



Research In Action

# Lab Dispatches

## Volumes 1 & 2

2012-2013 blog posts  
by the  
Edmond J. Safra Research Lab for Ethics

[www.ethics.harvard.edu/lab/blog](http://www.ethics.harvard.edu/lab/blog)



HARVARD UNIVERSITY  
Edmond J. Safra Foundation Center for Ethics

# Lab Dispatches, combined Vol. 1 & 2

*“**Institutional corruption** is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution’s effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public’s trust in that institution or the institution’s inherent trustworthiness.”*

[2012 - 2013 blog posts](#)

by the Edmond J. Safra Research Lab for Ethics  
Harvard University

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# The Ethics of Competition

[William English](#)

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An interesting cheating scandal recently rocked the 2012 Summer Olympic games. It didn't involve gambling, blood doping, or performance enhancing drugs. In fact, the problem was with poor, not enhanced, performance. Eight badminton Olympians were disqualified because they did such a good job of *losing*.

The details are a bit complex for those of us who don't regularly follow the sport, but in essence, four teams apparently tried to lose in a preliminary round in order to secure matchups in subsequent rounds that would increase their chances of winning a medal. More specifically, two Chinese teams were on track to play each other in the semi-finals, meaning only one could advance to the medal round. If one of these teams lost in the preliminary round, however, they would be placed in a different bracket and both teams would still have a chance to win medals. Thus,

the Chinese team started to play badly in their matchup with South Korea. However, it also became apparent to the South Koreans that their overall chances could improve by being in the other bracket as well. The result was a comically bad match, with each team trying their best to lose. A similar scenario played out an hour later between another South Korean team and Indonesia. The South Koreans wanted to lose to avoid competing against the other South Korean team, and Indonesia wanted to lose to avoid being in the bracket with the dominant Chinese team. (Badminton is not the only sport to suffer from these problems: similar accusations have been made of teams underperforming to secure better seeds in the soccer and basketball tournaments.)

Fans and Olympic officials were clearly dismayed by the poor performance of these world-class athletes, and the decision to disqualify them appears to be a popular one. However, it is worth asking what exactly these players did that was wrong. The answer is less obvious than it might appear at first glance, but likely holds some lessons for how we ethically evaluate a wide range of contests in the real world.

What game are you cheating at?

Consider the advice these teams might have received from a hardnosed strategy consultant. The Olympians had come to the games with a clear goal in mind – to win medals. The tournaments had a transparent structure, and, as a matter of strategy, losing in one round really could help achieve their ultimate goal of medaling. Athletes are constantly searching for new strategies to win. Why shouldn't the decision to throw an early game for a better tournament seed not be part of the game of winning?

Various rationales were put forward as to why this strategy was wrong. The official charge from the Badminton World Federation was “not using one's best efforts to win a match” and “conducting oneself in a manner that is clearly abusive or detrimental to the sport.” Others argued that this strategy robbed ticketholders of the money they paid to see a good performance. Perhaps the most straightforward charge came from a fan who remarked, “It's not in the spirit of the thing.”

In order to understand the outrage, I think it is useful to consider a distinction that the philosopher Alasdair MacIntyre made in his classic work on ethics, *After Virtue*, concerning the kinds of achievement people can seek. MacIntyre asks us to imagine teaching a seven-year-old child how to play chess. At first, the child is uninterested, but you tell her you'll play such that she'll always have a chance of winning and, if she does win, you'll reward her with her favorite candy. You might get her interested in chess this way, but so long as the candy is her only motivation, she has no reason not to cheat if given the opportunity (indeed she has every reason to cheat). However, over time the child may come to love the game of chess for what it is and appreciate the particular excellences required to play it well – strategy, concentration, creativity, imagination, and so on. MacIntyre describes these sorts of goods as “internal” to the practice of chess, contrasting them with “external” goods like money, prestige, or candy that might come as rewards to winning players. Importantly, to the degree that the child comes to be motivated by the goods internal to chess, she has reasons not to cheat to obtain external goods, for in doing so she would be robbing herself of the opportunity to achieve the goods that are internal to the practice.

#### Which goods are primary?

Internal and external goods often stand in uneasy relation to one another in the real world. With Olympic medals and glory on the line, it's understandable why players would be tempted to compromise their athletic integrity (the decision of one badminton player to leave the sport for good after the scandal perhaps suggests she really did see the external goods as primary – why play the sport if you can no longer medal?). Of course, when players play purely for medals, they are still playing a game. However, it's a game for the external rewards, not the internal goods of the sport – you cease playing badminton to show you are the best at badminton; you play badminton because it pays.

Again, it may be an open question, morally speaking, whether it's worth forsaking the goods and integrity of a particular practice for various external goods. However, sports are not the only arena in which this question arises. The professions that constitute the lifeblood of any society are also practices, complete with their own internal goods, standards of excellence, and purposes. Being a good doctor, for example, requires caring about the health of patients, diligence in keeping up with medical literature, exercising care in making diagnoses, judiciousness in recommending the best treatments, and so on. Good doctors are expected to exercise these virtues whether they work for a six-figure salary in a Manhattan hospital (large external rewards) or volunteer for a medical mission in Haiti (small external rewards). Something similar could be said of engineers, lawyers, public officials, plumbers, and so on.

It's useful to understand how professions are constituted by their own distinctive internal goods and virtues, because it is only from this perspective that we can speak meaningfully about a profession's “corruption.” A doctor who prescribes a truly inferior drug because of a financial kickback from a drug company wins at the game of wealth maximization, but has

failed as a doctor. The corruption of the “internal” purposes of professions by “external” rewards is a familiar complaint. Indeed, it seems that one purpose of the process we call “professionalization” - professional schools, medical boards, bar exams, professional meetings, etc. - is to shape the motivational fabric of professional’s lives so that they come to see the internal goods of a practice as primary and non-negotiable. The importance of shaping individual motivation in this way is hard to overstate. Although police, referees, and other “enforcers” are called upon to monitor and penalize extreme infractions of professional integrity, out of necessity we must ultimately rely on the voluntary discipline of professionals to keep up the standards of a practice.

So, shaping motivations and habits of mind at the individual level is crucial for creating professionals committed to the integrity of a practice. However, there are two further challenges to the integrity of practices, which can become opportunities if handled well.

### Structuring competition

First, new questions will always arise about the boundary lines of fair play. There was a point when it was not clear whether bunting should be a legitimate strategy in baseball, or whether swimmers should be allowed to wear rubberized tech suits. One can imagine decent arguments for and against, but it’s important that a consensus was reached that could provide players with common expectations about the legitimacy of such innovations. Similar questions arise in professions, although the right answers may be less arbitrary. Should auditors provide consulting advice to their clients, should politicians be able to accept donations from foreign nationals, should banks be able to use customer deposits to gamble in the stock market, should plumbers begin work without providing an estimate to customers, and so on? These strategies will tend to increase earnings in the short term, but in evaluating their legitimacy one must ask about their long-run effects on the purpose and integrity of these professions.

Note that this sort of underlying question does not arise for someone who is focused exclusively on external, material goods. To take an extreme example, we could imagine the proverbial third-world dictator, obsessed with power and wealth, who decides whether to rape, pillage, and murder based solely on the instrumental calculation of what he can get away with. True professionals consider more than external rewards and what they can get away with - not simply because of legal systems that restrain them, but also because many goods they value can only be achieved if the integrity and public purposes of the profession remain intact. (Perhaps this does suggest that we should be wary of professions where external rewards are seen as the only thing that counts.)

A second challenge concerns the way we create external rewards to tempt people in the first place. The badminton players bear ultimate responsibility for their actions, but the tournament designers may share part of the blame. As one player (from a team that was not disqualified) remarked: “The round-robin format was ridiculous. It brought about a very bad side of the game. The format encouraged match-throwing. I hope the format changes (in the next Olympics).” Indeed, it would be ideal if a tournament format could be found that did not provide such massive incentives to game the system by losing in early rounds. Change the structure of the competition and you remove the temptation to cheat. Economists and political scientists spend a lot of time thinking about these sorts of “institutional design” issues in the hope of bringing external rewards into closer alignment with the genuine



internal goods of a practice. Likewise, managers are constantly on the lookout for ways to improve the “choice architecture” of employees and customers and thus wrestle with these problems on a daily basis.

Changing institutions to encourage better behavior, while not creating new opportunities for malfeasance, is of course easier said than done. Indeed it can seldom be done perfectly, which is why we generally need to call on the personal integrity of professionals as well. The badminton episode illustrates the importance of each. Although unfortunate for the players involved, this peculiar scandal provides some useful lessons beyond the Olympics: the goodness of losing or winning depends on what game you’re playing; and both participants and rule-makers have a role in creating contests conducive to the “spirit of the thing.”

<http://www.ethics.harvard.edu/lab/featured/239-william-english-the-ethics-of-competition>

# The Politics of Distraction: A Call for a Fresh Look at Ad Effects

[Michael Jones](#) and [Paul Jorgensen](#)

Lab Fellows [Michael Jones](#) and [Paul Jorgensen](#) publish [a new study](#) in the *Journal of Political Marketing* on political television advertisements' influence (or otherwise) on congressional election results. Their results, also reported in [USA Today](#), are further explained for both scholarly and non-academic audiences in this blog entry, written for the Lab.

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Every election cycle millions of American's without TiVo are subjected to advertisement after advertisement about political candidates. Media outlets cover the advertisements as if they are legitimate news in of themselves and many a political scientist has built a case for tenure around the study of advertisements. Thus the candidate who runs the ad, the media who report on the ad, and political scientists who analyze the ad, are all convinced that ads are necessary to win elections. Of course, while *they* think ads matter *we* citizens are doing our best to limit exposure to the toxin poured into our communication environment every election cycle. Given these two truisms—that elites think ads matter and that the rest of us go out of our way to prove them wrong—we asked what turned out to be a pretty novel question: do political advertisements influence congressional election outcomes? Based upon our recent analysis of congressional elections from 2000 to 2004, the short answer is [no](#).

The long answer is more nuanced, but we think the nuance can be summed up in essentially three points. First, and despite being highly visible annoyances for most of us, ads are actually quite uncommon. According to our data, most of the congressional elections between 2000 and 2004 had no advertisements whatsoever. In these cases the races are almost always non-competitive—we don't even really need elections for most of these districts let alone a campaign. Second, in the elections where advertisements were aired, if one side advertises a whole bunch, then so does the other side—the advertisements drown each other out. Third, there is a statistically significant effect—ads are influencing what percent of the two-party vote a candidate gets, just rarely is it even close to enough to determine the winner or loser of a race.

Despite the nuance, we are not going to tell you that ads matter for congressional election outcomes. Our data simply do not indicate they do. In fact, we are excited about our ability to throw an empirical pebble onto the levy of “small ad effects” conjectures that political science has been building [“...for at least a decade or more.”](#) Why? Because in parsing out that ad effects are inconsequential in nearly all congressional election outcomes, our analysis indirectly shed some light on what is likely to matter in campaigns. In short, we found more influential effects in our models for non-airing expenditures—payment for staff, literature, and other activities associated with the *ground game*; however, given some recent [cogent summaries](#) concerning the state of advertisement knowledge, we think it is time to research political advertising from a critical approach, one that can incorporate institutional corruption.

Media coverage and research into political advertising misses a point only made in passing by those concerned with negative ads: political advertising harms our democracy. Although individuals and groups [try](#), the main effect of advertisements may not be in changing public perception, mobilizing/demobilizing voters, or even in altering the outcome of an election. On the contrary, political marketing agencies (a growth industry) aid and abet politicians in masking policy preferences bought and paid for by big donors. We should all thank [Mr. Romney's advisors](#) and [Mr. Ryan](#) for admitting as much publicly. It is high time we examine political advertising as a *result* of a system of influence, distracting most of us from real politics. Let's take [Murray Edelman](#) to heart, when he writes: "Sometimes politics is not myth or emotional at all, but a cool and successful effort to get money from others or power over them. Perhaps it can be cool and successful for some only because it is also obsessional, mythical, and emotional for some or for all."

<http://www.ethics.harvard.edu/lab/blog/242-the-politics-of-distraction-a-call-for-a-fresh-look-at-ad-effects>

# What Value Lobbyists?

[Paul Thacker](#)

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A constant stream of news and gossip floods Washington's information channels about Hill staffers leaving Congress for higher paying jobs "downtown." For the insider's inside view, read "[Politico Influence](#)" a daily email from *Politico* that covers fundraisers, job changes by Hill staffers, and client "gets" by lobbying firms.



Below, a typical snippet:

**FORMER HILL STAFFER JOINS PUBLIC RELATIONS FIRM:** Tonya Allen, the former press secretary for Rep. Nick Rahall (D-W. Va.) has joined North Bridge Communications, a D.C.-based public relations and crisis communications firm, as an account executive. Allen is also a former senior manager of public affairs for the American Meat Institute.

The tone of "Politico Influence" contains little hint of scandal, and why should it? Washington is rife with lobbyists, fundraisers, and staff passing through the revolving door to better paying jobs off the Hill. Beltway insiders thrive on information—all the better if you are the first to congratulate a friend who landed a high paying gig at a lobby shop or law firm.

A [recent paper by Jeff Lazarus and Amy McKay](#) attempts to quantify a university's success in acquiring earmarks after hiring a former Hill staffer or Members. In short, they examined

whether universities which hired former Hill staff or Congressmen won more earmarks, meaning money that Congress says must be spent on a specific program. In simpler terms, does hiring a former Hill staffer or Congressman translate into a \$2.3 million earmark for a new center on neuroscience or \$5 million to help build new dorms?

The authors conclude, quite obviously I believe, that hiring former congressional insiders increased the likelihood of getting an earmark. According to their study, this greater success was 30 percent in 2002 and 35 percent in 2003.

Unfortunately, the study suffers from a series of methodological flaws, two of which the authors acknowledge. While the study lumps them together, former Congressmen have much more power than former staffers. They are rarely refused a meeting, even with current Congressmen, and are more likely to get an “ask.” Second, staffers themselves are not the same. When it comes to earmarks, a former staffer who worked on appropriations—better yet, the Appropriations Committee—has a better handle on the earmark process and better relations with the staffers and Members who make final approvals.

But the earmark process has a host of other variables, some of which cannot be quantified. Just because a university hired a former Congressman and then won an earmark does not prove that this lobbyist was involved. Regardless of how hard they lobby, universities in the districts of Representatives on the Appropriations Committee are more likely to get an earmark. And in some situations, a Congressman might request an earmark just because he likes a campus. Perhaps it’s his alma mater or he has a child attending the school.

Finally, there are some technical issues with lobbying records that make the influence process difficult to suss out. Namely, lobbyists self-report and requirements are vague. Plus, there are examples, like [Newt Gingrich](#), who work to influence Congress but don’t bother to register. Even if they do register, there is no way to check if lobbyists are reporting accurately what they worked on. A lobbyist who won an earmark for his university could report that he worked on “educational issues.” But what does that mean?

University lobbying records list the names of all lobbyists, the issues or committees they lobbied, and lobbying expenses. Even if a lobbyist reports accurately that they lobbied the Appropriations Committee and the Science Committee and had \$50,000 in expenses, we are still left wondering what happened. The lobbyist could have had one meeting with Appropriations staffers to get the earmark but countless meeting with House Science staffers on policy matters. Lobbying forms do not account for the difference in time or expenses.

Finally, the study suffers from a framing issue, hinting that earmarks are a sign of corruption or undue influence. For my project at the Edmond J. Safra Center for Ethics, I am interviewing 100 current and former staffers about life on the Hill. Just last week, I interviewed my 61<sup>st</sup> staffer. At no point during these interviews, some of which involved staffers who work on appropriations, did anyone say that they thought earmarks were wrong.

If anything, staff were indignant at the very question. While acknowledging that they’ve seen bad earmarks, they also cited ways the money benefited taxpayers: bridges, a homeless shelter for veterans, and other needed projects back home.

Two veteran Democratic staffers were much more blunt in their assessment of the recent ban on earmarks. One staffer said that the ban fit a neat, simplistic Washington narrative

that Congress was out of control, instead of noting that Congressmen know much better how to target federal dollars back in their home district than the White House or federal agencies in Washington.

A staffer on the Appropriations Committee added that robbing Congress of the right to target dollars undermined the Constitutional separation of powers, leaving all spending decisions with the White House. Negative talk about earmarks implied that the White House budget was a “pure document” while congressionally targeted spending was “political.” Earmark reform was a way to score cheap political points and gave the false impression that politicians were tackling budget matters. Meanwhile real spending issues like bloated defense projects are ignored because they are politically complicated and protected by large corporate interests.

I don't envy Lazarus and McKay. They've chosen a tough task. Just about every staffer I've interviewed thus far told me that lobbyists can be a problem; undue influence can be a problem.

The question is how to control it.



*Attributions: [Wally Gobetz](#) and [Daquella Manera](#)*

<http://www.ethics.harvard.edu/lab/featured/247-paul-d-thacker-what-value-lobbyists->

# Institutional Corruption and Perceptions of Methodological Rigor in Medical Research

[Dr. Aaron Kesselheim](#)

Aaron Kesselheim's blog entry for the Lab, summarizes salient features of "[A Randomized Study of How Physicians Interpret Research Funding Disclosures](#)," a ground-breaking research article that appeared in *The New England Journal of Medicine* on Sept. 20, 2012. The Journal's [editorial](#) and Professor Lessig's [blog entry](#) offer complementary perspectives that draw out aspects of this study's significance.

Within a week the article also received worldwide press coverage, including [Reuters](#), [The Chicago Tribune](#), [The Boston Globe](#), [PLOS](#), [Scientific American](#), the German [Deutsches Ärzteblatt](#), the Greek [Pharma Market Journal](#), and the Dutch [Medisch Contact](#).

