

# Misbehavior

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# Road Map for Talk

- Definition of Misbehavior
- Causes of Misbehavior — *Excessive Greed*
- Is Greed Good?
- Examples of Misbehavior
- Dealing with Misbehavior — Regulation, Enforcement, Punishment, and Rehabilitation
- Academic Misbehavior
- Conclusions

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# A Definition of “Misbehavior”

- Behavior that substantially benefits a few (usually oneself) but causes significant harm to many
- Like any definition, there are big grey areas. For example, is the entry of an efficient firm that drives out an inefficient incumbent misbehavior? (the entry benefits the entrant but harms the owners/workers of the incumbent)
- Answer: no, if the entry results in lower prices or a better product that benefits sufficiently many consumers
- Is *predatory entry* where an entrant *underprices* to drive an existing (efficient) incumbent out of business, but thereafter drives up prices to a monopoly level?
- Answer: probably, if the predation ultimately results in permanent higher prices that harms many consumers.

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# Is “misbehavior” a fundamentally arbitrary concept?



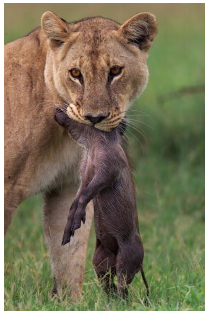
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# Minimize misbehavior to maximize cooperation

- What makes humans different from animals?
- While there are many things, a crucial difference is:  
the extent to which human progress has been achieved  
through **mass cooperation**
- *“Humans are not special because of their big brains. That’s not the reason we can build rocket ships — no individual can. We have rockets because 10,000 individuals can cooperate in producing the information.”* (Kim Hill, social anthropologist, Arizona State University).

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## Cooperation distinguishes *homo sapiens*

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- *“Early human groups, according to the new view, would have been more cooperative and willing to learn from one another than the chimpanzees from which human ancestors split about five million years ago.”*
- *“The advantages of cooperation and social learning then propelled the incipient human groups along a different evolutionary path.”*

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## Why we Cooperate

- title of a provocative 2009 book by *Michael Tomasello*, co-director of the Max Planck Institute for Evolutionary Anthropology in Leipzig, Germany
- Emphasizes that while animals do learn from each other, *“In terms of the number of things an individual human must socially learn (including linguistic conventions in order to communicate), human culture as compared with other animal species, is quantitatively unique.”* (p. 10)
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## Shared Intentionality

- Tomasello notes that *“Underlying these two singular characteristics of human culture — cumulative artifacts and social institutions — are a set of species-unique skills and motivations for **cooperation**.”* (p. 13).
- *“we may refer to the underlying psychological processes that make these unique forms of cooperation possible as ‘**shared intentionality**’ . . . the ability to create with others joint intentions and joint commitments in cooperative endeavors.”*
- *“These joint intentions and commitments are structured by processes of joint attention and mutual knowledge, all underlain by the cooperative motives to help and share with others.”* (p. 14)

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## Humans vs Chimps: Cooperation vs Aggression

- Tomasello says that Hill and Walker’s findings “*provided a strong foundation for the view that cooperative behavior, as distinct from the fierce aggression between chimp groups, was the turning point that shaped human evolution.*”
- Their findings also support a new view of human origins by Bernard Chapais in his 2008 book *Human Kinship*.
- Chapais “*showed how a simple development, the emergence of a pair bond between a male and female, would have allowed people to recognize their relatives, something chimps can do only to a limited extent.*”
- “*When family members dispersed to other bands, they would be recognized and neighboring bands would cooperate instead of fighting to the death as chimps do.*”

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## Greed in Humans vs Chimps

- We also need to be aware of our more chimp-like but still human characteristic: *like chimps, we can also be selfish and greedy*
- However humans tend to be *less greedy* (and more cooperative) than chimps
- Tomasello conducted laboratory experiments using “*the ultimatum game*” with human and chimp subjects.
- Though the “rational” outcome is to take 100% of the pie, when humans play the tendency is for 50/50 splits
- When chimps play, the predominant outcome is for the first mover to take 99% and leave 1% for the opponent (if the proposer chimp takes 100% the follower chimp will usually reject the proposed outcome).

