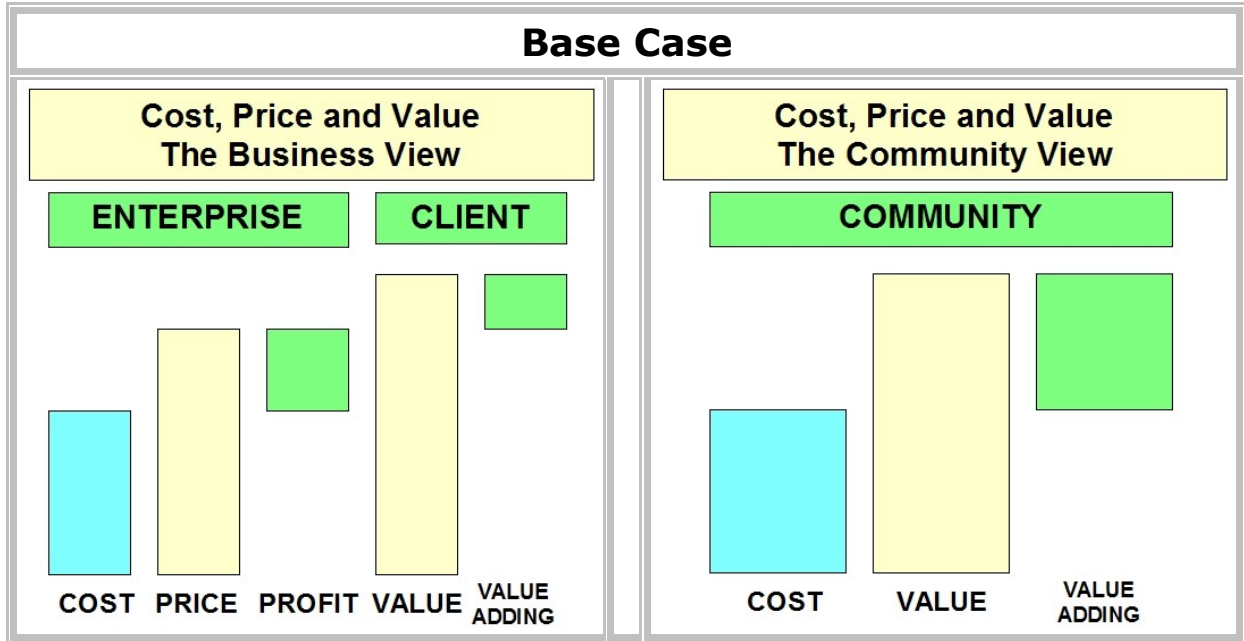
Price has an important role in the matter of economic incentive ... and the question of sustainability. The value chain works and is efficient when the transfer pricing through the value chain provides a reasonable rate of return on capital employed within each piece of the value chain. If any of the links in the chain become unprofitable, the value chain becomes dysfunctional.



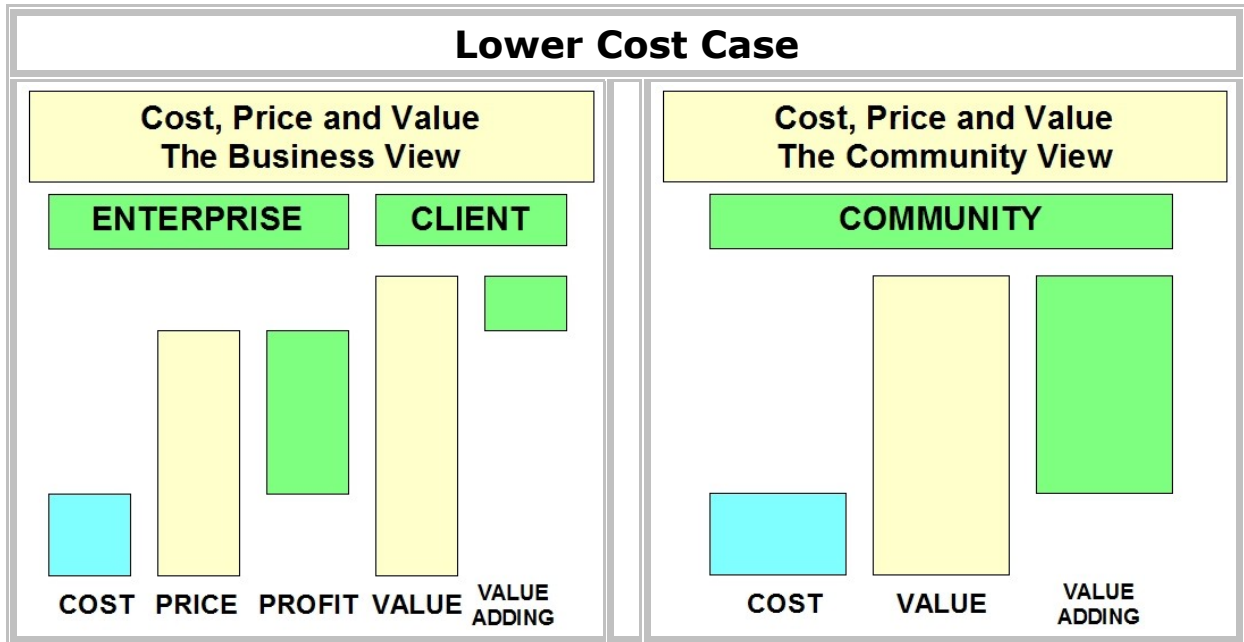
# HOW PRICE IMPACTS COMMUNITY

Price is a key variable in the performance of society. It is not as important as cost, but the way price is used in society determines the way value is shared between the various economic actors. The following graphic shows how an economic transactions that has costs and value is shared between the enterprise and the client depending on the price being applied to the transaction.