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In the past decade, pharmaceutical companies have repeatedly been found to engage in unethical behavior in clinical trial design and reporting. In response, most major medical journals now prominently report the sources of funding of clinical trials. But the impact of such disclosures on physician readers has not been studied. Safra Center research associates Aaron S. Kesselheim (Assistant Professor of Medicine at Harvard Medical School) and Christopher Robertson (Associate Professor of Law at the University of Arizona), and Safra fellow Susannah Rose (Assistant Professional Staff at Cleveland Clinic) conducted a randomized study of a national sample of practicing internists to determine how funding disclosure affects the perception of clinical trial results. They designed abstracts of clinical trials supporting three hypothetical drugs useful for hard-to-treat medical conditions. The trials had different levels of methodological rigor: high, medium, and low. They then varied the conflict of interest disclosure appended to these abstracts: pharmaceutical industry-funded, NIH-funded, or none listed. They found that while physicians readily distinguished among clinical trials of different methodological rigor – appropriately giving more credence to high-quality studies and less to low-quality studies – physicians tended to downgrade their perceptions of trials funded by the pharmaceutical industry compared to those with no funding source listed. The effect size was even greater when industry-funded studies were compared to NIH-funded studies. Most striking, the physicians consistently downgraded the credibility of industry-funded research, even if it was high-, medium-, or low-quality research.

These findings have profound significance for the generation of clinical trial data intended to influence patient care. First, the data suggest that episodes of unethical behavior in recent years in this field have led physicians to perceive widespread institutional corruption in the pharmaceutical industry, and to be skeptical of industry-derived research. Since the industry funds the vast majority of clinical research, such an attitude may unfairly tarnish even high-quality research, and slow the translation of important advances in patient care. Our

evidence suggests that the industry is now suffering a crisis of confidence. Institutional corruption has a cost.

Second, the data suggest that physicians do take conflict of interest disclosures into account when interpreting clinical research, but that these disclosure statements are indiscriminately applied. While it is reassuring to see that disclosures work as a policy mechanism, we need to find additional mechanisms to make sure that believable research is indeed believed. Additional mechanisms must be considered – such as blind funding grants, data transparency, or independent statistical review of industry-funded research – to promote physician trust and ensure that high quality research, no matter what its source, gets the credibility it deserves.

Third, the data suggest that physicians may be particularly receptive to NIH-funded research, which supports the importance of continued funding of high-impact clinical questions through NIH and other government programs, like the Patient-Centered Outcomes Research Initiative. Although the NIH has occasionally had its own difficulties with research integrity, our data suggest that it has maintained its credibility in the eyes of physicians.

<http://www.ethics.harvard.edu/lab/featured/249-believe-the-data>



# The Burden of Disclosure: What You Do Know Can Hurt You

[Sunita Sah](#)

In this original blog post by Lab Fellow [Sunita Sah](#), she discusses her article, "The Burden of Disclosure: Increased Compliance with Distrusted Advice." The article is in the [Journal of Personality and Social Psychology](#), the journal of the American Psychological Association and the [highest-impact](#) empirical journal in the field.

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Disclosure is commonly proposed as a solution to conflicts of interest. In the financial industry, disclosure is advocated as an important rule. Across countries, the Securities and Exchange Commission (SEC), the Financial Services Authority (UK), and the Autorité Des Marchés Financiers AMF (France) all commend disclosure. In medicine, in the US alone, the American Medical Association, the Medicare Payment Advisory Committee, and the 2010 Patient Protection and Affordable Care Act, all endorse disclosure as an important component in dealing with conflicts of interest. Disclosure is popular because it is perceived to work; the fuller the disclosure, the better. For consumers, disclosure is anticipated to act as a warning alerting them to their advisor's potential biases in the hope that they will be able to adjust the advice accordingly.

Seeking out disclosures, however, may not be as attractive as it sounds, and it may even backfire. Over six experiments, I found that even though disclosure decreased advisees' trust in the advice, it also caused increased pressure on advisees to comply with their advisor's recommendation. The increased pressure occurs because, instead of disclosure communicating only information about the conflict of interest, it also communicated how consumers could help their advisor. More importantly, it communicated, and made salient, that not taking the recommendation would not help their advisors. Imagine, for example, your financial advisor saying to you, "I highly recommend this fund for you. However, I must disclose that I will receive a commission if you invest in this fund." Consumers are now more likely to feel greater discomfort in rejecting the recommended fund than they would if the same recommendation was given without disclosure. Disclosure has become tantamount to a favor request.

The compliance pressure that comes with disclosure is not motivated by altruism, but rather by reluctance to appear unwilling to help the advisor once the advisor's interests are publicly disclosed. In my experiments, the burden of disclosure was significantly reduced (i.e., advisees were far less likely to follow advisors' biased recommendations) when the disclosure was secretly provided by an external source rather than directly from the advisor, suggesting that it is the *common knowledge* of the disclosed interests (not merely the advisee's knowledge of those interests) that creates pressure to satisfy them.

Other remedies that were effective in significantly reducing advisees' tendency to comply with biased advice were if advisees could make their decision in private or had an opportunity to change their mind. This suggests that cooling off periods for investment,

medical, or other important decisions, will be beneficial for advisees who hear about their advisor's conflict of interest directly from their advisor.

These findings show that people experience conflicting emotions when receiving disclosure of a conflict of interest from an advisor. Trust is central to advice-taking, yet compliance can occur in the absence of trust. Advisees are simultaneously aware that the advice is likely to be biased and trust it less, yet feel increased pressure to comply with the advice. Instead of a warning, disclosure can become a burdensome request to comply with advice that is trusted less.

<http://www.ethics.harvard.edu/lab/blog/251-the-burden-of-disclosure-what-you-do-know-can-hurt-you>

# The Banker Had No Face: Assessing Institutional vs. Managerial Responsibility in Mortgage Fraud Lawsuits

[Gregg Fields](#)

This original blog post by Lab Fellow [Gregg Fields](#) focuses on the absence of personal accountability in mortgage fraud cases.

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In journalism school, every student eventually learns about the “Five W’s.” It stands for Who, What, When, Where, Why. Then they’re taught about the H -- How.

It’s actually a useful framework for anyone conducting an investigation. But it’s apparently a methodology that isn’t embraced by government agencies allegedly digging into the root causes of the economic crisis.

A recent exhibit: [New York Attorney General Eric Schneiderman’s lawsuit](#) against affiliates of JPMorgan Chase. The civil complaint is about their role in massive losses investors suffered on residential mortgage backed securities, or RMBS.

A similar lawsuit was filed this week against Wells Fargo by Manhattan U.S. Attorney Preet Bharara.

The Schneiderman lawsuit, filed in early October, has garnered a fair amount of press, and some observers are even suggesting he may be laying the groundwork for an Eliot Spitzer-style assault on Wall Street.

The complaint has some rich details. There is the what -- the alleged rip-off of investors. There is the when, in that it occurred right before the Great Recession. Where is easy enough, in New York, of course. And the why is a no-brainer: Quick profits for the bankers, almost immediate losses for the investors.

The how includes details on how borrowers got mortgages they couldn’t possibly afford, and the loans were soon sold off to unsuspecting investors whose portfolios then sank.

## An incomplete picture

But if the complaint were an assignment for Journalism 101 it would have to be returned as an Incomplete. The reason: There is no “Who.” Schneiderman weaves a captivating tale that, in its best moments, conjures up comparisons with last year’s capsizing of the Concordia off the coast of Italy.

With one big difference. The Concordia had a captain, and we learned a lot about him -- not much of it complimentary -- in the weeks after that tragedy. In contrast, Schneiderman's lawsuit never says who was at the helm as securities marketed as investment grade ran aground and plunged underwater almost immediately.

The lack of suspects fits an increasingly popular legal strategy by regulators. Specifically, companies are often taken to task -- or at least, to court -- but not the managers who run them.

It may be true that at least in terms of free speech corporations are people. But this has nothing to do with the Citizens United decision. And it begs a perplexing question: Can a corporation be guilty of something when its management isn't?

Schneiderman sued under a New York state law, called the Martin Act, which actually doesn't require prosecutors to prove intent to commit fraud. So that might explain Schneiderman's strategy.

But the shortage of names is prevalent in federal actions, too, however. U.S. District Attorney Bharara's civil fraud lawsuit against Wells Fargo concerns allegedly shoddy handling of mortgages backed by the Federal Housing Administration. It cost the FHA hundreds of millions of dollars. Who did it? "Yet another bank has engaged in a longstanding and reckless pattern" Bharara said in a statement. Who, specifically? We can only speculate.

#### A bearish indicator

First, a couple of disclaimers. One, both banks have said they intend to fight the charges.

And certainly the case against JPMorgan Chase is something of a legal labyrinth. It may be the named defendant, but that's more by default than anything overt. The case Schneiderman is bringing focuses primarily on the actions of Bear Stearns & Co., which JPMorgan bought in 2008 in a marriage arranged, ironically, by the federal government. Its wedding gift was \$29 billion in assistance from the Federal Reserve Bank of New York.

At a Council on Foreign Relations event this week, JPMorgan CEO Jamie Dimon said his company has lost between \$5 billion and \$10 billion on the Bear Stearns deal. According to press reports, he made clear he didn't appreciate Schneiderman's lawsuit.

Another prime violator, according to Schneiderman, was EMC Mortgage Corp., a Bear Stearns subsidiary that bought mortgages for the parent and which JPMorgan now owns. (Schneiderman co-chairs a massive inter-agency group investigating the mortgage mess.)

The narrative in the complaint is sadly familiar to anyone who followed the mortgage meltdown. Bear Stearns was making a killing packaging home loans into securities that were then sold to investors. So Bear Stearns primed the pump, pushing lenders like EMC to approve risky mortgages, all the while touting them as sound quality.

We all know it didn't work out. And it's hard to fault Schneiderman for taking action. After all, New York's credibility as a reputable financial market is on the line. That's one of the most lucrative industries in his state.

### An empty lineup

But if the actions the lawsuits describe no longer are shocking, the complete absence of human defendants feels like a sucker punch. Consider this line from Schneiderman's complaint: "At all relevant times, defendants committed the acts, caused or directed others to commit the acts, or permitted others to commit the acts alleged in this complaint."

Fine. However, the defendants in this case are inanimate. They are legal entities. True, the lawsuit adds that it means "those acts were committed through their officers, directors, employees, agents and/or representatives."

Which begs the question: Who? Which individuals committed the acts? And if they were acting "within the actual or implied scope of their authority," then we need to know who gave -- or implied -- that authorization.

It would be less worrisome if Schneiderman's faceless predators were an anomaly in the current regulatory environment. But the truth is that Schneiderman's approach is increasingly the norm. In far too many regulatory actions, the thinking seems to be that train wrecks can't be blamed on conductors who ignored the signals, then took the wrong track.

### Size matters

There are a number of reasons why regulators would understandably prefer taking on companies rather than officers. For one thing, regulators are outgunned and underfunded. The organizations they oversee are much bigger than the agencies themselves. As one example, the Securities and Exchange Commission has about 3,800 employees. JPMorgan has a quarter of a million, give or take.

Then there's the mismatch in resources. In fiscal 2011, the SEC had a budget authority of about \$1.6 billion. JPMorgan's London Whale trader alone *lost* roughly four times that much, and Dimon, described it as a "tempest in a teapot." That's some teapot.

For regulators, the clear lesson is, if you're running low on fuel, look for shortcuts. And keeping legal actions simple is one way to reduce a lawsuit's travel time.

Secondly, financial institutions -- particularly of the too big to fail variety -- seem to take these actions, and their often considerable settlement amounts, as a simple cost of doing business. That's perfectly logical. The fines aren't designed to do real damage to their core business. And the odds are very good that the company will neither admit nor deny guilt as part of wrapping things up.

### The price we pay

It would be tempting to ask, "So who gets hurt?" And the answer is, all of us. Admittedly, the city on a hill analogy does get overused. But American exceptionalism is a fundamental value among a great many of this country's citizens, and even among a sizable slice of people who live in other lands. Central to this belief is the notion that we are a nation of law-abiders, governed by a system of laws.

What to make, then, of investigations that consistently produce smoking guns, but fail to find fingerprints? To have a corporation pay a fine shouldn't absolve any individual of

personal responsibility. Nor should it excuse regulators from performing their appointed duties. Banks are backed by the full faith of the U.S. government, and Americans need to have full faith that the regulatory process is rigorous and thorough. What happens when this confidence wanes?

If that sounds a tad too philosophical, consider the more practical consequences. The American standard of living is dependent on the economy's ability to attract capital. I have nothing against the Federal Reserve's QE1, 2 and 3. But the most effective form of economic stimulus is confidence. And people won't place their faith in a regulatory system that routinely produces heat but no light. It's a sham form of transparency that, frankly, is easy to see through.

To be sure, regulators do crack the whip on occasion. The Securities and Exchange Commission recently disclosed a laundry list of actions taken against players in the mortgage meltdown. Goldman Sachs, something of a poster boy, agreed to pay \$550 million and to reform its business practices.

Just this year alone, Bharara, the U.S. attorney in New York, has obtained settlements of \$158 million from CitiMortgage, \$202 million from Deutsche Bank and \$132.8 million from an organization called Flagstar.

And sometimes people -- real people -- pay the price. The former CEO of American Home Mortgage, Michael Strauss, [settled SEC charges](#) by paying a \$2.45 million fine and agreeing to a five-year ban on being an officer or a director. (Considering his company was defunct, one wonders how much demand there is for his services.)

But it's worth noting that Strauss earned over \$3 million in just 2006, and that a loan backed by his company's stock netted him a profit of more than \$2 million before it all collapsed, according to the original SEC charges. He is described as a resident of Southampton, N.Y., a burg not known for its mean streets. As part of his settlement, he neither admitted nor denied wrongdoing, according to the SEC.

Also on the SEC list is the now-notorious settlement with Citigroup. The SEC charged a Citigroup subsidiary with, in essence, betting against its own investors in a collateralized debt obligation, related to housing, that Citi was promoting.

#### The judgment call

Citi agreed to settle for \$285 million, without admitting or denying guilt. No senior officers were named, and a mid-level manager sued by the SEC was found not liable by a jury.

But [the settlement was thrown out](#) late last year by U.S. District Judge Jed Rakoff.

Rakoff's rejection is being appealed -- ironically, by both defendant Citi and plaintiff SEC -- and his action may yet be overturned. But a group of 19 legal scholars filed a [friend of the court brief](#) in support of Rakoff. Their reasoning: The SEC's perpetual policy of settling is an ineffective deterrent. "Citigroup and



Mr. Preet Bharara, US Attorney  
for the Southern District  
of New York

its affiliates have been enjoined from violating securities laws four times since 2000, yet have not been the subject of a contempt proceeding," the scholars said.

And in his eloquent opinion, Rakoff argued, simply yet forcefully, that the SEC hadn't met its legal, if not ethical, obligations.

"In much of the world, propaganda reigns and truth is confined to secretive, fearful whispers," Rakoff wrote. "Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the SEC, of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges."

As journalism students can tell you, it all starts with who.

<http://www.ethics.harvard.edu/lab/blog/252-the-banker-had-no-face-assessing-institutional-vs-managerial-responsibility-in-mortgage-fraud-lawsuits>

# No Charge: Why Regulatory Institutions Have Prosecuted So Few Bankers; and Why It Matters

[Gregg Fields](#)

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"In some cases there is a lack of law. In others, there are too few resources. And perhaps most significantly, this financial crisis, unlike its predecessors, comes after years of shuffling the regulatory deck, dealing the government a losing hand – so they fold."

They were icons of the industries they dominated.

Michael Milken of junk bond fame. Charlie Keating of the infamous Lincoln Savings. Enron gurus Andrew Fastow and Jeffrey Skilling.

Of course, they all have something else in common: each went to jail. They were incarcerated despite political connections that would be the envy of anyone on K Street. In the Senate, we had the famously faithful Keating Five. President George W. Bush was so chummy with Enron executives that he referred to its CEO, Ken Lay, as "Kenny Boy."

And of course, all could pay the most brilliant legal defense counsel imaginable. And perhaps they did. It didn't keep them out of prison. (Keating served four years before his original conviction was overturned; on the eve of a retrial he entered a plea agreement and was sentenced to time served. Lay died prior to his sentencing.) While the criminal cases against these financiers didn't restore the losses suffered by the victims, Americans could at least take comfort in knowing that justice does get served, even against the rich and powerful.

Which begs an obvious question: what has changed? The financial collapse that still haunts the U.S. economy dwarves anything since the Great Depression. There is ample evidence that certain actions warrant digging deeper. And of course, there is an implicit benefit to society when the rule of law prevails.

But so far the prosecutions related to the banking and housing collapses are of actors who, in the scheme of things, are mere bit players. A one-time mortgage executive, Lee Farkas, was convicted of fraud in 2011. But his firm, Taylor, Bean & Whitaker, was hardly a Wall Street kingpin. Angelo Mozilo, of mortgage giant Countrywide Financial, had a marquee name, and paid [a huge fine](#) to the Securities and Exchange Commission – a \$22.5 million penalty plus \$45 million in what the SEC called ill-gotten gains. But a grand jury criminal investigation of him [was later dropped](#).

## A new kind of crisis

A review of the record, and interviews with banking and legal experts, paints a picture of why, in terms of criminal accountability, it really is different this time -- and not, say critics,



in a good way. Specifically, there appear to be three very powerful forces at work, all of which mean individuals are less likely to be blamed, in either criminal or civil complaints, for financial malfeasance.

In some cases there is a lack of law. In others, there are too few resources. And perhaps most significantly, this financial crisis, unlike its predecessors, comes after years of shuffling the regulatory deck, dealing the government a losing hand – so they fold.



William Black, Associate Professor  
of Economics and Law, UMKC

“Banks fail for lots of reasons,” said William Black, an associate professor of economics and law at the University of Missouri-Kansas City. Among numerous regulatory positions, Black was formerly the litigation director of the old Federal Home Loan Bank Board. “When banks fail, it’s not necessarily a case of homicide. So you look. But they didn’t look.”

Experts say it’s simplistic to say that a major collapse is prima facie evidence of criminal culpability. For one thing, making bad investments, provided there is no fraud involved, likely falls under the so-called business judgment rule. That legal principle essentially immunizes officers and directors, provided they acted in good faith. It is considered a very high bar to overcome, and perhaps it is part of the reason why prosecutors are wary of going after individuals.