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# A Major Cause of Misbehavior — Excessive Greed

- Conclusion: humans tend to dislike other humans that are too greedy. We have an inherent sense of fairness that tends to moderate our more primitive biological urges for selfishness and greed.
- I argue that because of our innate sense of fairness and desire to cooperate, excessive greed on the part of certain “powerful” humans tends to result in conflict and breakdown of cooperation that is a distinguishing human characteristic.
- If so, then “excessive greed” — i.e. the ability to expropriate a greater share of the pie than what is regarded as “fair” or “merited” — could be a prime example of misbehavior.

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## Does greed need to be harnessed and regulated?

- Suppose we can show that excessive greed not only benefits the greedy, powerful person at the expense of others (i.e. it is “unfair”), but it also leads to breakdown of cooperation and reduces the overall output, well-being of the society as a whole, and over the longer run, it reduces rate of progress of human and social evolution
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# Are Competition and Cooperation Compatible?

- Clearly, humans are often not entirely altruistic and are often motivated by selfishness and greed.
- With scarce resources, humans must inevitably compete for their share of the pie, just as animals do.
- The ideal situation is when competition can be designed in an intelligent way to foster cooperative goals, maximizing the beneficial aspects of competition while minimizing the negative aspects
- Thus, even though competition necessarily implies winners and losers and some degree of inequality, if it is “intelligently designed” the collective benefits of the competition foster cooperation and development of the society as a whole

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## Competition vs. cooperation: the economic solution

- Of course, economists think they know the answer to this puzzle: **capitalism**
- The economist would say that there is no inherent tradeoff between competition and cooperation, or any necessary incompatibility between individual greed and desirable social outcomes
- The *First Theorem of Welfare Economics* tells us that any competitive equilibrium results in a Pareto efficient allocation.
- However there is nothing to guarantee that a competitive equilibrium results in an *equitable distribution of resources*, and to the extent that humans do care about fairness, even an idealized textbook competitive outcome may not be considered to be a desirable one in many societies.

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## *Laissez faire* and the “Invisible Hand”

- From the economics textbook perspective, there is no need to define “misbehavior” since in a competitive market the selfish motives of individuals and firms are compatible with efficient collective outcomes
- The *Second Welfare Theorem of Welfare Economics* tells us that any efficient allocation of resources can be achieved as a competitive outcome after a suitable initial redistribution of endowments.
- This often misinterpreted by “conservatives” (libertarians in the US, “liberals” in Europe and elsewhere) as a justification for limited or no regulation of markets.
- If any regulation is necessary, these people believe that markets *self-regulate* and that government regulation is only interference that makes things worse.

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# Biological Competition and Cooperation

- Evolution seems to have discovered effective ways of making competition and cooperation compatible.
- In the human body the cells are like the individuals in a society, competing for their share of the resources (oxygen, sugar, water, etc).
- Yet at the same time the cells are also cooperating, each doing their task so that the organism as a whole (e.g. the human being) is successful.
- Because of the overall intelligence in the way trillions of cells can coordinate their activities, there is a real sense in which “the whole is more than the sum of its parts”

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- In the human body the cells are like the individuals in a society, competing for their share of the resources (oxygen, sugar, water, etc).
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## Competition and Cooperation of Neurons

- This balance is especially clear in the human brain where clusters of neurons that activate in ways that enable the human as a whole (e.g. “the society”) to achieve rewards are themselves rewarded and stimulated via higher blood flow, neurotransmitter levels, and the overall strengthening of connections along particular circuits and pathways that enabled the organism to achieve goals.
- Thus, even though resources are scarce, competition of cells in the body and brain is sufficiently coordinated to result in successful behavior of the organism as a whole.
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# Competition and Cooperation in the Immune System

- Another example of decentralized cooperation is the *human immune system* where billions of white blood cells, killer T cells, antibodies and histamines operate in an exquisitely coordinated and intelligent fashion to protect the body from outside invaders, recognizing “friend from foe”
- Note that the immune system does not destroy all foreign cells. There are some bacteria which are *symbiotic* and beneficial to the organism in the whole (e.g. the bacteria in the intestines which helps us digest food) and the immune system knows not to attack those cells (provided they do not become too numerous)
- The immune system can therefore be regarded as the body’s “police force” that regulates “misbehavior” of foreign cells and viruses/proteins.