For society as a whole the value adding is the difference between the value and the cost. For the client the value adding is what is left of value adding after the enterprise has taken out its profit. In the profit maximizing enterprise the goal is to have profit as much as possible, and the amount left in the hands of the client is of little consequence.

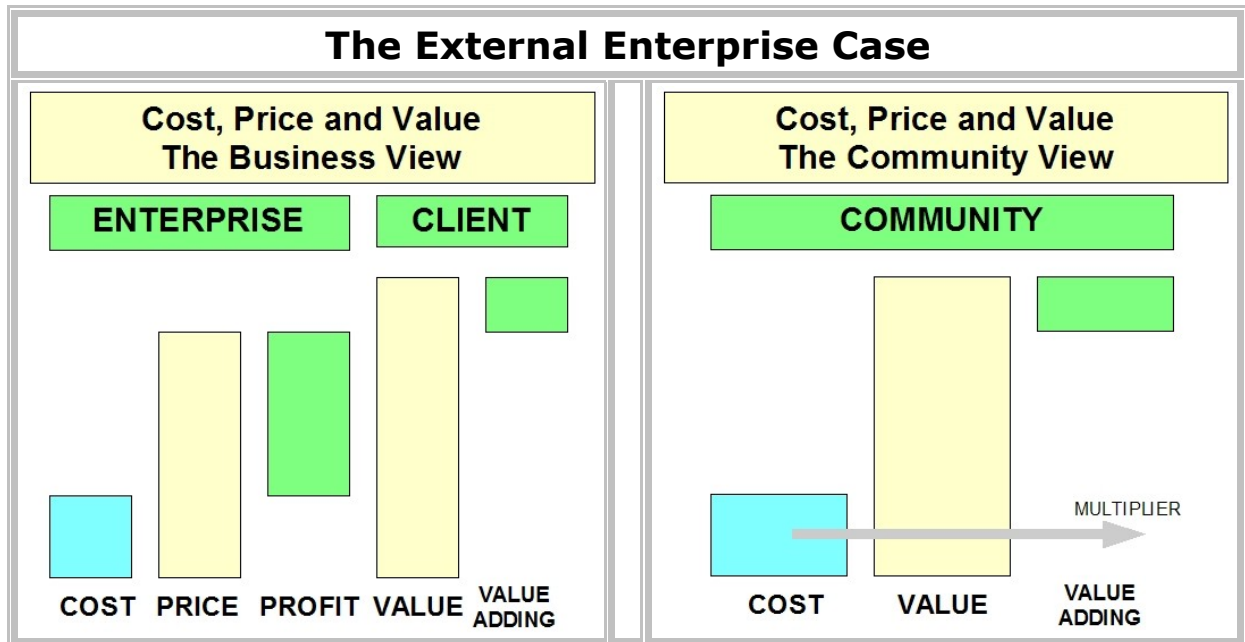


In a lower cost case the enterprise profit increases at the same price point ... and the amount of value derived by the client stays the same.



If the client and the enterprise are in the same community it does not matter so much whether the client or the enterprise has what share of the value added ... but where the enterprise is from outside the community it matters a lot. In the case where the enterprise is external ... the case of Foreign Direct

Investment (FDI) for example ... the value adding for the community is small because the profit leaves the community. If the costs are incurred in the community there is some multiplier effect ... but typically local disbursements are small and most of the costs, as for example in mining are equipment, fuel, expatriate payroll .... with rather little value for the community.



## Value chain

The value chain is very well understood in the corporate sector, and there has been very effective profit improvement for the corporate sector by taking advantage of all sorts of cost improvement opportunities in manufacturing to improve the profit bottom line.

But the deep knowledge of the corporate value chain is not matched by anything like the same amount of understanding of the value chain as it impacts social value and the impact of corporate activities on society.

### Example

The relocation of manufacturing from the United States to China has been very profitable ... but what are the costs to society that do not figure in the corporate accountancy. Nobody has been doing Community Accountancy and nobody knows. We do know corporate profits increased as more and more manufacturing was outsourced to low cost areas. We do know something of the job creation in these low cost areas and we do know something of the job losses in the places where manufacturing plants were closed ... but what we know is far less than what we need to know. We do not really know very much at all about the impact on the communities --- this is not part of a system of metrics, and only part of what we need to know is on the record.

### Value Chain

Al Gore on July 17th, 2008

"We're borrowing money from China to buy oil from the Persian Gulf to burn it in ways that destroy the planet," he said. "Every bit of that has to change."

### Example

Over the past 30 years the USA has taken apart most of the regulatory framework around banking and the capital markets, with very good results reported by the institutions in the sector over this period of time. The good results do not, however, take into account the costs of the periodic failures of big institutions in the sector (Continental Illinois) and whole segments of the sector (Savings and Loan). But worse they do not take into account the wealth that is merely removed from one segment of society to become profit in the banking and finance sector. The sub-prime mortgage crisis is just the latest in a series of moves over the years by the banking and capital market industry to concentrate wealth in their sector at the expense of society as a whole.