“This was more of a business cycle crisis,” said Ken Thomas, a Wharton lecturer in finance and independent banking analyst. “There were lots of bad decisions, but this was the Great Recession.”

Thomas, who has written extensively on banking regulations, said that over the years banking laws have grown more opaque, raising another legal hurdle. To give one example, there have been rampant allegations about questionable trading in derivatives. (At its simplest, a derivative is a contract that derives its value from something else. A classic case would be a “futures” contract, which allows someone to purchase, for instance, a barrel of oil at a set price on a certain date, regardless of market price on the delivery date. The goal, theoretically, is to hedge risks.)

The derivatives market has mushroomed in recent years, growing roughly seven-fold from an estimated \$80 trillion in notional value in 1998 to more than \$600 trillion today, according the Bank for International Settlements, which comprises the world’s leading central banks. (Notional value is the value of the assets involved; the actual worth of a derivative contract itself would be much less.)

But regulation often moves at a much slower pace than market innovation. And in any case, derivatives were effectively not regulated at all – a decision expressly supported by the Clinton administration in 2000, when the newly passed Commodity Futures Modernization Act removed “over the counter” derivatives, or those traded between private parties like banks, from regulation. The law led to a sharp increase in inter-bank trading in credit default swaps, or contracts that pay off loans that go bad. Credit default swaps were a major reason why the mortgage crisis soon spiraled out of control.

"The grey area has gotten very big," said Thomas. "Things you think would be convictable just are not. Things that were clear-cut black and white back in the S&L crisis no longer are."

### No time to lose

Another detectable dichotomy between the current crisis and previous ones is this: Washington was in a much weaker bargaining position this time precisely because of the scope of the collapse.

Consider that Milken's Drexel Burnham Lambert and its junk bond empire disappeared from the scene after pleading nolo contendere to government charges. Keating's Lincoln Savings was seized by regulators and then sold off. Hundreds of other S&Ls were put out of business as well.

Enron was forced into bankruptcy and was soon gone. So was its accounting firm, Arthur Andersen, which was convicted by a jury of obstruction of justice, for shredding Enron documents that the Justice Department was seeking. (Years later the conviction would be overturned by the U.S. Supreme Court, but it was too late to save the firm.)

By contrast, during this crisis, the federal government fought doggedly – at a cost of hundreds of billions of dollars – to save the institutions most publicly linked to the collapse. In the process, the federal backstop expanded from banking to insurance to seemingly unrelated industries, like auto manufacturing. "The S&L crisis was focused on one industry," said Thomas. "This one was across every economic sector."

### Regulation on a budget

The dearth of prosecutions may also be the simple result of too few resources.

In the late 1980s, during the S&L crisis, bipartisan support created the Financial Institutions Reform, Recovery and Enforcement Act, or FIRREA. (It passed the Senate 91-8 and the House by 320-97.) Among other things, it created the Resolution Trust Corp., a new agency charged with cleaning up the zombie thrifts that were headed for collapse. In other regulatory innovations, FIRREA deactivated the moribund Federal Home Loan Bank Board, and placed oversight of the industry under a newly created Office of Thrift Supervision (which has since been merged into the Office of the Comptroller of the Currency.)

Thanks to FIRREA funding, by early 1992 the Justice Department reported that it had charged roughly 1,000 people with S&L fraud, 30 percent of whom were officers, directors, or top executives. The conviction rate was over 90 percent, agency officials said at the time. However, the regulatory momentum underwent a fundamental shift in the 1990s, one that meant sharp cutbacks in government manpower, at least when it comes to financial regulation.

A case in point is the Federal Deposit Insurance Corp., which of course plays a major role in regulating banks. In 1990, just after FIRREA passed, the FDIC had 19,247 employees. By 1992, the agency's payrolls swelled to 22,459, partly because of RTC hires. But the numbers began a sharp contraction in the mid-1990s. By 2006, as dangerous lending practices were at their zenith, the FDIC was down to just 4,476 workers, or less than a fourth of the peak. As

the banking crisis grew, FDIC's employee count did rise, to 8,150 in 2010. But it has since fallen back to currently just 7,626, according to the latest [FDIC figures](#).

"When you have this kind of regulatory race to the bottom, you're not going to get the leaders," says Black.



Eric Holder, Attorney General of the United States

The FDIC is hardly alone. Under U.S. Attorney General Eric Holder, for example, the Department of Justice has been in a hiring freeze for nearly two years. According to a recent report on the front page of the [Financial Times](#), the DOJ is taking advantage of America's lawyer glut and using unemployed attorneys – who are working as unpaid prosecutors.

#### A strong defense

Money and people are always an issue with litigation, of course. But it is particularly nettlesome in this case, precisely because of the complexity of modern banking. The expertise to unravel what happened, and then trace it backward to individuals, is expensive. As with the Agatha Christie thriller, *Murder on the Orient Express*, the casualty is easy to see. Identifying the suspect takes an investigator as savvy as Hercule Poirot. "You have to be trained in spotting these types of fraud," said Black.

The resources are also scarce in the field. In fiscal 2008, when the financial crisis began, the Department of Justice's total budget allocations for U.S. Attorneys' offices nationwide was \$1.018 billion, according to data obtained by the Washington Post through a Freedom of Information Act request. In fiscal 2011, it was \$1.122 billion, for an increase of just 10 percent spread over three fiscal years. And that's for all U.S. Attorneys' activities.

Furthermore, the reality is that many potential criminal targets "had so much money, they could hire the best lawyers around," said Thomas. By contrast, a 2009 survey by the National Association of Assistant U.S. Attorneys found that the top salary for an assistant U.S. attorney was \$153,000 annually. Those without experience can earn as little as \$50,287, depending on location, according to the DOJ website.

#### A long-term decline

While there may be disagreements about the causes, what is clear is that white-collar prosecutions have tumbled, according to the Transactional Records Access Clearinghouse at Syracuse University. TRAC found that [white-collar crime prosecutions](#) for the first 10 months of fiscal 2012 are down 16.5 percent from the previous year. Although they are up a bit – 6.7 percent – from five years ago, they are 11.9 percent below from 10 years ago, and 18.6 percent from 20 years ago. The trend is even sharper with bank fraud prosecutions. They are down 17.2 percent in the last year, 29.6 percent over the last five years, and 55 percent from 10 years ago. They are off by 47 percent from 1992.

Amid the scarcity of resources, some regulators are combining forces. But the results have been mixed. The DOJ and 49 states, for instance, negotiated a \$25 billion settlement with five major mortgage lenders earlier this year. It was the largest multistate settlement since the Big Tobacco accord of 1998.

However, the states are not legally required to provide homeowner relief with their share of the settlement. According to a recent report by Enterprise Community Partners, a housing advocacy group, less than half the \$2.5 billion disbursed so far is going toward housing programs. A second multi-jurisdiction entity formed earlier this year was the Residential Mortgage- Backed Securities Working Group, a state-federal effort backed by the White House. The most public result so far is a civil suit by New York Attorney General Eric Schneiderman, co-chair of the group, against JPMorgan Chase.

But legal experts have noted that civil complaint primarily targets the activities of Bear Stearns. Ironically, JPMorgan actually purchased Bear Stearns with more than \$29 billion in assistance from the Federal Reserve Bank of New York. Furthermore, the complaint does not name any individuals. A similar civil lawsuit was filed recently against Bank of America by Preet Bharara, the U.S. attorney in Manhattan.

Looking ahead, other regulatory agencies with a role in future financial oversight say they are being starved. The Dodd-Frank Act of 2010, for instance, gave much of the responsibility for regulating derivatives to the Commodity Futures Trading Commission. Yet, the agency's budget has remained static despite its new responsibility. In fact, the CFTC's current \$205 million budget would be cut by \$25 million, if critics in the House have their way for fiscal 2013. The White House had asked for a CFTC funding increase, to just over \$300 million. (Fiscal 2013 started Oct. 1, but its budget has not been passed; the federal government is operating on stopgap measures that run through next March.)

One of the strongest supporters of trimming CFTC funding is Rep. Jack Kingston, a Georgia Republican and member of the powerful House appropriations committee. "Some members of Congress look at every issue as an opportunity to grow the government and hire more people," [Kingston said in June](#). "It's certainly not the path to economic recovery. It's also not the most effective way to ensure the integrity of the commodity, futures, and swaps markets."

But Gary Gensler, CFTC chairman, countered that its limited resources mean the agency cannot possibly interpret, and enforce, the Dodd-Frank Act, which runs some 2,000 pages long, without more resources. "The result of the House bill is to effectively put the interests of Wall Street ahead of those of the American public by significantly underfunding the agency Congress tasked to oversee derivatives – the same complex financial instruments that helped contribute to the most significant economic downturn since the Great Depression," said Gensler, himself a veteran of Goldman Sachs.

In a sports analogy, he likened the subcommittee's proposed cuts to multiplying the number of NFL games by eight, without hiring any additional referees. "Imagine the mayhem on the field, the resulting injuries to players, and the loss of confidence fans would have in the integrity of the game," he said.

What's certain, said Black, the UMKC professor, is that the current muddle means investigating possible financial crimes, and prosecuting when warranted, will be a rare occurrence. "Prosecuting these people is like getting to the top of Everest," Black said. "It's hard, but it's not impossible. But you need a guide."

<http://www.ethics.harvard.edu/lab/blog/254-no-charge>

# What Is Left Unsaid in This Campaign

[Daniel Weeks](#)

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Much has been said by politicians and the press in this campaign. In three presidential debates alone, we've heard the two contenders for our nation's highest office speak of tax cuts, deficits, jobs, and the middle class literally hundreds of times.

But much has also been left unsaid. In those same presidential debates, poverty was hardly featured and the word "inequality" didn't appear at all.

How can it be that the Holy Bible refers to helping the poor and vulnerable more than 2,000 times, yet two professing Christians running for president of the United States disregard this unholy scourge?

As we did not hear in the debates, nearly 50 million Americans are currently living in poverty – more than at any other time in our nation's history – and between a third and half of all Americans are within a few lost paychecks of the poverty line. When a quarter of all American jobs pay less than poverty line wages for a family of four, systemic poverty and inequality become more than abstract economics: they are moral and Constitutional concerns.



*New Orleans*

So they should be treated by the men and women who aspire to lead our country.

But the politics of modern elections do not favor the least of these God's children. Consider that one in 10 American adults – most of them poor and disproportionately people of color

– are legally barred from voting because of a past conviction. Or that those at the bottom of the economic ladder are seven times less likely to engage in politics than those at the top, largely because of legal and social barriers to political participation.

Consider, also, that a fraction of 1 percent of the population – those at the very top – contribute more than 80 percent of the billions of dollars that fund campaigns, and just five wealthy interests accounted for a majority of super PAC spending in this election.

Could it be because poor people are America's "second-class citizens?" Could it be because economic and political inequality are increasingly one and the same thing in a system where money is a necessary condition to seeking public office?

If our less fortunate neighbors in poverty had the chance to speak and be heard in this election, what would they say?

It was in hopes of hearing directly from some of these second-class citizens that I recently set off on a "[Poor \(in\) Democracy](#)" tour by Greyhound bus through the southern and eastern U.S., retracing the steps of *Democracy in America* author Alexis de Tocqueville on a poverty-line budget of \$16 per day.

I spoke to jobless youth in Boston and New York, immigrant vendors in Philadelphia, retired cooks and clerks in Pittsburgh, working poor janitors and social workers in Cincinnati, undocumented immigrants and activists in Memphis, former farm hands in Mississippi, hurricane homeless in New Orleans, grocery store stockers in Montgomery, park workers in North Carolina, and homeless people on Capital Hill in Washington, D.C.

They were male and female, black, white, and brown. They ranged from 23 to 65 years old and spoke English, Spanish, Haitian, and French. Some were ex-offenders, some were unemployed, some were on welfare, some were homeless, and too many were all of the above. All were below – or within easy reach of – the poverty line.



*Poverty in the land of Rosa Parks, Montgomery*

What did they have to say about poverty and our democracy? More than I could possibly do justice to here, but a few messages bear repeating in the final days of this election.

"How can I support my kids on eight bucks an hour when the company denies me benefits and cuts back my hours and my workload stays the same?" asked a janitor and mother of two in Cincinnati.

"How can our kids grow up to be equal citizens when so many are living in poverty and attending failing schools?" was the accompanying question from a single mother of four, who works full-time with people on welfare and depends on food stamps herself.

"I get in line at the temp agency at 5 a.m. but if I've worked the last three days they cut me off, say it's someone else's turn," was the lesson from a homeless mechanic in New Orleans, who once helped Coast Guard troops pull stranded neighbors off of rooftops during Hurricane Katrina. "I know I've made mistakes, but all I want is a job so I can get off the streets and pay my way."



*New Orleans, seven years after Katrina*

"Whatever happened to the land of second chances?" several people asked, referring to the loss of voting rights and other civil liberties – not to mention the black mark against future employment – that results from a single conviction in many states.

"Why do some Americans hate the poor – aren't we Americans too?" others asked, referring to laws in many southern states that make homelessness and panhandling illegal. Many related stories of being jailed for weeks at a time after asking pedestrians for spare change or sleeping outdoors in public view. "I've been on the housing list for the last 10 years."





*At home under the bridge in New Orleans*

To my question about who determines the course our country takes, there was but one universal refrain: "American politics is all about the money."

I do not recommend sleeping in bus stations, on park benches, in borrowed beds, or on the bus for those who can make the choice. But as long as millions of fellow citizens cannot, those in more privileged positions – especially our politicians – would do well to take to heart these unhappy facts of life. Perhaps then we might hear from the lips of our nation's leaders more than a passing reference to the scourge of poverty and political inequality in our time.

As Alexis de Tocqueville observed nearly 200 years ago, "America is great because America is good; if America ever ceases to be good, she will cease to be great."



*Home under Interstate 80 in New Orleans*

[Daniel Weeks](#), the past president of Americans for Campaign Reform, is conducting interviews around the country for a book on poverty and democracy through an [Edmond J. Safra Center for Ethics](#) fellowship at Harvard University. For more information, click [here](#).

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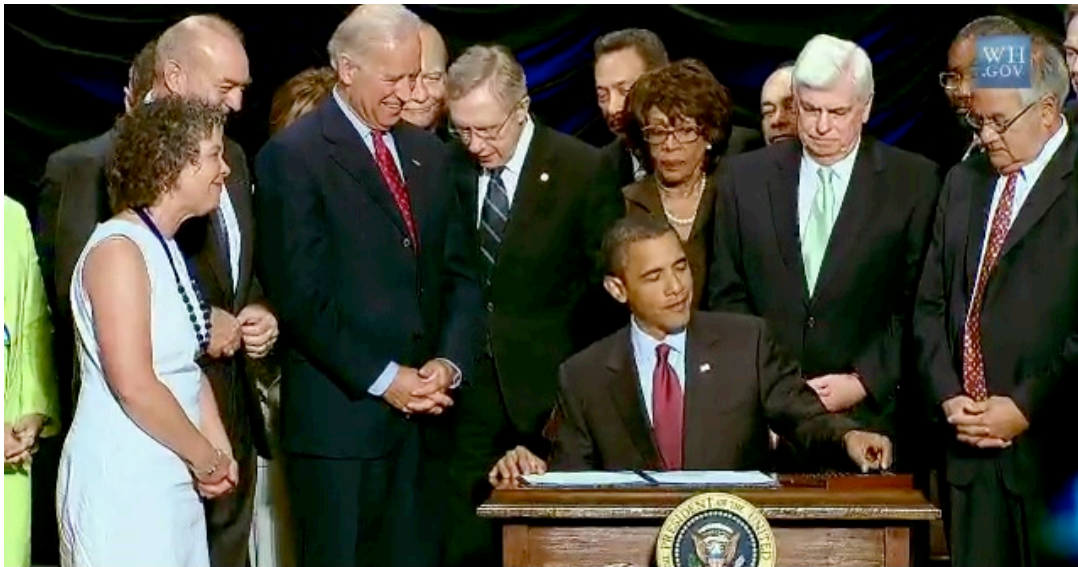
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# Reformers at Bay: Analyzing Institutional Failure in the Implementation of Dodd-Frank

[Gregg Fields](#)

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The re-election of President Obama and Congressional gains by the Democratic Party would theoretically provide momentum for the implementation of the Dodd-Frank Act.



Mitt Romney, after all, vowed during his campaign to repeal the financial reform law altogether. Though most pundits saw that as a long shot, clearly financial reform wouldn't have been a priority in a Romney administration.

Meanwhile, Dodd-Frank has a new high-profile advocate in the Senate: Elizabeth Warren, the Massachusetts Democrat. Warren created the Consumer Financial Protection Bureau, mandated by Dodd-Frank. It was at last summer's Democratic convention that Warren blasted "Wall Street CEOs—the same ones who wrecked our economy and destroyed millions of jobs." (It's safe to say they think the same of her.)

And of course, during second terms presidents begin thinking about their legacy. In that regard, the Dodd-Frank Wall Street Reform and Consumer Protection Act could be something of a legislative jewel in Obama's crown, along with the Affordable Care Act.

Nevertheless, the recent record suggests that Dodd-Frank faces a rough road ahead. It will pretty clearly remain the law of the land. But at 2,000 pages it is an extremely complicated one, covering everything from student loans to credit default swaps.

Financial industries and other business interests have already geared up to fight. And so far, they've done well in court.

But perhaps the most significant threat to implementing Dodd-Frank is, simply, institutional inertia by the agencies that should be taking the lead. Much of the financial regulatory infrastructure is facing stagnant budgets, declining headcounts and powerful Congressional critics. And a little-known law from the 1990s makes it much tougher for regulators to put new rules in force.

In that sense, the post-election question isn't whether Dodd-Frank will survive. Rather, it's whether it will make a difference. "Dodd-Frank was an unusual law, in that so many of the hard decisions were handed off, with deadlines," said James Overdahl, a former chief economist at both the Securities and Exchange Commission and the Commodity Futures Trading Commission. "More than a law, it's an instruction to regulatory agencies to develop law."

### Past As Prologue

When discussing Dodd-Frank, it helps to start with its historical significance. It is pretty clearly the most sweeping effort to restructure the nation's financial system since Franklin Roosevelt's New Deal. And that is perhaps fitting, since it addressed the biggest economic collapse since the Great Depression.