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## Misbehavior from a biological perspective

- An example of misbehavior in the context of the immune system are various types of *auto-immune disease* that occur when cells in the immune system fail to recognize friend from foe and attack the body's own cells.
- Another example is *cancer* when certain clusters of cells divide without limit, overwhelming the body and leading to a breakdown of the cooperative operation of cells in the body, often leading to death.
- Thus, the success of the organism as a whole depends on elaborate and highly sophisticated mechanisms to detect and destroy misbehavior by foreign cells and when possible to prevent misbehavior of our own cells.
- An organism that is unsuccessful in regulating such misbehavior either dies, or is severely compromised (ill)

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## Misbehavior from a social perspective

- We defined “misbehavior” in a biological context when certain cells (individuals) fail to follow certain “rules” that lead to success and survival of the organism as a whole. In cases like cancer, the cells involved appear to be *greedy* in that they are dividing and multiplying in an out of control fashion, harming the operation of the other cells in the body
- In a similar way, for humans, we can think of them as the individual “cells” in the larger organism — society.
- Misbehavior occurs when individuals or groups of humans fail to follow certain rules, often by becoming too greedy and consuming more resources than is justified by their contribution to the organism as a whole, resulting in harm to the society and the other individuals in the society.

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## Summary of discussion so far

- Both the economic and biological perspectives suggest that it may be unnecessary to try to define misbehavior and explicitly police societies.
- Instead, biological and social evolution have “automatically” develop sophisticated systems for self-regulating misbehavior of various agents within these systems (in economics, this is capitalism)
- As such, this suggests that competition and cooperation can be compatible with each other and conservatives (“right-wingers”) asserts that humans need competition and the promise of big payoffs to motivate them to do great things for society.
- These people believe that **greed is good** and it makes no sense to define misbehavior as **excessive greed**.

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## The Case for Unbridled Greed — Gordon Gekko



- Click the photo to see Gekko's paean to the virtues of greed

## Are Economists the “high priests of greed”?

- Most of our economic models treat individuals and firms as fundamentally greedy decision makers: firms maximize profits and consumers maximize utility
- The only factors constraining the greed of consumers and firms are 1) budget constraints, and 2) competitive landscape
- However we still have very far to go in using economics to show how many individuals, firms and *governments actually behave*.
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## Where economic theories falls short

- However it seems abundantly clear to me that sufficiently greedy people, firms, and government leaders are often able to get what they want by *bending or circumventing the rules*
- But most of economics, founded on game theory, *assumes that all economic agents always follow the rules of the game.*
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## Is anything really “strategy-proof”?

- Concepts such as *strategy-proofness* and *incentive compatibility* give a false impression that economists know how to create incentives that prevent actors from “gaming the system”
- However these concepts are actually only applicable to a much more limited type of misbehavior — *misreporting of private information for private gain*.
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## Do Auction Rules Prevent Misbehavior?

- Auctions are a clear example of sets of rules imposed on bidders designed to result in competitive, desirable outcomes (example, first price sealed bid auctions with posted or secret reservation prices)
- However most theories of auctions have *assumed away* the possibility of collusion by bidders. When collusion occurs, the optimal auctions designed by economists under the assumption that bidders follow the rules can perform very poorly
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# The need for continually evolving laws and regulations

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- Thus, the immune system provides a better analogy for thinking about regulating misbehavior:  
the system must be continually evolving and responding to new and potentially unexpected ways it can be attacked or exploited.
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- Instead he concludes the book by stating a naively optimistic view of what firms actually do  
*“The discussion of the theory of the firm presented here shows that firms exist to improve the efficiency of economic transactions.”*
- What is needed is more work on the economic theory of crony capitalism because looking around the world, this is how things “really work”

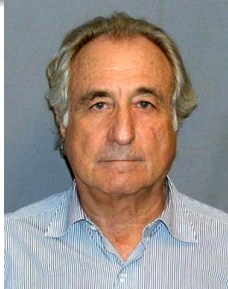
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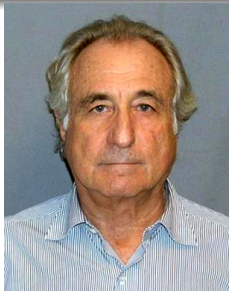
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## Is Greed Good for Wall Street? Bernard Madoff



- founder of *Madoff Securities*, at one time the largest market maker at NASDAQ, and former chairman of NASD
- mastermind of the world's largest Ponzi scheme, a fraud valued at \$64.8 billion and resulting in over \$20 billion in losses to thousands of investors

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## Is Greed Good for Banking? Dick Fuld