Furthermore, Dodd-Frank was created during a political alignment that is rare in Washington. Specifically, the Democrats controlled the House and the Senate for two years after Obama was elected. He signed Dodd-Frank into law just months before the Democrats were trounced in House races in 2010, producing a legislative gridlock that surely would doom the measure were it introduced today.

To be sure, Dodd-Frank has had some impact already. The Office of Thrift Supervision, which supervised institutions with savings and loan charters, has been merged into the Office of the Comptroller of the Currency, which is widely viewed as a stricter overseer.

And though Congressional opposition doomed Warren's expected nomination to run the CFPB, the agency itself is operational under its director, Richard Cordray.

But by most measures, Dodd-Frank needs to pick up the pace. According to [Davis Polk](#), a global law firm that has closely tracked Dodd-Frank progress, as of Nov. 1 a total of 237 rule-making deadlines have passed. But in 61 percent of those cases the deadlines weren't met. In 33 cases, rules haven't even been proposed.

Even when rules are adopted, they can face legal firefights – battles that regulators often lose. Under the Administrative Procedure Act, originally passed in 1946, federal courts generally have the right to review rules promulgated by federal agencies.

But more recent deregulation gives challengers to Dodd-Frank a greater chance of success. Specifically, a law passed in 1996 during the Clinton administration, called the National Securities Markets Improvement Act, requires that the SEC must consider the effect of any new rule on "efficiency, competition and capital formation."

That requirement has contributed to a string of courtroom losses for regulators, particularly the CFTC and the SEC.

There have been mutterings of judicial bias, particularly regarding the U.S. Court of Appeals of the D.C. Circuit. But that view was disputed in a recent Wall Street Journal op-ed piece, titled “Why Dodd-Frank Rules Keep Losing In Court,” by Eugene Scalia, a Washington attorney (and son of the Supreme Court justice). He has successfully sued the SEC four times.

“For the SEC and CFTC, this sort of litigation is relatively new,” he wrote. “Until recently, their rules were seldom challenged.” But increased judicial review is a good thing, he said, “given the important Dodd-Frank rule-makings that lie ahead.”

### Benched By The Bench

A recent court case illustrates the dynamics at work. The Securities Industry and Financial Markets Association (SIFMA) and the International Swaps and Derivatives Association sued the CFTC. They opposed a new rule, adopted after Dodd-Frank, limiting the size of positions that traders can take on 28 different commodities. The CFTC said its goal was to reduce risk and limit volatility.

In September of this year, Robert Wilkins, a judge for the U.S. District Court for the District of Columbia, granted the industry associations a summary judgment – vacating the rule and sending it back to the CFTC to develop a new one, if it chooses. Among other problems, “the CFTC’s error in this case was that it fundamentally misunderstood and failed to recognize the ambiguities in the statute,” the court’s opinion said, referring to Dodd-Frank.

Not surprisingly, the decision was praised by T. Timothy Ryan Jr., SIFMA’s CEO, while Gary Gensler, a former Goldman Sachs executive who now heads the CFTC, expressed his frustration.

“I believe it is critically important that these positions limits be established as Congress required,” Gensler said. The agency has indicated it may appeal.

This was, admittedly, just one rule and Gensler may yet find an approach that passes court muster. But it points to just how arduous the process of adopting Dodd-Frank is. And of course, going forward, the CFTC is in charge of regulating financial derivatives, the complex contracts that played such a central role in the 2008 banking collapse.

The U.S. Court of Appeals for the D.C. Circuit has also been tough on regulators. In one example, in 2010 the SEC adopted a so-called “proxy access rule.” Championed by SEC Chairman Mary Schapiro, the rule was adopted after Dodd-Frank and was designed to make it easier for dissident shareholders to get candidates elected to corporate boards.

But the U.S. Chamber of Commerce and the Business Roundtable sued. And in 2011 a three-judge panel of the U.S. Court of Appeals for the D.C. Circuit [threw the rule out](#).

“We agree with the petitioners and hold the Commission acted arbitrarily and capriciously” the appeals court ruling found.

Overdahl, the former SEC economist, said the ruling wasn't completely surprising. "The SEC has been on a short leash with the (appeals) court," he said.

### A Pause in Progress

Whether courtroom setbacks will have a chilling effect on future SEC rule-making is subject to speculation. But it's perhaps worth noting that in August Schapiro said the SEC wouldn't pursue toughening regulations for [money market mutual funds](#), such as requiring them to strengthen their cash reserves. There were debilitating runs on money market funds in 2008 at the height of the financial panic.

It isn't clear where that issue will go from here. This week, the Financial Stability Oversight Council, or FSOC, created by Dodd-Frank and comprising the top federal financial regulators, met and pledged to continue pushing for stricter money market fund rules.

What's clear is that more courtroom battles are certain.

Recently, CME Group, which owns the Chicago Mercantile Exchange, sued in U.S. District Court in Washington to block a new CFTC rule that would require greater disclosure of "swaps" transactions, a form of financial derivative. The CFTC hasn't replied to the filing yet.

Ultimately, some experts say implementing Dodd-Frank boils down to a simple question: Who will pay for it?

"While much progress has been made, U.S. regulators are operating with limited resources to implement reforms that apply to very complex markets and institutions and are essential for the national economic interest," the FSOC said in its 2012 annual report.

It added: "Ultimately, for these reforms to be successful, regulators must have the necessary resources to undertake their policymaking, supervisory and enforcement responsibilities."

<http://www.ethics.harvard.edu/lab/blog/256-reformers-at-bay>

# Demythologizing Corrupted Facts and Claims by Big Pharma

[Donald W. Light](#)

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A few months ago, I co-authored with Dr. Joel Lexchin an article in the British Medical Journal showing that only about 10 percent of new drug products fit the industry's claim to develop clinically superior drugs to make patients healthier.<sup>1</sup> About 90 percent of the time, companies use patent protection from normal price competition for monopoly pricing to develop minor variations rather than serious innovations. This constitutes a hidden business model they do not discuss.

Responses from leaders of the industry reflect the institutional corruption of facts, figures, and accounts, an important part of institutional corruption that would be good to develop further. In particular, the heads of first the British and now the European pharmaceutical trade associations, who use staff and paid journalists and science writers to manufacture a large portion of the articles in the general and science press, published on the BMJ website "facts" about how much they spend on research that are not supported by independent sources. Joel and I have just published the following response.<sup>2</sup> Besides the mythic size of investments in research and development, the most important point concerns the lack of testing and caution about the serious side effects of new drugs. About 1 in every 5 new drugs (and 1 in 3 biologicals) cause enough serious harm to result in regulators adding their most severe warning or in being withdrawn from patient use altogether.<sup>3</sup>

Public and professional trust in the pharmaceutical industry is low, and the responses here show why. [A recent study](#) of doctors' (dis)trust of the pharmaceutical industry funded by the Edmond J. Safra Center for Ethics at Harvard University found that they trust even well-designed trials less if sponsored by the industry.<sup>4</sup> Stephen Whitehead, one of the respondents and the Chief Executive for the Association of the British Pharmaceutical Industry, wrote as if our data-based analysis was just a one-sided polemic and therefore he did not challenge our facts, while he offered one of his own: companies invest one third of sales in R&D. We challenged him to verify such a staggeringly high amount, but he has not done so. Instead, he wrote to discredit our "lack of understanding" and reported the industry invested one third of profits, a much smaller amount. Another tall tale cut down to size. He cited the ONS 2010 *Business Enterprise Research and Development Report* for exact figure of 34.3%.

Once again, we cannot trust Mr. Whitehead to check his facts. That Report contains no such figure that we can find, and in reply to an inquiry, Mr. Jim Nicholls, an officer at the Office of National Statistics wrote to say that "Unfortunately, we do not collect/publish sales or profit figures..." So even the cut-down claim of R&D investment has no basis in the ONS R&D report. We then searched the ABPI (the pharmaceutical trade association that Mr. Whitehead runs) for the missing figures on sales and profits but found none. We called, and a nice lady said someone would call back, but no one has. We emailed too, but no reply.

Who knows what trustworthy, verified facts would show to be the pharmaceutical industry's investment in R&D?

Now a more nuanced and thoughtful response has come from a senior team from the European Federation of Pharmaceutical Industries and Associations, led by Richard Bergström, but there are more inaccuracies. We thank Richard Bergström for his comments but we also take issue with much of what he has to say. First, we need to be clear that the ending of the Norwegian "medical need clause" in 1996 had nothing to do with predictions about the future value of new drugs being "unfeasible." The Norwegian model was abandoned because Norway harmonized its drug regulatory system with that of the European Union and the EU that did not have a medical need clause.

Second, we reject the claim that predictions are not possible. While occasionally some drugs prove to be more valuable than initially thought,<sup>5</sup> in general most new drugs provide little to no new therapeutic value. As documented in our article, an independent detailed assessment of the postmarket value of all new products (and new indications for existing products) over the last decade found only 76 out of 991 (7.7%) new products and indications offered any significant therapeutic gain.<sup>6</sup> Mr. Bergström continues the industry myth that equates innovation with a new molecular entity (NME), when most are not therapeutic advances.

Third, if as Mr. Bergström says, new drugs cannot be adequately evaluated until they are in clinical use in the real world, why then do drug companies spend hundreds of millions of dollars promoting the early adoption of these new products rather than waiting to see how valuable they actually are? Why do drug companies persist in running clinical trials on highly selective patient groups rather than testing them in a more real world environment?<sup>7</sup>

Finally, many drug candidates "fail to survive" clinical trial testing because companies withdraw them for economic reasons (43%) rather than for reasons of efficacy (31%) and safety (21%).<sup>8</sup> Even then, most clinical trial results do not show that the products being tested are outright failures but yield mixed results that lead companies to discontinue their development. The word "failure" is part of pharmaceutical mythology and should be replaced by the more accurate word, "withdrawal."

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<http://www.ethics.harvard.edu/lab/blog/259-demythologizing-corrupted-facts-and-claims-by-big-pharma>





# Studying the Everyday Lives of Professional Federal Lobbyists

[Maggie McKinley](#)

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One of the primary research areas addressed by the Edmond J. Safra Lab's project on Institutional Corruption focuses on how the loss of public trust in an institution caused by a belief that the institution is corrupt serves to weaken the functioning of that institution.<sup>1</sup>

The focus of the Lab is incredibly timely, as recent Gallup polls have found that public trust in many of our nation's most fundamental institutions—including “the medical system” and “public schools”—has been declining steadily.<sup>2</sup> My [cohort of Fellows](#) study this loss of trust in a broad range of contexts: from medical research to academic research to the various professions.

The loss in public trust, however, has been nowhere more marked than in the institution of Congress; an institution that, for the last three years, Gallup has ranked dead last for public trust out of sixteen institutions—behind banks, big business, and HMOs.<sup>3</sup> In a July 2012 survey, Americans ranked reduction in government corruption as the number two issue for the next president to prioritize in 2013—ahead of lowering the budget deficit and confronting terrorism.<sup>4</sup> This growing concern over corruption and increased loss of public trust has paralleled a heightened public fervor over the engagement of lobbyists in the legislative process. Not only do lobbyists rank lower than lawyers and used-car salesmen in honesty and ethical standards,<sup>5</sup> seven out of ten Americans feel strongly that lobbyists have too much power—topping the list over major corporations, banks, and the federal government.<sup>6</sup> Given the dependence of this institution on public support and participation in order to function, this severe of a negative public perception, even a perception based on misconception or stereotype, will doubtless have real consequences for the institution over time.

However, despite this fervent and resolute public outcry deploring the corruption of our federal government as aided and abetted by “lobbyists,” two years ago when I began to develop a research study around this question, I encountered a puzzle: there exists little to no empirical data on the everyday practices of federal lobbyists—professional or otherwise—and no ethnographic research on the everyday lives and community composition of this profession.<sup>7</sup> Moreover, there appeared to be a broad and unexplored assumption in the general public, as well as in the academy, that the definition of who was a “lobbyist” excluded professionals who advocated on behalf of progressive causes—even those registered as lobbyists—and did not include amateur citizen advocacy.

For instance, the term “lobbyist” is readily deployed to describe the Abramoffs of the world, but many are shocked to learn that some of the first federal lobbyists were in fact Quakers—who, on the first day of our newly-minted Congress, set up offices in a hotel across the street from Congress Hall in Philadelphia in order to lobby for the abolishment of slavery.<sup>8</sup> It is equally a surprise that the community of lobbyists includes great historical figures such as

Dorothy Detzer—a twenty year peace advocate whom *The New York Times* called “the Most Famous Woman Lobbyist”<sup>9</sup>—and modern-day heroes like Chai Feldblum who led ACLU efforts to draft and pass the Americans with Disabilities Act.<sup>10</sup> Further, discussions of the so-called “revolving door” focus on for-profit representation and neglect the possible added value of cause lawyers moving between state employment and the causes that they serve.<sup>11</sup>

Belying this definitional ambiguity, is the fact that the term has steep professional consequences for anyone branded as a lobbyist—including heavy disclosure requirements, ethics restrictions, formal and informal limitations on future employment, and strong social stigma.<sup>12</sup> Further belying this ambiguity, is the simple fact that the public appears to stigmatize and distrust something that no one has documented in a rigorous enough fashion to afford an informed opinion on the subject.

From this puzzle the Language of Lobbying Project was born. I designed the study to employ mixed-methods in order to capture what day-to-day life looks like over the course of a calendar year, a session, and a congress for folks employed as professional lobbyists in D.C. In particular, the study replicates—in modified form—the methods of my most recent research institution, the UCLA Alfred P. Sloan Foundation Center on the Everyday Lives of Families—an interdisciplinary center designed to allow researchers from a broad range of disciplines to work off of the same data set—and combines for each participant: questionnaires, in-depth semi-structured interviews, activity and spatial tracking, and audio-recorded periods of ethnographic observation over the course of a series of work days and professional activities identified as typical by the participant.<sup>13</sup>

In addition, the study draws upon the field of language socialization developed by Linguistic Anthropologist Elinor Ochs, to incorporate the observation and documentation of a clinical setting where students are trained as professional legislative advocates both in the context of a seminar and through practical work on behalf of real clients.<sup>14</sup> The language socialization component of the study is intended to capture those moments when the ideology and practices of the community are laid bare in the course of teaching and correction, and to document how lobbyists are socialized to language and through language to become competent members of the community and profession of federal lobbyists in D.C. All too often, once we become competent at an area of expertise, it is challenging to articulate what it is we are doing and why; studying a practice in the context where an individual with expertise within the field of legislative advocacy is instructing a more junior member of the community as to the proper procedures of the profession allows for fuller documentation of ideal practices and their motivating ethics, worldviews, and ideologies.

Finally, once the study was underway this fall, I decided to open participation to a series of short semi-structured interviews with lobbyists who fit a broad range of professional types within the community—e.g., a range of substantive disciplines, in-house legislative affairs, consultants, trade association representatives, multiple political parties, and various types of clientele. I designed these interviews to glean a topology of the community and to refine the study to capture all of the relevant contextual information for each participant in order to situate them within this community.

Data collection began two short months ago, and will be underway until mid-August of 2013, with intermittent follow-up research continuing until the end of the 113<sup>th</sup> Congress. What this means for my everyday life is that I spend my days observing and recording moments of legislative advocacy in a broad range of settings—from coalition gatherings to

pitches on the Hill to meetings with clients and third-party vendors—as well as conducting in-depth interviews with professional lobbyists on their ideal strategies, the composition of their community, and their views on the profession.

Although this study is still in its most nascent stages, I have already begun to draw the contours of the community and the profession, including documenting novel distinctions that could prove important in designing future research. One such example is the distinction of “access lobbying”—a term which draws fewer than ten relevant hits on Google, yet is ubiquitous throughout the lobbying community—from “substantive or issue lobbying.” As described by my participants, the everyday practices of an individual lobbyist or lobbying firm will vary based on whether the lobbyist or firm focuses on providing the service of “access”—namely, securing meetings with the right congressional actors—as opposed to providing the service of substantive policy research, drafting, and intelligence. While the distinction between “access lobbying” and “substantive lobbying” is more of a spectrum than a strict dichotomy—with most lobbyists and firms providing some level of access and some level of substantive service—it follows that any study that does not account for this distinction could end up with skewed findings from a sample that draws too heavily from only one side of the spectrum. These are the types of distinctions that the Language of Lobbying Project is designed to document.

From the culmination of these methodologies, the study seeks to capture what it is that lobbyists do every day and to describe in a rigorous and neutral fashion these practices to the academy, as well as the general public. In particular, it is my hope that greater public awareness of the techniques of legislative engagement and the broad range of professionals in the lobbying community—including advocates who lobby on behalf of the disempowered and voiceless, as well as those who advocate for the health of business and markets—might help to dispel stereotypes and to provide a deeper understanding of the distrust and stigmatization of this profession, legislative engagement more generally, and the damage done to the democratic institution most vulnerable to lack of public participation eroded by a loss of public trust—our Congress.

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<sup>2</sup> Jeffrey M. Jones, *Confidence in U.S. Public Schools at a New Low*, GALLUP POLITICS (June 20, 2012), <http://www.gallup.com/poll/155258/confidence-public-schools-new-low.aspx>.

<sup>3</sup> *Id.*

<sup>4</sup> Jeffrey M. Jones, *Americans Want Next President to Prioritize Jobs, Corruption*, GALLUP POLITICS (July 30, 2012), <http://www.gallup.com/poll/156347/americans-next-president-prioritize-jobs-corruption.aspx>.

<sup>5</sup> Jeffrey M. Jones, *Record 64% Rate Honesty, Ethics of Members of Congress Low*, GALLUP POLITICS (Dec. 12, 2011), <http://www.gallup.com/poll/151460/record-rate-honesty-ethics-members-congress-low.aspx>.

<sup>6</sup> Lydia Saad, *Americans Decry Power of Lobbyists, Corporations, Banks, Feds*, Gallup Politics (Apr. 12, 2011), <http://www.gallup.com/poll/147026/americans-decry-power-lobbyists-corporations-banks-feds.aspx>.

<sup>7</sup> There are, of course, notable and valuable studies utilizing interview methodologies to document lobbying influence and tactics. See, e.g., FRANK R. BAUMGARTNER ET AL., *LOBBYING AND POLICY CHANGE: WHO WINS, WHO LOSES, AND WHY* 1 (2009); ANTHONY J. NOWNES, *TOTAL LOBBYING: WHAT LOBBYISTS WANT (AND HOW THEY TRY TO GET IT)* 1 (2006). However, no study to date has utilized mixed-methods to document the language, culture, community, and everyday practice of federal lobbyists.

<sup>8</sup> KENNETH R. BOWLING, *THE HOUSE & SENATE IN 1790S: PETITIONING, LOBBYING, & INSTITUTIONAL DEVELOPMENT* 64-67 (2002).

<sup>9</sup> See DOROTHY DETZER, APPOINTMENT ON THE HILL 1 (1948).

<sup>10</sup> See Chai Feldblum, *The Art of Legislative Lawyering and the Six Circles Theory of Advocacy*, 35 MCGEORGE L. REV. 785 (2003).

<sup>11</sup> Doug NeJaime, *Cause Lawyers Inside the State*, 81 FORDHAM LAW REVIEW (forthcoming 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2152501](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2152501).

<sup>12</sup> Eric Lichtblau, *Tired of "Tainted" Image, Lobbyists Try Makeover*, N.Y. TIMES, May 3, 2012, at A17.

<sup>13</sup> See, e.g., Ochs, et al., *Video Ethnography and Ethnoarchaeological Tracking*, in THE WORK AND FAMILY HANDBOOK 387-410 (M. Pitt Catsoupes, et al., eds. 2006).

<sup>14</sup> See, e.g., Elinor Ochs, CULTURE AND LANGUAGE DEVELOPMENT: LANGUAGE ACQUISITION AND LANGUAGE SOCIALIZATION IN A SAMOAN VILLAGE 1 (1988).

<http://www.ethics.harvard.edu/lab/blog/261-studying-the-everyday-lives-of-professional-federal-lobbyists>

# From Institutional Corruption to Pharmageddon?

[Donald W. Light](#)

In the December issue of [Health Affairs](#), the leading US policy journal, Don Light reviews the new book by David Healy, *Pharmageddon*.

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As a practicing psychiatrist and leading authority on pharmaceutical policy, Healy has published several books on how the dependency of researchers, regulators, and physicians on pharmaceutical funding has distorted diagnosis, drug development and treatment. (See for example *The Antidepressant Era*. Harvard University Press, 1997)

Light considers Healy's book as "the most powerful and deeply thought of a new crop of books on pharmaceuticals and medicine." For example, Healy describes how pharmaceutical companies co-opted randomized clinical trials that promised to make drug development more scientific. His account of how Abbott transformed the rare condition of manic depression (MD) into "bipolar disorder" that is alleged to affect 5,000 times more people per million is worth the price of admission. He gives specific examples of how companies have hid harmful side effects from view. He shows how the FDA's decision to make many more drugs "by prescription only" has distorted the physician's role and turned most physicians into marketing agents. Good researchers and clinicians end up doing bad things to patients. The patient-centered medicine that Healy used to practice is hardly possible now. The review is available through [pharmamyths.net](#). Here is the review:

Medicine in the Thrall of the Culture of Drugs

Donald W. Light

*Pharmageddon* by David Healy. Berkeley (CA): University of California Press 2012 302pp; \$39.95

Review in *Health Affairs*. December 2012; 31 (12) 2826-28

"Medicine as we know it is at death's door," David Healy writes part way through *Pharmageddon*. It is a central theme running through the book by this professor and psychiatrist, working within the National Health Service in North Wales, United Kingdom. The practice of medicine should, he believes, require knowing patients as whole persons, preferably over many years. Instead, he says, medicine is becoming fractured, evolving into a series of problem-based short office visits that make use of guidelines to make medical decisions. Pharmaceutical giants play a huge role in this shift, having moved far beyond discovering new drugs to trying to shape how patients are diagnosed and treated.

Healy's view that pharmaceutical companies are overly influencing medicine comes as no surprise, as the author is one of the world's most widely published critics of pharmaceutical hegemony. (The same view has preoccupied my own work in bioethics and health policy.) In *Pharmageddon*, Healy makes full use of Welsh storytelling skills to weave the tale of how the pharmaceutical giants have come to shape patients' personal relationships with their bodies and with their physicians. Citing many studies by others as well as recounting his own experiences, Healy educates readers about the ways in which major pharmaceutical companies have influenced diagnostic categories and clinical guidelines so that physicians – and millions more patients – believe in certain disorders or in new “at-risk” situations that require the use of a drug.<sup>1</sup> In my view, Healy's book is the most powerful and deeply thought of a new crop of books on pharmaceuticals and medicine.<sup>2-4</sup>

One of Healy's case studies of how pharmaceutical companies have conjured up new diagnoses concerns manic depression. Up until the 1990s, the condition, as then diagnosed, was a rare one that affected only ten people in a million. Healy describes the reengineering marketing campaign by Abbott Laboratories to replace the term “manic depression” with the existing phrase “bipolar disorder,” which according to Abbott, affects up to 50,000 people per million. Disease awareness campaigns followed, suggesting that bipolar disorder might be the cause of other problems as well, such as anxiety and depression, and inviting people to self-diagnose.

Marketing achieved the ultimate success: Bipolar became a fashionable disorder. Healy describes how marketers organized conferences to develop guidelines for diagnosing the disorder, ones with a strong basis in clinical trials run by pharmaceutical companies to prove the benefits that suited their marketing goals. In ten short years, what had been for decades a rare disorder treated by specialists became a broadly constructed mental condition without, Healy contends, solid evidence either that the condition existed or that the drugs prescribed for it were effective.

Healy details several other examples and emphasizes the downside risks. Prescription drugs have become a leading cause of illness, hospitalization and death.<sup>2</sup> Abbott is at it again now, promoting medication to help with “low T” – lowered testosterone – which, of course affects any middle-aged man who is ten years older than he was a decade earlier (<http://www.isitlowt.com>).

Before the 1970s, Healy contends, researchers in major pharmaceutical companies carried out in-depth, observational investigations, just as their academic counterparts did, on how diseases worked and what compounds might have the right mechanism of action. Spectacular discoveries, major clinical advances, and huge profits resulted. Then a new generation of company executives bent on selling more drugs for still more profits changed to having research programs develop new products around clinical targets identified by marketing departments.

Healy contends that the number of breakthrough compounds dropped dramatically. Since then, about fifty out of every sixty “new drugs” marketed have offered few or no advantages over previous ones to offset their risks of harm.<sup>5</sup> Today, Healy contends, the Food and Drug Administration in the United States and the European Medicines Agency, the overarching regulatory agency for twenty-seven nations in the European Union, approve drugs without real evidence that they are better for patients, and they might be worse.

In the United States in the early 1960s, reformers thought requiring randomized clinical trials would lead to superior new drugs. Using case illustrations, however, Healy describes how pharmaceutical companies shape randomized clinical trials to get the results they need for marketing. As a result, physicians who believe that randomized clinical trials mean that new drugs have proven benefits – and could be prescribed with confidence – are being misled. In a quartet of chapters, Healy describes how the big pharmaceutical companies make marginally different drugs look better than they are.

First, giant pharmaceutical companies do their random sampling for clinical trials from patient populations that exclude those most likely to experience adverse reactions. They also lower the threshold for demonstrating that a new product is better than an inert substance by eliminating subjects who have a strong response to a placebo. Companies use high doses and short trials to maximize evidence of benefit, even though higher doses are more likely to produce harmful side effects weeks after data collection ends. These high, more dangerous dosages then go into the drug's label and into clinical guidelines.

Physicians are impressed by large trials, but companies do them primarily to prove that small benefits are statistically significant. It is not that the Food and Drug Administration is complicit in this. Rather, the agency works within rules and practices that have been set up with a good deal of influence from the pharmaceutical companies and lobbyists.

Second, pharmaceutical companies have repeatedly hidden, denied, or trivialized harmful side effects. Healy has some harrowing examples based on his own experiences as an expert on psychotropic drugs. He was among the first to note that Paxil increased suicidal thoughts in young patients, and he recounts how he began investigations revealing that clinical trials showing high rates of suicide were hidden by GlaxoSmithKline, the maker of the drug, including miscoding suicidal children as “noncompliant.” Healy describes his critical role in the lawsuit by Eliot Spitzer, then attorney general of New York, against GlaxoSmithKline for “fraudulent interference with the practice of medicine.”

Third, pharmaceutical companies have long kept academic investigators under contract to prevent them from publishing negative results so that prescribing physicians could get a full picture of harms as well as benefits.<sup>6</sup> Healy describes how, since the 1980s, companies have retained teams of skilled scribe writers and editors to craft articles for medical journals. He estimates that 90 percent of the articles on new drugs in medical journals are ghost managed, and other independent investigators agree.

In his twenty-seven pages of references to supporting studies, Healy cites recent studies that document how the published medical knowledge read and trusted by doctors is seriously biased.<sup>7</sup> Correcting biased medical science takes years, while billions of dollars are racked up by pharmaceutical companies in the meantime. These actions reflect not conspiracy but rational economic behavior by executives who are seeking good returns on their investments.

There you have it: trivial but “significant” benefits from drugs; undertested and underreported risks of harm; ghost-managed articles, reviews, and editorials; and \$57 billion spent on marketing to get doctors to prescribe the resulting drugs.<sup>8</sup> The weight of the evidence leads Healy to recommend that patients would be better off if fewer drugs required prescriptions. Of course, ads would endlessly tell patients why they needed to take a certain drug, but then they do already. However, patients might be more self-protective instead of



uncritically trusting their physicians and basking in the benefits of the placebo effect.<sup>9</sup> And the role of physicians would change from using their expertise and authority to prescribe to looking out for harmful side effects from the drugs that their patients decided to take.

Today medical leaders think having evidence-based medicine will rationally rein in costs, but Healy writes that the giant pharmaceutical companies know better because they control how the evidence is constructed and gets into guidelines. Pharmaceutical companies “are prepared to conceal trials or adverse events that might pose problems for their marketing, ghostwrite such trials as are published, and aggressively counter attempts to doctors to describe problems that arise in the course of therapy.” Furthermore, physicians are known to report only a small fraction of harmful side effects once drugs come into broad use, compromising the evidence that could be built up in post-marketing drug surveillance.

Healy sees tragic results for society and the economy. More workers think they are “sick.” Long use of drugs for prevention or chronic management heightens people’s anxieties and alters their bodies or minds in ways not sufficiently understood. “Treating raised cholesterol levels and other ‘number disorders’ . . . when medical necessity doesn’t call for it is more likely to lead to a decrease in American productivity . . . an expense that is crippling American industry,” Healy asserts.

In *Pharmageddon*, Healy offers a fresh insight that new strategies to develop “personalized medicine” and raise costs to new levels (for instance, by figuring out ways to re-patent drugs going off patent) are undermining universal health care in Europe and elsewhere, often with little evidence of real clinical gain. For the most part, he writes, looking for cures is out for pharmaceutical companies because that would end sales. Researching and developing drugs for cancers, and HIV/AIDS are largely paid for by taxpayers and donor foundations for specific diseases but then priced at levels that threaten the commitment of nations to affordable universal health care. Increasingly, countries and insurance companies conclude that the modest benefits do not warrant the staggering prices charged and decide not to cover them for patients. However, this leads to two-tier access for patients willing to pay privately.

If people want to understand how the way they think about their bodies as a bundle of risks to be managed by drugs came about, why the workforce is getting “sicker,” why the major pharmaceutical companies are banking on further overdiagnosis and overtreatment, and why this is undermining universal health care, they should read this book.<sup>4,10</sup> Then, readers should go on to discuss its implications in classrooms and policy circles.

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<http://www.ethics.harvard.edu/lab/blog/262-from-institutional-corruption-to-pharmageddon>

# Good Reasons Why Physicians Should Not “Believe the Data”

[Donald W. Light](#)

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In September, *The New England Journal of Medicine* published [an important study](#) funded by the Edmond J. Safra Center for Ethics that measured the loss of trust in medical science as an institution that should be dedicated to trustworthy research for treatments that restore or maintain patients’ health.

Specifically, 503 board-certified internists were shown abstracts of hypothetical clinical trials allegedly funded by industry or by the NIH. Respondents said they distrusted reports of trials funded by pharmaceutical companies significantly more than those funded by NIH, even if well-designed.<sup>1</sup> They “were half as willing to prescribe drugs” tested by industry.

[This study](#) highlights the depth of distrust that has arisen from years of evidence that researchers and authors, who must constantly raise funds for their work from the pharmaceutical industry, have repeatedly run biased clinical trials, then slanted the analysis of trial data in favor of the sponsor’s drug, and then further biased how the results are written up in what becomes published medical science. Several current or recent fellows at the Center are studying institutional corruption in pharmaceuticals, including Pavel Atanasov, Lisa Cosgrove, Carl Elliott, Marc-Andre Gagnon, Adriane Gelpi, Alison Hwong, myself, Jonathan Marks, Jennifer Miller, Genevieve Pham-Kanter, Marc Rodwin, Susannah Rose (a co-author of the NEJM article), Mildred Schwartz, Sergio Sismondo, and Robert Whitaker.

Dependency corruption arises when an institution such as medicine, which is dedicated to getting and keeping patients as healthy as possible, has its mission corrupted or distorted by those involved having to seek funds from companies primarily dedicated to maximizing profits for shareholders and executives.<sup>2</sup> Researchers dependent on corporations eager for drug approval and widespread use have distorted both the trials and their write-up in abstracts and journal articles. These become the medical knowledge that doctors use to prescribe, certified as trustworthy by reviewers and editors of top medical journals. Thus the corruption of medical science has come to threaten the trustworthiness of top journals, and editors have fought back for over a decade to minimize the opportunities for biased articles and the distrust it has engendered. Such distrust is hard to overcome, except by structural changes that remove dependency corruption itself.

In response to the article, Jeffrey Drazen, the Editor-in-Chief of *The New England Journal of Medicine*, wrote an editorial to urge that physician readers “Believe the Data.”<sup>3</sup> The issue never was the data, which physicians and even most reviewers never see, but the ways in the data gets written up in biased articles that get through reviewers and editors to be published in top journals.

Drazen starts by expressing concern about the general distrust found by the study, because new drug development so greatly relies on industry funding and the altruism of patient participants. He claims that “this lack of trust” depends on negative press stories and cites five that were about other manifestations of institutional corruption, such as concealing trial results, trying to suppress unfavorable publication, and misleading promotion of drugs. Ironically, Drazen concludes with examples of ways in which *The New England Journal of Medicine* is continuing its multi-year efforts to protect its scientific integrity and trustworthiness from incomplete or biased research articles.

In response to this editorial, I wrote the following [short letter](#), now published, that could cite only a few of the many systematic studies documenting good reasons for distrusting articles by industry-sponsored authors in medical journals. As concerned physicians have said, medical knowledge and medical science have become corrupted in ways that take years to find out and correct, if ever. Here is the letter:

“Dr. Drazen’s editorial,<sup>3</sup> invoking physicians to believe articles based on well-designed trials that are company-sponsored, misrepresents the source of physicians’ distrust as “press coverage of a few examples... “ Systematic studies show that such articles are three to four times more likely to favor a company’s product than independently sponsored articles.<sup>4,5</sup> The editorial also equates NIH researchers’ interests in promotion and recognition to the interests of multi-billion dollar corporations that shape trial design, execution, data collection, coding, statistical analysis, decisions about which negative results or trials not to include, analysis in an article, abstract, and conclusions, often ghost-managed by one of the 182 publication-planning companies that shape, edit, and write articles for top medical journals.<sup>5,6,7</sup> Unfortunately, studies of sponsorship support physicians’ distrust of published articles based on trial data of drugs.”

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# What Can \$6 Billion Buy?

[Clayton D. Peoples](#)

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In 2003, Ansolabehere and colleagues wrote an article on campaign finance that appeared in *Journal of Economic Perspectives* and received considerable press. It was titled, [“Why is There so Little Money in U.S. Politics?”](#)

How times have changed. The *Citizens United* decision has ushered in a whole new era of campaign spending that reached record heights in the 2012 elections. Federal candidates raised and spent more than \$6 billion. An article written today might be better titled, “Why is There so Much Money in U.S. Politics?”

Why is there so much money in U.S. politics? Probably the simplest answer is that money influences policy. Although the scholarly literature on contribution influence is mixed--likely due in part to the fact that most studies look at only a few bills--recent meta-analyses of the literature show that contributions have a significant effect on legislation (Stratmann 2003; Roscoe and Jenkins 2005). Moreover, my own research on 1,000s of bills over more than a decade shows that contributors have a consistent influence on legislative voting.

I studied if/how contributors influenced voting on all bills over a 16-year period, 1991-2006--adding up to 7,000+ bills--and [published the findings](#) in *The Sociological Quarterly* in 2010. The verdict? Contributors significantly influenced lawmakers' votes on bills in all Congresses except for the 107th (2001-02), which is when the Bipartisan Campaign Reform Act (BCRA--better known as the ‘McCain-Feingold’ bill) was debated and passed.

It is not especially surprising that an analysis of *all* the bills over an extended period reveals consistent contributor influence. As a lawmaker interviewed by Schram in his 1995 book *Speaking Freely* put it, “(People) will often look for...the grand-slam example of influence of these interests. But rarely will you find it. But you can find a million singles...regulatory change, banking committee legislation, (etc.)...” Scholars have been looking for the “grand slam”; they should have been looking at all the “singles.”

But do “singles” matter in the grand scheme of things? Yes, they do. The lawmaker’s quote above lends some insight into this. Little regulatory changes and banking committee codes may seem inconsequential when passed, but can have catastrophic effects down the road. There are two such pieces of legislation, in particular, that are prime examples of this: the Gramm-Leach-Bliley Act of 1999 and the Commodity Futures Modernization Act of 2000. They may have been viewed as harmless “singles” initially; but we now know that they both helped lead to the Global Financial Crisis:

The Gramm-Leach-Bliley Act of 1999. This Act repealed part of the 1933 *Glass-Steagall Act*, which had sought to rein in banking practices after the onset of Depression. For instance, Title I of the *Act* allowed banks to merge with entities that buy/sell securities. Dubbed the “Citigroup Relief Act,” it benefits big banks, but creates “too big to fail” in the process.