## Fuld's role in the "Crash of 2008"

- CEO of *Lehman Brothers*, the investment bank whose bankruptcy in 2008 nearly collapsed the world financial system
- according to Luigi Zingales, University of Chicago, "Causes and Effects of the Lehman Brothers Bankruptcy" "*While commercial banks are regulated and cannot leverage their equity more than 15 to 1, at the beginning of the crisis Lehman had a leverage of more than 30 to 1.*"

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# Is Greed Good for Mortgage Lending? Angelo Mozilo



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- chairman and CEO of *Countrywide Financial*, in 2006 the largest mortgage lender in the US, accounting for 20% of all mortgages amounting to 3.5% of US GDP
- earned over \$600 million during his employment at Countrywide until it was purchased by Bank of America in 2008
- email from Mozilo to Countrywide execs in 2004: "*the type of loans currently being originated combined with the unprecedented stretching of all aspects of credit standards could cause a bump in the road that could bring with it catastrophic consequences.*"
- Fined \$67.5 million by the U.S. SEC for misleading investors, but due to indemnification by BoA, Mozilo only had to pay \$22.5 million

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## Is Greed Good for Energy Markets? Jeff Skilling



## Skilling's role in Enron's demise

- CEO of Enron, was paid \$132 million in 2001 convicted on 39 counts of fraud, insider trading and other crimes that precipitated the bankruptcy of Enron, the loss of 20,000 jobs and the life savings of many employees
- he presided over electricity price manipulation in California and is famous for his joke “What is the difference between California and the Titanic? At least the lights were on when the Titanic went down”
- collateral damage: closure of accounting firm *Arthur Andersen* one of the “big 5” U.S. accounting firms. “I think Arthur Andersen deserved the death penalty. There were not public accountants. They were not acting on behalf of public interest.” (p. 726 of Kurt Eichenwald, *Conspiracy of Fools*)

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## Is Greed Good for Indian Telecom? A. Raja



- an Indian politician from the Dravida Munnetra Kazhagam(DMK) political party, appointed Union Cabinet Minister for Communications and Information Technology in 2007

## How not to run an auction

- Currently in jail for his role in enabling bidding collusion in the *2G Spectrum Scam*
- To enable his cronies to win the 2G auction cheaply in exchange for billions in side payments, Raja cancelled the originally scheduled competitive auction and announced with little warning (except to the cronies destined to win the auction) that the auction would be held on the 52nd floor of a skyscraper in Mumbai. Conveniently, all of the elevators in this building were out of order on the day of the auction.
- In 2011, *TIME* magazine listed Raja as second on its Top 10 Abusers of Power list, just behind Richard Nixon (who earned his top rank place for the Watergate scandal which lead to his impeachment/resignation in 1974)

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# Is Greed Good for Insurance? Joe Cassano AIG-FP



## Cassano's role in AIG's demise

- CFO of AIG's *Financial Products* subsidiary that sold default insurance (credit default swaps) to banks and other investors. Vanity Fair magazine dubbed him "The Man Who Crashed the World."
- According to WSJ: "He earned \$280 million in cash – more than AIG chief executives – and for every dollar his financial products unit made, 30 cents came back to Cassano and other top execs"
- "Cassano was a guy with a crude feel for financial risk but a real talent for bullying people who doubted him."  
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# Is Greed Good for Egypt? Hosni Mubarak



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## Is Greed Good for Libya? Mohamar Gaddafi



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# Is Greed Good for Yemen? Ali Abdullah Saleh



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## Is Greed Good for Syria? Bashar al-Assad



## Is Greed Good for Zimbabwe? Robert Mugabe



- According to the *New York Times* “Fewer than 1 in 4 Zimbabweans have jobs and life expectancy, nearly 60 in 1990, has plunged into the 30s”

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## Is Greed Good for North Korea? Kim Jong-Il



## Kim Jong-Il's record as "Dear Leader"

- An estimated 1 million North Koreans perished in concentration camps since 1972
- An estimated 3.5 million North Koreans died of starvation between 1995 and 1997 alone
- Meanwhile an elite bureaucratic and military upper class enjoys all modern luxuries

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## Is Greed Good for Football? FIFA Corruption Scandal



- Serge Blatter announcing that Qatar “won” the right to hold 2022 World Cup (i.e. it paid Serge the highest bribe)
- “Corruption? Crisis? What crisis? There is no crisis!”