The Commodity Futures Modernization Act of 2000. This Act established provisions for "swap" agreements. For instance, Title III of the Act paved the way for transfers of financial risk via derivatives such as collateralized debt obligations insured with credit-default swaps. The Act allows bundling of risky bonds. Initially, firms and investors make money...until bundled securities become worthless "junk bonds," which leads investors to lose money and companies to collapse.

In my work with the Center over the past year, I have been examining the impact of contributors on these bills. It turns out that not only did contributors have a significant influence --they were *the most significant* influence on these bills. Contributors had a greater effect on these bills than even the usual factors (e.g. party affiliation).

I think the ultimate question now is, "What can \$6 billion buy?" We know that money influences policy. Even a decade ago, when there was less money in politics, money influenced voting--and not always for the better. Bills like the Gramm-Leach Bliley Act and the Commodity Futures Modernization Act benefitted a few at the expense of many. The fact that there is even more money in politics today raises a very scary prospect. What can all this money buy? If history tells us anything, whatever it is, it won't be good--at least not for the vast majority of us.

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# A Seat in Congress

[Ted Gup](#)

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The idea is neither new, nor mine alone, but well worth revisiting: to curb excessive partisanship in Congress, get rid of the seating scheme that separates one party from another. Mix 'em up. Imagine Senators Barbara Boxer (D- Ca.) and Tom Coburn (R- Okla.) side-by-side, whispering in the back row, sharing a bag of chocolate kisses, and finding a way off the fiscal cliff.

OK, so it may not usher in an Age of Aquarius, but it can do no harm, and it may just do some good. Robert Frost was right when he wrote, "Something there is that doesn't love a wall, that wants it down." The aisle that divides Congressional members is just that, a wall that does not merely recognize but contributes to the notion that the chasm between parties is wide. It creates a geography that legitimizes that divide, gives it length and breadth, and a visual that is antithetical to reconciliation and the common good. It puts an institutional imprimatur on the schism, the very incarnation of "taking sides."

You say it's only a place to sit, but where you sit in Congress telegraphs to one and all where you stand. It says that you begin from a different place and will likely end there as well. It is no coincidence that we speak of "winning a seat in Congress," as if it were a sedentary prize, rather than a chance to rise to leadership. And for those who say it can't be done, it can and has already been tried on select occasions. At the State of the Union (2011) and at inaugurations, lawmakers allowed themselves to mingle and fraternize with the opposition. There were no reports of fratricide or partisan mayhem. Brooking that chasm may be symbolic only but isn't a symbol of collaboration better than one of division? Besides, Congress is full of symbols that command respect, the gavel and mace among them.

Sure conservative talk show hosts have dissed the idea, and politicians of both stripes have given it the back of the hand as so much window dressing. These days any gesture in the direction of "Kumbaya" – Democratic Representative Nancy Pelosi's description of the idea -- is tossed out, but interestingly some of those rejections appear to be grounded in the fear that it might threaten party purity or discipline – a stronger endorsement for shuffling the political deck, I could not imagine.

But if there is one thing that most members of Congress agree on, without respect to party or politics, it's that the old sense of community – the cross-aisle socializing after hours, the meeting of spouses and children, the friendly pick-up game of basketball, is sorely missed. Party rivalries have given rise to bloodsport. Community has dissolved into an assemblage of strangers rife with suspicion, resentment and petty feuds. Much of it has been brought on by the relentless need to raise campaign cash, which itself has spawned a Tuesday-through-Thursday schedule, the every-weekend-home-routine, and the unraveling of a social fabric that long transcended hyper-partisanship and fostered a human perspective. The aisle that divides feeds into the idea of isolation and containment, promotes party – as opposed to *national* – identity, and reinforces loyalty to caucus, not country. It is George Washington's worst nightmare, the one he warned of in his celebrated Farewell Address of 1796.



There are those in Congress even today who point out that the design of the House and Senate in the semicircle was intended to create a shared focus and a sense of unity, as opposed to the architecture of Parliament where opponents face each other. And there have been times when history and happenstance have forced The Other to take a seat with the opposition. The "Cherokee Strip," as it came to be known, was the product of a gross imbalance between Democrats and Republicans in the Senates of 1907-1909, 1937-1939, and 1939-1941 requiring members of the dominant party to sit with the minority. It drew its name from a narrow section of land in Oklahoma that belonged neither to the Indian Territory nor to the US government – a no man's land. By the 89<sup>th</sup> Congress (1965-1967) four senators sat in a makeshift fifth row rather than join the opposition. There was even a time in the 1950's when Senator Wayne Morse of Oregon left the Republicans and, declaring himself an Independent, took his seat in the middle of the main aisle. Former Rep Henry Hyde (Rep. – Ill) was often to be seen sitting with the opposition and no one ever questioned his conservative *bona fides*.

Of course, the roots of this scheme of sitting with one's own – the "Birds-of-a-feather" syndrome – are not so easily ascertained. You'd think there would be an abundance of records on when the practice started, by whom, and why. In fact, the shelf is rather scant, documentary evidence hard to come by. Even some Congressional historians confess it is something of a mystery. A souvenir from the 24<sup>th</sup> Congress (1835-1837) – one of the earliest in the possession of Congressional staff – shows that already the parties had parted ways. By then, the House had 242 members who arrayed themselves by party, though it was a more exotic mix than today, with 75 anti-Jacksonians, 143 Jacksonians, 16 anti-Masonics, and 8 nullifiers.

But there was a time before political parties – brief as it may have been – and the competition for seats had less to do with political position and more to do with what was perceived to be the best seat in the house (or Senate, as the case may be.) The rule was first come, first serve. In those early and innocent days of the Republic, a time of horse and carriage, a decided advantage went to those who lived closest to the Capitol. That would have been the delegates from Virginia and Maryland. Others, conscious of their geographic disadvantage, finally insisted in 1845 on instituting a lottery system. Balls of marble or other material were placed in a box and drawn out by a page who called out the number on the ball which corresponded to a member's name on a list. The winner had his choice.

But the evolution of parties, at least as expressed on the floor of Congress, has a murkier background and even those who specialize in such arcane topics have few sources to turn to. Charlene Bickford, Director of the First Federal Congress Project, says that in the First Congress members sat largely, though not exclusively, by state. (That sounds like an excellent idea to me, reminding members that they represent the same folks back home.) But just when the parties divided the House and Senate by seating arrangement is less clear. One of the earliest documents to address it is the "Plan for the House of Representatives," done by New York's Representative Philip Van Corlandt in 1796. The schematic and names scribbled in are thought to have been a way to help count votes on the House floor. What it shows is some members sitting by state, but others arrayed by seniority. Mind you, seniority in 1796 was a relative thing, given the infancy of government. A year later, a visiting Polish aristocrat found the members in the House sitting randomly, or at least with no discernible pattern. Party does not yet appear to have surfaced as an organizing principle.

The point is, Congress has not always been seated by party alignment, there have often been those who dared to cross the line, and the ossification of the current scheme hardly seems to be serving us well.

Maybe a bit of rejiggering won't bring us eternal harmony, but it's surely worth a try. Even the allies and their foes could leave their trenches and cross the line to observe a moment's peace that Christmas of 1914, before getting back to the business of killing. Is it too much to ask of our legislators to do the same?

<http://www.ethics.harvard.edu/lab/blog/266-a-seat-in-congress>

# Political Money in 2012

[Paul D. Jorgensen](#)

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In our recent [story for Alternet](#), Tom Ferguson, Jie Chen and myself wanted to refocus post-election coverage back onto campaign finance. Two troubling narratives emerged after the election: big money [lost](#) in 2012, and Obama's groundswell of small donors beat Romney's brazen billionaires.

Despite the best efforts of some to proclaim *Citizens United* a [dud](#), money played an important role in the 2012 federal election, and a majority of Obama's itemized money came from large donors, albeit less brazen. Our story covers the need to formulate alternative hypotheses about the 2012 election, with new numbers about Obama's donors, but does not cover the intensive data efforts necessary to analyze donors.

Political analyses rarely answer one basic, descriptive question: how much did a donor give? The lack of analysis is not surprising given that both the Federal Election Commission (FEC) and the Internal Revenue Service (IRS) do not give individual donors unique identification numbers; instead, public data only lists each transaction without any attempt to aggregate money by donor (not to mention the difficult design of the data, which is not intuitive). The data must be transformed and cleaned in order to make sense of *who* funds our elections.

The problems are well known: name misspellings and variations, donors giving from different locales, and uncomfortably high amounts of missing data. Even though the FEC has not updated the itemized list of Obama donors (his campaign filed electronically, seemingly making the disclosure process faster), we analyzed all pro-Obama donors up to October 17 (the most recent data available until the FEC updates its files). Our name-matching algorithms and settings are able to match donors who use a combination of nicknames, prefixes/suffixes, addresses, and have a misspellings. We also have rules to decipher when spouses give money using their husband or wife's name.

Using these techniques, we find that 50% of itemized, pro-Obama money came from donors who gave at least \$10,000, which is only 2.7% of pro-Obama itemized donors. These donors are hardly small.

<http://www.ethics.harvard.edu/lab/blog/267-political-money-in-2012>

# White House Stalls EPA Report

[Sheila Kaplan](#)

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A landmark Environmental Protection Agency report concluding that children exposed to toxic substances can develop learning disabilities, asthma and other health problems has been sidetracked indefinitely amid fierce opposition from the chemical industry.

[America's Children and the Environment, Third Edition](#) is a sobering analysis of the way in which pollutants build up in children's developing bodies and the damage they can inflict.

The report is unpublished, but was posted on EPA's website in draft form in March 2011, marked "Do not Quote or Cite." The report, which is fiercely contested by the chemical industry, was referred to the White House Office of Management and Budget (OMB), where it still languishes.

For the first time since the ACE series began in 2000, the draft cites extensive research linking common chemical pollutants to brain damage and nervous system disorders in fetuses and children. It also raises troubling questions about the degree to which children are exposed to hazardous chemicals in air, drinking water and food, calling attention to exposures in their indoor environments – including schools and day-care centers – and through contaminated lands.

## Politics of Postponement

In the making since 2008, the ACE report is based on peer-reviewed research and databases from federal agencies, including the Food and Drug Administration, Housing and Urban Development and the Centers for Disease Control and Prevention. Public health officials view it as a source of one-stop shopping for the best information on what children and women of childbearing age are exposed to, how much of it remains in their bodies and what the health effects might be. Among the "health outcomes" listed as related to environmental exposures are childhood cancer, obesity, neurological disorders, respiratory problems and low birth weight.

The report cites hundreds of studies; both human, epidemiological studies that show correlation between exposure to certain chemical pollutants and negative health outcomes; and animal studies that show cause and effect. In some cases, the authors note that certain chemicals have been detected in children, but that not enough is known about them to draw conclusions about safety.

The EPA's website still notes that the report will be published by the end of 2011. But after a public comment period that was marked by unusually harsh criticism from industry, additional peer review and input from other agencies, the report landed at OMB last March, where it has remained. No federal rule requires the OMB to review such a report before publication, but EPA spokeswoman Julia Valentine said the agency referred it to the OMB because its impact cuts across several federal agencies.

The spokeswoman said EPA had no idea when OMB would release it, allowing publication. A spokeswoman for the White House Office of Management and Budget said she would not discuss the review process or give an estimated release date.

Some present and former EPA staffers, who asked not to be named for fear of losing their jobs, blamed the sidetracking of the report on heightened political pressure during the campaign season. The OMB has been slow to approve environmental regulations and other EPA reports throughout the Obama Administration—as it was under George W. Bush according to reports by the Center for Progressive Reform, a nonprofit consortium of scholars doing research on health, safety and environmental issues.

Why is it taking so long? One must ask the question,” said a former EPA researcher who works on children’s health issues. “It is an important document and it strikes me that it’s falling victim to politics.”

### EPA Versus the Pentagon

The EPA states that the report is intended, in part, to help policymakers identify and evaluate ways to minimize environmental impacts on children. That’s an unwelcome prospect to the \$674 billion chemical industry, which would face greater legal liability and lose business if the EPA or Congress bans certain substances mentioned in the report or sets standards reducing the levels of exposure that are considered safe.

Among other findings, the report links ADHD to numerous substances, including certain widely available pesticides; polychlorinated biphenyls (PCBS), which were banned in 1979 but are still present in products made before then and in the environment; certain polybrominated diphenyl ethers (PBDEs), used as flame retardants; and methyl mercury, a toxic metal that accumulates in larger fish, such as tuna. The draft also cites children’s exposure to lead, [particularly from aging lead pipes](#), as a continuing problem.

Among the other widespread contaminants linked to learning disabilities is perchlorate, a component of rocket fuel , fireworks and other industrial products, which has polluted water around the country. The Department of Defense, which wants to avoid paying to clean it up, is alarmed by research showing that the chemical interferes with thyroid function and otherwise damages the nervous system, according to R. Thomas Zoeller, a biology professor at the University of Massachusetts Amherst, and an expert on perchlorate, who has sat in on Defense Department presentations on perchlorate while serving on EPA advisory panels studying the issue. Zoeller also expressed outrage about the Air Force’s hiring of two consultants, Richard Mavis and John DeSesso, who wrote a letter to the editor of *Environmental Health Perspectives*, attacking an EPA scientist who had published a study showing that perchlorate causes brain damage.

The incident occurred in 2009, when Mavis and DeSesso wrote to *EHP*, which is published by the National Institute of Environmental Health Sciences, attacking a study authored by Dr. Mary Gilbert, of EPA. Mavis and DeSesso were identified as having worked on an Air Force contract, but this was little consolation to Zoeller. “I don’t like my tax dollars going for one federal agency to refute the work done by scientists at EPA,” he said. The Defense Department and the Air Force declined to comment. Dr. DeSesso said their perchlorate work and the EHP letter were completely objective and not designed to assist the Air Force on the issue.

One of the new sections of the long-awaited report notes that children may be widely exposed to pollutants in schools and day-care centers. Among them are pesticides; lead; PCBs; asbestos, a mineral fiber long used as insulation and fire-proofing; phthalates, chemicals that are used to soften vinyl and as solvents and fixers, and are found in numerous consumer goods, among them: toys, perfumes, medical devices, shower curtains and detergents; and perfluorinated chemicals, which are used in non-stick and stain-proof products. The study notes that these substances are (variously) associated with asthma, cancer, reproductive toxicity and hormone disruption.

The American Chemistry Council (ACC), the chief industry trade group, has accused EPA of lacking objectivity and vilifying its products. It has filed dozens of pages of comments accusing the EPA of ignoring certain studies – including some funded by ACC itself—that would help businesses make the case that their products are safe. The ACC also contends that EPA has not included enough positive comments about the role of chemicals in society.

ACC members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer," wrote ACC senior toxicologist Richard A. Becker. . . . "The exclusive focus on exposure is particularly problematic as it may lead to the incorrect conclusion that exposure to chemicals (e.g. phthalates) at any level is not only cause for concern, but also a direct source of negative health effects."

Becker also expressed the ACC's contention that EPA was painting too bleak a picture of children's health in America.

It is troubling that the draft ACE report seems to make such little effort to provide a complete overall picture of child health in the United States," Becker wrote. "For example, the draft report does not refer to *The Health and Well-Being of Children: A Portrait of States and the Nation* . . . which concludes the health and well-being of children in the U.S. is improving overall with 84.4% of children in the United States listed as being in excellent or very good health, an increase from 83% in 2003." Other ACC members, representing manufacturers of BPA, phthalates and other substances, also weighed in against the report.

### Buying Time

The chemical industry is a key donor to lawmakers. So far, in the 2012 election cycle, chemical companies and their trade groups reported donating more than \$43 million to congressional and presidential candidates, with Republicans reaping 78 percent, and Democrats 22 percent. The ACC also paid for television advertising in congressional races around the country. The industry spent more than \$52 million on lobbying in 2011, and is on track to top that for 2012.

Nsedu Witherspoon, executive director of the Children's Environmental Health Network and a member of the EPA Children's Health Protection Advisory Committee, which oversaw the report, called it a major accomplishment, reflecting the explosion of research since the first ACE was published. She also praised EPA chief Lisa Jackson for standing behind it. Industry critics, Witherspoon said, "in many cases are the same ones out there trying to debunk the original research," that the study cites.

On Thursday, December 27, Jackson, who was praised by environmentalists but vilified by industry and many Republican lawmakers, said she would resign in January. Jackson had

made no secret of her disappointment with President Barack Obama's resistance to strong climate change protection.

Rena Steinzor, a professor at the University of Maryland School of Law, and president of the Center for Progressive Reform, said the ACE report need not have gone to OMB for review in the first place. Steinzor notes that Executive Order 12866 states that proposed significant regulations—generally defined as those that could cost more than \$100 million—need be reviewed by OMB, but studies do not. The Executive Order gives OMB up to 60 days to review such proposals—although it allows for extensions. In practice, OMB has missed numerous such deadlines. But the ACE report, which is not a proposed regulation, falls into a gray area.

If it's not a rule, I don't know what it's doing there," Steinzor said. "And even if it were a rule, there would be a deadline and they'd be violating it."

In an email statement to the Investigative Reporting Workshop, EPA spokeswoman Julia Valentine said, "The report was provided to OMB so that they could conduct an interagency review process to ensure accuracy and consistency."

She noted that because the report addresses children's health, it includes issues that are the focus of many departments and agencies within the Department of Health and Human Services -- including the Centers for Disease Control, the Food and Drug Administration, the National Institute of Environmental Health Sciences and the National Cancer Institute.

Steinzor, whose organization has studied OMB under numerous presidents, doesn't buy it.

The report should be released now, she said, " because to protect children adequately we need all the information we can get... I guess I understand why there was great anxiety and paranoia before the election ... (but) why would you not do it now? It's sad that things have gotten so polarized that we're afraid to release scientific information."

<http://www.ethics.harvard.edu/lab/blog/268-white-house-stalls-epa-report>

# Doctors Pressured to Prescribe Brand Name Drugs

[Genevieve Pham-Kanter](#) and [Eric G. Campbell](#)

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Edmond J. Safra Center Faculty Affiliate [Eric G. Campbell](#) (Professor, Harvard Medical School and Massachusetts General Hospital) and Lab Fellow [Genevieve Pham-Kanter](#), along with co-authors Lisa I. Iezzoni and Christine Vogeli at Massachusetts General Hospital, have published [a study in JAMA Internal Medicine](#) looking at how frequently doctors prescribe brand name drugs at the request of their patients.

Analyzing data from a national survey of physicians in 7 specialties, they find that 37% of physicians reported prescribing a brand name drug *even when a generic was available* because their patients requested the brand. Certain types of industry relationships were important predictors of physicians acquiescing to patient demands for brand name drugs. Physicians who received workplace food and/or beverages paid by pharmaceutical companies, who received free drug samples, and who reported meeting frequently with industry representatives were more likely to acquiesce to patient demands for brand name drugs despite their knowing that there were generic substitutes for the brands. Physicians who more frequently read medical journals (relative to those who never or rarely read these journals), however, were less likely to accommodate these kinds of patient demands. A summary of the study may be found [here](#). The study in *JAMA Internal Medicine* may be found [here](#).

This piece was also covered in the [Harvard Gazette](#).

<http://www.ethics.harvard.edu/lab/blog/269-doctors-pressured-to-prescribe-brand-name-drugs>



# On Confidence Lost: Does the World Still Trust Washington to Steer International Financial Reform?

[Gregg Fields](#)

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Massive regulatory failures preceded the recession. The legacy is diminished faith in America's global economic leadership.

For regulators, it was the economic equivalent of a Rodney Dangerfield moment.

AIG, the insurance giant saved by an infusion of \$182 billion from Washington in 2008, recently considered joining a lawsuit against the federal government. The argument: the terms of the life-saving bailout had been far too onerous for shareholders. The original lawsuit was filed by former AIG Chairman Maurice Greenberg, who invited his old firm to join him.

It was an episode with absurdist overtones. Who bites the hand that feeds you \$182 billion? Adding to the irony, AIG had just unveiled TV ads proclaiming "Thank you, America" for coming to its rescue.

Ultimately, [the company passed](#), but not before senior officials of the Treasury Department and the Federal Reserve Bank of New York gave a presentation to AIG's board, according to *The New York Times*.

It wasn't the only recent instance where federal regulators, to paraphrase the late Dangerfield, got no respect. Indeed, the problem is going global. Other countries, mindful of the regulatory failures that preceded the 2008 collapse, are openly bristling at Washington's efforts to reassert its global economic leadership, an uncharacteristic stance with far-reaching implications.

The issues we want to focus on are international connections, said David Skeel, corporate law professor at the University of Pennsylvania and author of *The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences*. "But we're seeing fallout. There's a lot less deference to the U.S. than there used to be. There's less of a feeling that the ways we do things are superior."

Why the resistance? Some blame a lingering bitterness over the institutional failures that were a core cause of the 2008 economic collapse. Once the world's regulatory standard-bearer, the market meltdown revealed that U.S. financial oversight was rife with industry-friendly regulations. There remains the issue of a complicit Congress, dependent on campaign contributions from Wall Street. And even when regulators mean well, the difference between the checks that agencies should perform and the balances of people and money required can seem woefully lopsided.

That institutional ineffectiveness is crimping American credibility at a critical juncture. The dangerous derivatives trading that drove AIG to the brink of collapse is still largely unregulated. Last year's London Whale trading scale at JPMorgan demonstrates it's an ongoing threat.

True reform clearly requires extensive international cooperation. Yet, many countries seem wary of Washington's ways -- and mistrustful of its motivations.

American regulators still lead in influence, "but not the way they once did," Harvey Pitt, the former chairman of the Securities and Exchange Commission, told me. "If you're the leader you can have a lot of sway, but not if you embrace what I call American geocentrism."

### Border disputes

A closer look at a recent episode involving the Commodity Futures Trading Commission, or CFTC, illustrates the dynamics at work.

Title VII of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* put the CFTC, primarily, in charge of bringing swaps, a form of derivatives, under regulatory oversight. Previously, derivatives were largely unregulated.

(Derivatives are complex, and come in all shapes and sizes. But at their simplest they act like insurance policies against financial shifts. But when movements are unusually swift, steep and large, as when the subprime mortgage market collapsed, the damage can quickly rip through the entire system.)

The danger, of course, is that if U.S. laws are too strict, and apply only domestically, rogue practices will simply migrate to the country of least resistance. In an age of electronic trading, trading can be conducted anywhere.

"As the (CFTC) and the international regulatory community move forward, we all recognize that risk has no geographic boundary and money can move in and out of markets and jurisdictions in milliseconds," Gary Gensler, the CFTC chairman, said recently.

But if an international standard is developed, and everyone adheres to it, that problem could be curtailed. So last year, the CFTC announced plans for a set of rules governing cross-border transactions in swaps. Much of it focused on defining a "U.S. person," which would include U.S. corporations and affiliates overseas. CFTC standards regarding derivatives would apply to foreign entities trading swaps with U.S. persons.

It was a bold move at extra-territorial reach for the CFTC -- and the reaction was a furious rebuke. "Washington, we have a problem," pronounced Patrick Pearson, head of the financial infrastructure unit at the European Commission, at a November meeting of international regulators, according to *Bloomberg News*.

Other countries, including traditional economic allies like Japan, also balked. And on Dec. 21, Gensler announced he was tabling the cross-border transaction rules until next summer. The delay "provides time for the (CFTC) to work with foreign regulators," he said.

## Beat the clock

In isolation, the CFTC's difficulty in asserting its authority might not seem alarming. America regularly has disputes with even its closest economic partners. And some sources interviewed said Gensler should have known other countries don't like being told what to do. (A CFTC spokesman said Gensler wasn't available for an interview.)

As for the delay -- well, that's more the norm than the exception with Dodd-Frank. As of Jan. 2, regulatory agencies overall have missed roughly 60 percent of the law's required rule-making deadlines, according to the Polk Davis law firm, which tracks the law. (Gensler has testified to Congress that his goal is to construct rules "in a deliberative way -- not against a clock.")

But to some skeptics the endless inaction smacks of deliberate dead-end dithering -- and gives financial giants time to lobby for more palatable rules.

"Wall Street and its army of lobbyists will use the additional time to continue their war on financial regulation that may hurt their profits, but which will protect the American people from having to bail them out again," Dennis Kelleher, President and CEO of a pro-reform group called [Better Markets](#), said when the cross-border transaction rules were delayed. "If the rules don't apply overseas, then U.S. firms will just move their businesses to offshore markets and avoid the rules that protect U.S. investors, markets and economy."

In a follow-up interview, David Frenk, the director of research at Better Markets, said that, with Dodd-Frank, "it's staggering the impact the industry is having with this thing."

As for cross-border transactions rules, "I think we'll end up with a compromise that waters it down," he said. "That's not a good outcome. The statute is there for a reason."

## Sizing up the situation

Perhaps. But some complain that Dodd-Frank doesn't seem to recognize regulatory realities. And even former Rep. Barney Frank, the Massachusetts Democrat whose name is on the law, acknowledges it has one significant shortfall.

One issue is this: the notional value of derivatives contracts around the world exceeds \$600 trillion, according to the Bank of International Settlements.

The CFTC has approximately [700 employees](#) in total. CFTC employment is up about 10 percent from the 1990s, according to a budget request Gensler filed last year with Congress. But the futures market has grown fivefold in that time, and Dodd-Frank added oversight of the swaps market, which is eight times bigger than the futures market.

So the question isn't so much if the CFTC has the right ideas, but whether it's big enough to implement them. Pitt, the former SEC chairman, used an analogy to illustrate the dilemma.

"When I was little, I had a doggie and I worried that he chased cars," Pitt said. "And I was never sure what would happen if he caught one."



Gary Gensler, current Chairman of the CFTC

Jeff Harris, a former chief economist at the CFTC, and currently a finance professor at Syracuse University, said size isn't the only thing that matters. Other issues are experience and expertise.

Traditionally, the CFTC oversaw markets in agricultural commodities like soybeans. Putting together massive international agreements on regulatory restructuring is something else altogether.

"The CFTC hasn't historically been at the table for negotiations of this type," Harris told me. Furthermore, because derivatives were previously unregulated, other countries are being asked to put their faith in a U.S. system that is actually a work in progress.

"Part of the problem with Dodd-Frank is, it steps into areas where there wasn't much regulatory oversight at all," Harris said.



Harvey Pitt, 26th Chairman of the SEC (2001-3)

### Twice as nice

Other observers say Dodd-Frank ignored a relatively simple but potent fix, for the reason that it might crimp Congressional campaign fundraising.

The issue is merging the CFTC with the much larger SEC. Experts say it's only logical, given the scarcity of regulatory resources. "Merging the SEC and CFTC has been a no-brainer for decades," Skeel, the corporate law professor at Penn, told me.

Frank, who didn't run for re-election, concurred. "The existence of a separate SEC and CFTC is the single largest structural defect in our regulatory system," he said in a November [press release](#).

The stumbling block is that the CFTC doesn't report to the same Congressional committees as the SEC. More committees mean more members of Congress to receive campaign money.

It's particularly relevant here, because FIRE -- for finance, insurance and real estate -- was the most generous sector of all in the 2012 campaign cycle, contributing more than \$573 million to various candidates, according to [OpenSecrets.org](#).

Frank introduced legislation -- whose prospects are bleak -- to [merge the agencies](#) in November. Adding it to Dodd-Frank would have doomed the law, he said. "Had we sought to merge those institutions in the overall financial reform bill, it would almost certainly have caused the defeat of the legislation," he said.

### The platinum standard

The global resistance to U.S. leadership, and the plodding implementation of Dodd-Frank, is in stark contrast to Washington's regulatory heritage.

Indeed, historically American regulators were a veritable rapid response team whenever -- and wherever -- economic disasters struck. In 1987, for instance, a new Federal Reserve

chairman named Alan Greenspan moved quickly to stabilize world financial markets after the infamous Black Monday stock market crash.

And the U.S., either on its own or in concert with international bodies like the International Monetary Fund, played lead roles in dramas like the Mexican peso crisis of 1994 or the Asian economic panic of the late 1990s.

But the current impasses reflect the cost of lost credibility after regulatory failures of the kind that preceded the Great Recession. And in many ways, that may prove to be the greatest loss of all.

Said Pitt: "One thing we've seen with the subprime meltdown, Enron and other scandals is, the U.S. regulatory regime is not perceived as the platinum standard."

<http://www.ethics.harvard.edu/lab/blog/271-on-confidence-lost>

# Dirty Money: Mere Exposure to Money Motivates to Think Business, Cheat and Lie

[Maryam Kouchaki](#)

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Lab Fellow Maryam Kouchaki, along with co-authors Kristin Smith-Crowe, Associate Professor, and Arthur P. Brief, Presidential Professor and Chair in Business Ethics, both at the University of Utah's David Eccles School of Business; and Carlos Sousa, a former University of Utah graduate student, have [published a study](#) in *Organizational Behavior and Human Decision Processes* showing how mere exposure to money – even simply using money-related words – will trigger unethical behavior.

“To our knowledge, we are the first to empirically test the link between mere exposure to money and unethical outcomes,” write the researchers. “Testing this link is important because money is a central pursuit of business organizations, and, as recent scandals illustrate, immorality in organizations can have devastating effects.”

The researchers conducted four studies which are reported in the article, “[Seeing Green: Mere Exposure to Money Triggers a Business Decision Frame and Unethical Outcomes.](#)” The first two demonstrate the connection between money and unethical behavior, while the second two examine the link between money, adoption of a business frame of mind, and unethical acts. Thinking about money leads people to think ‘business,’ and it’s this framing of a situation as a business one that leads to unethical behaviors, such as lying, cheating and acting in one’s self-interest without regard to others.

In one of the studies, participants exposed to money-related words were twice as likely to lie as those who were not. In others, they cheated and made unethical decisions more often in order to earn more money. The four studies used college undergraduates enrolled in introductory business courses. The researchers used various kinds of money cues for some of the participants, while the control groups were not exposed to money references. The participants then had to make choices between ethical and unethical behaviors.

“Our findings suggest that money is a more insidious corrupting factor than previously appreciated, as mere, subtle exposure to money can be a corrupting influence,” write the researchers. Because their subjects were U.S. residents, the findings are not generalizable to other cultures.

The researchers believe that their work cements the relationship between business and unethical behavior. Previous psychological research has shown that economics education among business students promotes greed, and that business students are more likely to cheat and engage in self-interested behavior. Other work finds that after exposure to money, people are less likely to help others, less likely to ask for help, and more likely to work alone. Other researchers have demonstrated that priming people to think about business elicits

competitive and self-interested behavior. "We will continue to live with headlines reporting business wrongdoing until we take effective steps to alter the nature of business education and subsequently the practice of business," Brief said.

Altering business organizations is not easy; money is an integral part of business. Yet this research suggests that we should be aware of the potential of environmental or contextual cues for influencing people's unconscious unethical behavior. Everyone should be warned about the potential moral obstacles of money and business.

<http://www.ethics.harvard.edu/lab/blog/272-dirty-money>

# Conflicted: GOP vs. EPA-Funded Scientists

[Sheila Kaplan](#)

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Are government-funded researchers more biased than those bankrolled by America's top polluters? The House science committee says so. Amid much lobbying by the oil and chemical industries and other companies, the GOP is working to revamp conflict of interest rules governing EPA science advisory panels; making them more hospitable for industry scientists-for-hire; and taking seats away from EPA-funded academic researchers.

The EPA Science Advisory Board Reform Act of 2012, first introduced last fall by Texas Rep. Ralph Hall, then chairman of the House Science, Space, and Technology committee, is expected to be reintroduced shortly by incoming committee chairman Lamar Smith, also of Texas, who was a co-sponsor.

The EPA review panels were established by Congress in 1978 to advise EPA on the quality of scientific and technical information being used to support regulations, and weigh in on many significant issues. They fall under the Federal Advisory Committee Act, which calls for all advisory boards to be "objective." EPA's own policy states that "committee membership must be balanced by points of view," but the definition of "balanced" has fluctuated with each agency chief. In 2010, the Obama Administration adopted a policy barring federally-registered lobbyists from serving on the committees—although their science advisors may do so.

In a press release accompanying the legislation, the Committee said it would "limit conflicts of interest" on the panels, and "enhance transparency."

But what's truly transparent is the bill's beneficiaries: the oil, gas and chemical industries, which gave nearly \$53 million to Republican congressional candidates and GOP party committees in the last election cycle, according to the Center for Responsive Politics (CRP), a nonpartisan research group which studies money in politics. [CRP's numbers are based on Federal Election Commission records released in mid-November, 2012.]

Federal lobbying reports show that the American Petroleum Institute, Exxon Mobil Corp., Berkshire Hathaway and Lockheed Martin Corp. were among those lobbying on the legislation. The American Chemistry Council has called it a top priority.

It's easy to see why. The Act would change the makeup of the panels, so that no more than ten percent of the members could be researchers with EPA grants or other financial support. Since the committees need only include nine people, this rule paves the way for leaving out EPA-funded scientists altogether.

As Jennifer Sass, a senior scientist for the Natural Resources Defense Council, wrote in her blog:



“For example, while a university professor with a competitive research grant from EPA to study the cancer risks from chromium-contaminated drinking water would be disallowed, a scientist with funding from the chromium industry would be permitted on the Board, as long as the financial conflicts were disclosed publicly. This would essentially block the experts whose research shows the health risks of contaminants, while favoring researchers that fail to find a risk.”

The proposal would also require all risk assessments conducted by EPA to be reviewed by a Scientific Advisory Board, a prospect that Richard Denison, senior scientist for the Environmental Defense Fund, noted in his column is a “provision that the ACC [American Chemistry Council] knows full well, would add years to the already overly protracted process of EPA’s completion of such assessments.”

Denison also pointed out that the new conflict-of-interest guidelines “would reverse longstanding conflict-of-interest policy and practice followed by virtually every authoritative scientific body in the world – including the National Academy of Sciences, the International Agency for Research on Cancer and the World Health Organization – by allowing unfettered access of industry representatives with direct conflicts of interest to serve on the SAB and its panels, as long as their conflicts are disclosed.”

The EPA Science Advisory Board Reform Act of 2012 was met with an outpouring of opposition from environmental groups, public health officials, the American Public Health Association, and, last week, well-known activists Erin Brockovich and Lois Gibbs. Gibbs, executive director of the Center for Health, Environment & Justice, was especially concerned with provisions that would require the advisory boards to respond in writing to all public comments, a change she wrote would build even more delay into an already maddeningly slow system.

The American Chemistry Council, on the other hand, is delighted.

“We cannot overstate the importance of this bill to Americans who must have confidence in a regulatory system that is transparent and that makes decisions based on sound science and with the best interests of our country in mind,” wrote the ACC in a press release about the bill. “Chairman Hall and fellow committee members have taken an important first step toward achieving that goal by proposing legislation that would strengthen the scientific integrity of the advisory panels on which EPA relies to make those decisions.”

“Not only would this bill lead to improvements in how panels are formed, but it would also hold peer review panels accountable in responding to public comment, ensuring that legitimate scientific concerns are transparently addressed. The bill would also ensure that SAB expert panels clearly communicate to the Administrator any uncertainties associated with their findings and recommendations.”

The committee had its first organizational meeting on Wednesday, January 23.