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## Is Greed Good for Cycling? Lance Armstrong



- Armstrong, shown celebrating his victory in the 2005 *Tour de France*, by drinking a glass of human testosterone

## Is Greed Good for Cycling? Floyd Landis



## Collateral Damage from Cheating

- “Winner” of the 2006 *Tour de France* whose title was subsequently stripped when drug tests revealed that his “skewed testosterone/epitestosterone ratio during stage 17” (Wikipedia)
- He was suspended from professional competition through January 30, 2009, following an arbitration panel’s 2-to-1 ruling on September 20, 2007.
- His father-in-law, despondent over the loss of business at his restaurant following the stripping of the title from Landis, committed suicide in 2006
- “On May 20, 2010, after almost four years of contesting the allegations against him, Landis admitted to continual doping and alleged that Lance Armstrong and many other top riders who rode on his team doped as well.” (Wikipedia)

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## Is Greed Good for Skating? Tonya Harding



- an American figure skating champion who won the 1991 U.S. Figure Skating Championships and placed second in the World Championships

## “Competing” by damaging your opponent

- According to *Wikipedia* Tonya Harding “*became notorious after her ex-husband, Jeff Gillooly, conspired with Shawn Eckhardt and Shane Stant to attack her skating competitor Nancy Kerrigan at a practice session, during the 1994 U.S. Figure Skating Championships.*”
- “She avoided further prosecution and a possible jail sentence by pleading guilty on March 16 1994 to conspiring to hinder prosecution of the attackers. She received three years probation, 500 hours of community service and a \$160,000 fine. As part of the plea bargain, she was also forced to withdraw from the 1994 World Figure Skating Championships and resign from the U.S. Figure Skating Association

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## Is Greed Good for Catholics? Sex Abuse by Priests



## Catholic Church's denial of sex abuse

- The reality of sex abuse by Catholic priests, which has been documented to be widespread in numerous countries around the world, has been ignored for decades at the highest levels of the Vatican, who usually only shuffled abusive priests from one location to another
- A recent study of the problem was done by the John Jay College of Criminal Justice funded by a \$1.8 million study, funded primarily by the U.S. Conference of Catholic Bishops and other Catholic organizations
- The study found *“that neither celibacy nor homosexuality were to blame for the crisis. Instead, the study blames the free-love vibe of the Woodstock era for the abuse.”*

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## Reaction to the John Jay report

- According to a May 18th article in the *New York Daily News*, Robert Hoatson a former Catholic priest “who counsels victims of sexual abuse says the five-year study of the Catholic Church crisis conducted by the John Jay College of Criminal Justice is one of the most dangerous and self-serving documents he’s ever seen”
- “The cover-up continues but now it is being continued by a formerly reputable institution” said Hoatson, the president of an abuse victim support group called Road to Recovery. *“John Jay gave the bishops what they wanted. They got what they paid for.”*

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## Is Greed Good for Muslims? Osama bin Laden



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## Is Greed Good for Protestants? Rev. Terry Jones



## Rev. Jones: Koran Burner

- Threatened to burn thousands of copies of the Koran on Sept. 11, 2010, a day he dubbed “International Burn a Koran Day.” After cancelling this, he burned actual copies on March 20 2011
- Jones ignored admonishments from U.S. General David Patraeus and numerous Christian religious leaders.
- Patraeus believed that Jones’s misguided exercise of freedom of expression was highly counterproductive and would endanger thousands of U.S. troops in Afghanistan and elsewhere
- On April 1, 2011 protestors in the northern Afghanistan city of Mazar-i-Sharif, protesting this burning, attacked a United Nations Assistance Mission, killing at least 12 people, including at least 7 U.N. workers.

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## Debate over the Need for Regulation and Enforcement

- In light of all the misbehavior that has occurred over the last decade, the financial shenanigans leading to fraud and bankruptcies of large firms like WorldCom, Enron, Lehman Brothers, Chrysler, GM, Bear Stearns, etc. etc you would think there would be widespread support among policy makers for stricter regulation and tougher penalties for misbehavior
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## Do economists agree on regulation/enforcement?

- It is as politicians had just been born and have no memory of the Great Recession and all the misbehavior in the preceding decade
- Fortunately there is more agreement on the need for regulation among many (though not all) economists
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*"The roots of this crisis have to be found in bad regulation, lack of transparency, and market complacency brought about by several years of positive returns."*

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The main response to the Crash of 2008: the *Dodd-Frank Act*

- 1. consolidation of regulatory agencies and new oversight council to evaluate systemic risk
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## Opposition to regulation is often a sign of corruption

- The opposition to Dodd-Frank and even mild attempts to tighten regulation of Wall Street and prevent a recurrence of a financial market meltdown is overwhelmingly *Republican*
- While some part of the opposition is ideological, much of it is corrupt, funded by generous political donations from Wall Street
- For example the Securities and Exchange Commission faces division in votes to impose tighter regulations with Republican members of the commission reliably voting against any new regulations
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## Assigning Cox to Guard the Chicken Coop



- During the Bush Administration, *Christopher Cox* was appointed as the S.E.C. Commissioner, a person who was reliably hostile to attempts to investigate/regulate Wall Street

## Intentional Regulatory Incompetence

- High internal hurdles were imposed to bring a case against any firm. Combined with understaffing, it is no surprise that the S.E.C. missed multiple warnings about Bernie Madoff during Cox's regime.
- In a *Washington Post* article in 2007, Richard Ferlauto, a pension director of a union of state, county and municipal employees said that Cox "has emerged at the anti-shareholder wolf shedding his sheep's clothing"
- Even a Republican Senator, Charles Grassley, chided the SEC for its outmoded computer equipment "They've got a computer system that can't search for the the securities industry is reporting — that's like working with one hand tied behind your back."

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## Even worse, “Regulatory Barriers to Entry”

- During the 1980s and 1990s, the SEC denied the ability of new, more efficient trading platforms to enter the market and compete against the New York Stock Exchange
- The rationale: entry of competitors would confuse investors and threaten the *law of one price*
- As a result of this protection, the NYSE was shielded from internal competition. However the SEC could not shield it from international competition
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## Other opposition to reasonable regulation

- Republican SEC commissioners vote against new rules to toughen internal controls over credit rating agencies (Standard and Poors, Moody's, Fitch) even though a Congressional panel concluded that their lax practices going into the Crash of 2008 constituted “essential cogs in the wheels of financial destruction”
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## Regulation and the “Revolving Door”

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- Example 1: Spencer Barasch, a former SEC staff member who, according to the *New York Times* “who has been accused of repeatedly blocking efforts to investigate R. Allen Stanford, the Houston financier charged with running a \$7 billion Ponzi scheme, is the subject of a federal criminal inquiry for having done legal work for Mr. Stanford after leaving the S.E.C.

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- Example 2: Meredith Baker, a Republican commissioner in the F.C.C. who approve a merger between Comcast and NBC promptly resigned and takes a job as senior vice president for government affairs for NBC Universal, which Comcast acquired in January, 2011
- In addition to the “revolving door” there is a problem of an excessively cozy between regulators and the industry they are regulating
- Example: the April 2010 BP oil rig explosion. Lax oversight by the regulator MMS enabled this to happen. According to John McQuaid, “MMS has also been plagued by scandals in recent years, including one in which eight employees were disciplined for partying, having sex with, and receiving expensive gifts from their energy industry counterparts.”

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- These penalties are often levied on the shareholders of the company rather than the executive who actually misbehaved. Even when executives are fined, they often have indemnification agreements written with the corporation they abused that guarantees their legal fees and most of any any fines are paid by the shareholders rather than by them
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## Towards a better theory of regulation

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- The focus of these academics is on *reducing or eliminating regulations* not on increasing or strengthening regulations
- Example 1: in 1999 Larry Summers was assistant Treasury Secretary in 1998 vigorously opposed regulation of derivatives markets proposed by CFTC commissioner Brooksley Borne. In 1999 Summers supported the repeal of the *Glass-Steagall Act*, a depression era law that provided a strict separation between commercial banking and investment banking

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## Is there any hope better regulation of misbehavior?

- Not much, at least in the US. Corruption, as manifested by enormous payments to lobbyists and campaign contributions by corporations and special interests, is deeply entrenched and considered to be a legitimate form of “free speech”
- The Supreme Court has affirmed that corporations have essentially the same status as individuals, including the right to unrestricted free speech including unrestricted spending on lobbying and public interest media commercials — basically thinly disguised campaign commercials
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## We can agree on at least minimal regulations

- Example: Northern Mexico. Virtually anyone would agree that when corruption and lawlessness reach such epidemic proportions, life no longer becomes tolerable
- Northern Mexico is now essentially a *failed state* without any effective government or law and order
- Instead the country is “run” by warring drug gangs. Ciudad Juarez, with 8000 killings since 2008, is the most violent city on earth. 97% of the killings go unprosecuted
- More than 250,000 have fled from the city, 25% of the houses are empty/abandoned, and 6000 small stores have closed in the past few years. We can all agree that we don't want to leave “regulation” to the drug gangs.

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# Obvious Misbehavior: Scott Reuben



## Reuben's role in pharmaceutical fraud

- paid \$73,000 by Pfizer to study the effect of *Celebrex* on post-operative pain, but faked the data and “never conducted the clinical trials that he wrote about in 21 journal articles dating from at least 1996” (Wikipedia)
- “Reuben's studies led to the sale of billions of dollars worth of the potentially dangerous drugs known as COX2 inhibitors, Pfizer's *Celebrex* and Merck's *Vioxx*, for applications whoss therapeutic benefits are now in question.”

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## Less Obvious Misbehavior — Martin Feldstein



- Feldstein has made many important contributions to economics and is on many economists' "short lists" to receive a Nobel Prize

## Feldstein's role as a financial advisor

- A regularly quoted “financial guru” who advises the U.S. on “fiscal responsibility” he was the Chairman of the Council of Economic Advisers for Reagan and a member of Economic Recovery Advisory Board under the Obama Administration
- He has also been a member of the Board of Directors of AIG and currently on the board of Eli Lilly and Company. He earned over \$6 million as a director of AIG, including \$247,000 in 2008 the year it received a \$180 billion bailout from the US government to prevent it from going bankrupt and collapsing the world financial system
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## Is high director compensation a “bribe”?

- Given problematic decisions (and likely misbehavior) by Eli Lilly and AIG noted above, did Feldstein approve, or speak out against this misbehavior?
- Is the super high compensation paid to Directors such as Feldstein in effect a “bribe” that dissuades them from speaking out against corporate misbehavior (or reckless behavior), or did Feldstein just fail to see it, or was it intentionally concealed from him?
- It is a well known problem that CEOs tend to “stack” their boards with “friendly” directors who in turn repay the favor by approving generous CEO pay packages

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## Who to blame, the CEO or the director?

- Many CEOs avoid choosing people who ask “hard questions” to be on their Boards, preferring instead people who have high profile reputations but who are willing to “play by the rules”
- Is the loci of misbehavior mostly with a CEO who fails to choose a Board that exercises effective oversight, or is the misbehavior on the part of the director who takes the huge fees while “looking the other way”?
- Regardless of whether there is misbehavior on Feldstein’s part, shouldn’t his full “track record” be taken into account when looking to him for advice on “fiduciary responsibility”?

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## Academic Misbehavior — Larry Summers



## Larry Summers and the Revolving Door

- We have already discussed several examples of corruption resulting from the “revolving door” for regulators and policy advisers, some of which are illegal and others are still legal
- Larry Summers’s history as a major policy adviser is an example of revolving door corruption that is still legal in the U.S. but nonetheless a type of misbehavior
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## The Payoffs to Championing Deregulation

- According to a *New York Times* article, though he “*plays down his stint in the hedge fund business as a mere part time job, the financial and intellectual rewards that he gained there would make even most full-time workers envious. . . . he earned \$5.2 million in just the last of his two years*”
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## Academic Misbehavior — Frederic Mishkin



- Mishkin is a Professor at Columbia University and a former Vice President of the Federal Reserve Board. Click the photo to see his interview in the documentary, *The Inside Job* by Charles Ferguson, who won an Academy Award for this work

## Conclusions

- While some greed is indeed good, since it does motivate us to do great things, I have argued that “excessive greed” is bad and is a chief source of mishbehavior by our leaders
- Misbehavior, including corruption, “crony capitalism”, abuse of power, fraud terrorism/violence, fraud, etc. etc. needs to be recognized as a problem of near epidemic proportions throughout the world that causes serious harm to billions of people
- Economists are well positioned to analyze, define and develop policies for dealing with misbehavior because many types of misbehavior arise due to a problem of *incentives*, particularly poor enforcement and lack of consequences for misbehavior by powerful leaders

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- It is equally naive to model governments as “benevolent social planners”. Although the work on *rent seeking behavior* dates back to the seminal work of Gordon Tullock in the late 1960s, there is still inadequate research on *crony capitalism* and *government corruption*.
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- However it is important to start in the place where we can have the most impact — keeping our “own house in order”
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- At the very minimum, such payments should always be clearly disclosed. The American Economic Association may enact guidelines on this in the near future.

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