<http://www.ethics.harvard.edu/lab/blog/273-conflicted-gop-vs-epa-funded-scientists>

# A Good Housekeeping Seal for Bioethics: Could It Improve Trust and Ethics in the Pharmaceutical Industry?

[Jennifer E. Miller](#)

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The public's "negative view of the pharmaceutical industry is a major problem... (and there is) no shortage of "experts" with solutions on how to fix the problem. Unfortunately, many of the proposals are shockingly naïve and without merit," grumbles John LaMattina, former President of Pfizer Global R&D. In response to LaMattina's challenge for outsiders to develop more realistic reform strategies, this blog post proposes the introduction of an *ethics accreditation system, akin to a Good Housekeeping Seal*, as a practical means for the industry to credibly improve its ethics and restore its broken image.

As it stands, the majority of Americans distrust pharmaceutical companies, believing that they are consistently dishonest, unethical, and more concerned with profits than with individual and public health. Interestingly, this was not always the case. The industry was once "the world's most admired."<sup>[1]</sup> Merck, the company responsible for the Vioxx scandal, was ranked the "World's Most Admired Company" for seven straight years (1987-1993) by *Fortune* magazine.<sup>[2]</sup>

A mere sixteen years ago, one could still find pharmaceutical companies ranking among the top ten most admired companies (30% of the companies were from big pharma).<sup>[3]</sup> In stark contrast, today the industry is ranked barely above tobacco and oil companies in terms of its perceived trustworthiness. It has lost an essential component for innovation that is not just lamentable for the industry, but for all of us.

In fairness, some of the "distrust in the pharmaceutical industry can be arguably linked to a corresponding rise in the distrust in big business generally."<sup>[4]</sup> However, "not all big business is distrusted. The automotive and technology industries are comparatively [well respected industries](#)."<sup>[5]</sup> Is an ethics accreditation system a possible step forward for remedying at least some of the trust gaps?

In other industries, accreditation, certification, and rating systems have been helpful tools for both improving and demonstrating quality. These programs generally perform three functions: they set and communicate standards, they evaluate companies according to these standards, and they signal to both internal and external parties when the standards have been credibly implemented. Some programs focus more on evaluating the integrity of a company's processes and others evaluate outcomes.

There are, for example, programs that evaluate and signal car safety (awarding a rating of 1 to 5), the environmental impact of a building (LEED certification), whether a food is healthy or organic (the heart healthy checkmark and organic foods certifications), the quality of

educational programs, the adequacy of factory working conditions, and the ethics of diamond mining. There is also a program that considers whether an IRB has processes in place to adequately protect human research subjects. Perhaps the most famous of these types of programs, is the Good Housekeeping Seal, which evaluates whether a product fulfills its marketing claims.

While many of these programs have incentivized both companies and consumers to maintain certain quality standards within different industries, the question remains if such a program would work in the pharmaceutical industry for bioethical concerns.

The demand question: Who cares about ethics?

A primary concern about the suitability of implementing an ethics accreditation program for the pharmaceutical industry is a basic economic supply and demand question. Who would care about or look to see which companies have a high ethics rating? Would patients, regulators, doctors, investors, internal company management, payers, governments or research subjects look for an ethics seal? If there is no demand for a bioethics quality indicator, then there may be no incentive for companies to participate.

There are two main reasons why the demand question is less straightforward in the pharmaceutical industry than, say, for a certification of organic foods. In the first place, most patients do not know who makes their drugs. Second, not all disease states have multiple treatment options. Notwithstanding, company executives (like LaMattina) acknowledge that when distrust is high and value is questioned, “patients and payers (alike) will balk at taking or reimbursing new medicines,” a challenge that is not unique to the pharmaceutical industry.<sup>[6]</sup> In the beverage sector, for example, the Mondavi family understood the importance of improving the overall image of Napa Valley, California wines (arguably benefiting all vineyards in the region) in order to improve its own brand and sales.

More realistically, the demand for ethics accreditation may originate from within the industry itself as a means for keeping regulators and politicians at bay. As I mentioned in a [Pharmalot interview](#), this is in fact why most accreditation systems originate and are embraced by industries. This is, for instance, the reason accreditation systems were implemented to evaluate IRBs and universities. With trust levels so low, drug companies are at significant risk for increased regulations and sanctions:

“It is not unusual to hear a politician say during a campaign speech: “Elect me and I will protect you against Wall Street, oil companies, and Big Pharma!”... Concerned that the fines are not proving enough of a detriment to prevent the illegal detailing of drugs, the Justice Department and the FDA are considering a variety of more drastic ways to penalize offending companies. One idea being discussed is taking away a company’s patent rights as a condition of any settlement. Another idea is to limit business with Medicare, thereby reducing the company’s sales. Changes like these would have a bigger effect on a company’s bottom line than even the billion dollar fines now being imposed.<sup>[7]</sup>

This of course raises further questions of whether sanctions or regulations are more effective means for improving ethics than accreditation (or some combination thereof). However, for our purposes, we shall table this discussion for now. Instead, let us turn to another common concern held by critics: Can an accreditation program reliably assess if pharmaceutical companies are doing what they say they are doing; or, is it relatively easy to game, capture, manipulate, or invalidate an accreditation evaluation?

This common question raises some interesting sub-questions. For instance, how would a company game, capture, manipulate, or invalidate an ethics accreditation program?

#### How does one capture a program?

What is the typology of program capture?

Perhaps the best known method for capturing an accreditation or rating program is through finances. When a program becomes financially dependent on the institutions that it is supposed to be impartially assessing, there is a risk that the evaluating agency will cater to the institutions seeking accreditation to maintain their patronage. This risk can increase when there is more than one available accrediting or rating agency, as companies can play agencies off of each other by patronizing the more lenient program.

A second, lesser known method for capturing a program is to capture the individual site-reviewer. This might be done by, for instance, an understood but unspoken promise of a potential job offer, should one be sought. This type of capture might fall under concerns associated with revolving door policies.

Both of these 'capture' risks can be arguably reduced. On the issue of finances, one could design a program that is independently funded (so far our program has not accepted any industry funding). Unfortunately, this is likely not a sustainable model. In practice, most accreditation programs are nonprofits that accept nominal membership or review fees, from companies seeking accreditation, to cover basic expenses. These fees are generally scaled to company revenues. Perhaps one method for beginning to address financial capture concerns is to cap each individual corporate membership or review fee so that it does not supersede more than 10% of the nonprofit's annual operating budget. Moreover, the accrediting organization can also refrain from selling any other services (for example, consulting services) to institutions and industries it accredits.

Similarly, individuals involved in recommending or voting on whether a company is accredited, could be asked to refrain from "going in-house" for a certain period of time after stepping down from their accrediting roles. These are high and relatively uncommon bars to set for accreditation programs, but are nonetheless achievable options. But, are they enough to gain the trust of critics?

#### How does one game or invalidate an accreditation program?

Industry critics also commonly worry that pharmaceutical companies will game an ethics accreditation program, thereby invalidating the program's credibility. How might a pharmaceutical company game an accreditation system? A prominent technique might be to exploit asymmetries in information. This concern likely has to do with the competency of the individuals selected for on-site review teams and as voting members of the accreditation council. One would think there are enough potential experts to choose from that can reduce this type of gaming risk. The inquiry then becomes what 'types' of expertise and individuals are needed.

Many critics also worry that the employees of companies seeking accreditation are not sufficiently incentivized to be truthful during accreditation interviews and surveys, if the information shared might prevent the company from being accredited. Preliminary

discussions with Edmond J. Safra Center Fellows seem to hint that the following may help in addressing this risk: (1) avoid allowing the company to self-select which individuals are interviewed, (2) avoid group interviews, and (3) set up a confidential system whereby management does not have access to knowing which employees were interviewed.

## Conclusion

There are clear challenges to implementing a robust ethics accreditation system for the pharmaceutical industry. However, they are largely surmountable challenges and the benefits to all stakeholders are well worth the efforts. As I stated in AboutPharma:

“A successful pilot (of an accreditation program could) demonstrate a company’s commitment to transparency, to ethical standards, to protecting research participants and patients, to helping doctors and others make informed decisions, and (an interest to) credibly communicate that ethics comes first (at a time when most think profits trump all else).”

This solution-oriented program cannot be easily dismissed by the industry, nor its critics, as “shockingly naïve and without merit.” To the contrary, this program offers deep learning, a rigorous and consensus based methodology, and a win-win opportunity. An ethics accreditation program for pharma companies is a substantial gain for them, since promoting the good rarely tarnishes a reputation.

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<http://www.ethics.harvard.edu/lab/blog/274-on-restoring-trust-and-ethics-in-pharma>

# Unaffordable Housing: High-Cost Projects Subvert Government's Mission to Address Nation's Affordable Housing Crisis and Require Comprehensive Reform

[Zach Fox](#)

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Across the country, state agencies in charge of administering the nation's affordable housing policy are looking at cost. But the debate might not be going far enough, as developers and state officials tend to focus on a lucrative tax credit when all programs deserve a second look.

There is a growing body of literature that taxpayer-funded affordable housing has become too expensive, with costs often exceeding the private-market substitute. In [a 2012 survey by Affordable Housing Finance](#), 84% of its readers thought development costs were excessive in at least parts of the country. A 2011 report from the online news publication *Voice of San Diego* summed up the issue in its article's headline: [Building "Taj Mahals" with Taxpayer Money](#).

## LIHTC in danger

The nation's most significant affordable housing subsidy is the low-income housing tax credit. As tax reform talks drag into apparent perpetuity, every federal program is at risk, heightening the urgency to prove that the tax credit is judiciously applied. When credits are awarded to luxury projects that cost in excess of \$300,000 per unit, that is a difficult case to make.

All told, the low-income housing tax credit cost the federal government about \$29 billion from 2007 through 2011, according to [a study by Smart Growth America](#). That sounds like a big chunk of change, until one considers that the cost of the mortgage interest deduction, which subsidizes homeownership, runs \$396 billion over the same time.

Nonetheless, Congress' most hawkish members might not see an equivalency, and it is hard to blame them. One would be hard-pressed to find a homeowner in favor of eliminating the mortgage-interest deduction, just as it would be quite the accomplishment to find an average man on the street knowledgeable of the low-income housing tax credit. Indeed, Sen. Tom Coburn (R-Okla.) has explicitly called for the wholesale elimination of the tax credit.

Consider costs, maybe?

That has left state agencies and developers scrambling to figure out how to bring costs down. The state of California [ordered a review](#) of affordable housing costs that is due to be released in March. The state of Washington concluded [a similar study in 2009](#).

There are numerous drivers of the high cost of affordable housing, but at least one potential solution appears to be fairly well-understood: consider cost. That was the first recommendation from the state of Washington's study, which called on the state agency to place "increased emphasis on cost control as a funding decision factor." Likewise, the National Council of State Housing Agencies issued [a memo in December 2011](#) that recommended a cap on per-unit costs. Both of these suggestions relate to the state agency's "qualified allocation plan," which is a scoring rubric used to grade projects. Essentially, the recommendation is to award more points to cost-conscious projects.

These recommendations make sense; after all, if agencies are not considering costs, how can they possibly contain them? It might be difficult to imagine a state agency failing to consider costs while handing out millions of dollars of taxpayer funds, but there are legitimate reasons why affordable housing reached this point. Briefly, anti-affordable housing sentiment from community members has encouraged agencies to pursue high-quality, aesthetically pleasing designs in an attempt to avoid the stigma attached to public housing. Further, more expensive "mixed-income" projects that offer both affordable and market-rate units have become the gold standard for agencies interested in improving socioeconomic integration.



*High cost has become a concern in the nation's affordable housing efforts, as state agencies have shown favor to aesthetically pleasing designs, such as these projects in Santa Monica, Calif., and Aspen, Colo.*

### Bond financing under the radar

Another problem is that this discussion does not go far enough. Much of the talk has been focused on reducing costs for projects that receive the so-called 9% tax credit, as opposed to projects that receive the 4% tax credit or ones that receive tax-exempt bond financing. This makes sense on the surface. The 9% is designed to provide a 70% present-value subsidy to a project, compared to 30% for the 4% credit, so there is fierce competition for the 9% credit while much of industry refers to the 4% as "noncompetitive." This explains clearly why competition is fiercer for the higher-subsidy credits.

State agencies received requests for about \$2.24 billion in 9% tax credits but handed out only \$917.4 million in 2010, [the latest data available](#) from the National Council of State Housing Agencies show. By contrast, the nation's state agencies issued \$8.89 billion in bonds in 2010

but had authority to issue up to \$31.13 billion that year. It should be noted here that tax credits are far more valuable in that they give developers extra cash and directly lower government tax revenue, compared to bond financing that costs the government little and serves developers as attractively priced debt. In effect, state agencies needed developers to ask for more debt.

However, that is not the case across the board. New York has been forced to reject applicants looking for a piece of the state's bond issuance.

"Here in New York there is fierce competition for volume cap," said Deborah VanAmerongen, strategic policy advisor for Nixon Peabody. "The state and city housing agencies both have more demand on that resource than they can fund in a given year."

Disconcertingly, huge chunks of New York's state bond cap, up to \$600 million, have been spent on ultra-luxury developments that offer very few affordable units relative to the amount of financing. The New York State Homes and Community Renewal did not return a request for comment.

The obvious question becomes why not reallocate some of, say, Arkansas' cap, to New York?

The state agencies' top industry group, the National Council of State Housing Agencies, does not recommend such a process, largely because cap usage fluctuates so much year to year that reallocation would be difficult, said Garth Rieman, director of housing advocacy and strategic initiatives for the council.

"Plus, [congressional budget forecasters] all recognize that a certain amount of bond authority goes unused, so that's factored into cost projections," Rieman said. "So to go to a reallocation system where all that bond authority is used would involve potential costs to the federal government."

With state agencies scrutinizing how they distribute tax credits, perhaps the federal government should reconsider its allocation of both tax credits and bond authority. Without an explanation from the state of New York, it is hard to know why it used its bond cap to give so much money to projects that produced so few affordable units. Being generous, one might assume the agency made the calculation that having some units in high-cost neighborhoods is better than none.

But is it the best use of funds? The nation has a well-documented lack of affordable housing, and the gap between what people can afford and what landlords charge is growing. From 2007 to 2010, the number of American households paying more than half their income in rent increased by 2.3 million, according to [the latest report from Harvard's Joint Center for Housing Studies](#), which called the prospects for meaningfully addressing this crisis "bleak." It is part of the state agencies' missions, as well as that of the Department of Housing and Urban Development, to address the lack of affordable housing. They are failing at this task. During this time of introspection for the industry, all programs should be under a close microscope, not just the 9% credit.

<http://www.ethics.harvard.edu/lab/blog/275-unaffordable-housing>



# Burning Down the House: Dependency Corruption Issues in Credit Rating Practices

[Gregg Fields](#)

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A new federal lawsuit against Standard & Poor's raises a vexing question: Where is the line between an opinion that is paid for, and one that is bought?

Who knew that tweaking the lyrics to a Talking Heads song could so accurately reflect what happened during the mortgage meltdown?

In March 2007, an analyst at Standard & Poor's noticed something about the subprime mortgage-backed securities that had received relentlessly rosy ratings from S&P: They were crashing.

So the analyst sent an email to his colleagues, providing his own version of the Talking Heads' classic "Burning Down The House."

"Subprime is boiling over/ Bringing down the house," one of his three stanzas read in part. It was a fitting tribute to a band also known for their concert movie, "Stop Making Sense." The analyst even videotaped himself singing his ditty, while his S&P coworkers laughed.

## Heart of the matter

That picture—of S&P fiddling while its customers got burned—is one of several disturbing take-aways from [a civil lawsuit](#) filed last week against S&P and its corporate parent, McGraw-Hill Cos. The case was filed in U.S. District Court for the Central District in California by the Department of Justice.

The DOJ claimed S&P's actions on how it rated mortgage-backed securities—and a related type of investment known as collateralized debt obligations—cost federally insured financial institutions more than \$5 billion. And it didn't have to happen, U.S. Attorney General Eric Holder said at a press conference.

"Put simply, this alleged conduct is egregious—and it goes to the very heart of the recent financial crisis," Holder said.

In examining the voluminous case—it runs 119 pages long—a picture emerges of a system that appears to be built on a foundation of a perfectly legal form of dependency corruption. (This isn't a criminal case—the lawsuit is seeking damages suffered by federally insured financial institutions.) More broadly, considering how the mortgage meltdown shook the world, the case is a prime example of why institutional corruption issues should be a public policy priority.

First, it's helpful to define some terms. Dependency corruption is a system where institutions responsible for serving the public become dependent—typically, financially—on relationships that skew their ability to perform their duties.

The example most often used is the relationship between Congress and large campaign contributors. Congress is dependent on large contributors to finance the massive cost of campaigns. This dependency—in the 2012 cycle, the financial industries were the most generous donors—can skew the incentive Congress has to put the public first.

### How it rates

At first blush, the S&P case might not seem to fit this model. Most notably, it isn't a government entity; it's part of a corporation that properly seeks to earn profits. And it doesn't take campaign contributions.

But S&P plays a quasi-regulatory, and vital, role in the financial markets. It is, in fact, designated a nationally recognized statistical rating organization, or NRSRO, by the Securities and Exchange Commission. There are only ten.

S&P rates creditworthiness. And the case filed last week concerns its involvement in assigning ratings to residential mortgage-backed securities, or RMBS, from 2004-07.

It was a heady time, with the housing market booming and investment houses buying up massive pools of home loans that became the collateral for securities then sold to investors.

That would all be fine, except for a couple of issues. One, many of the home loans were "subprime," or those made to impaired borrowers. As we now know, they were ticking time bombs that, when they exploded, produced collateral damage throughout the economy.

Two, and a more significant problem, according to the lawsuit: Investors bought the securities based on the presumably objective—and laudatory—ratings issued by S&P.

### Co-dependent

And that's the difficulty, said Holder. S&P wasn't impartial. And in fact, the lawsuit contends that, in its efforts to protect profits, S&P kept high ratings on questionable securities long after even its own employees were feeling queasy over soaring default rates. (At one point, some executives looked at the high defaults and thought they were typos.)

S&P "falsely claimed that its ratings were independent, objective and not influenced by the company's relationship with the issuers who hired S&P to rate the securities in question," Holder said, adding that "in reality, the ratings were affected by significant conflicts of interest, and S&P was driven by its desire to increase its profits and market share to favor the interests of issuers over investors."

The issue is one of dependency. S&P was paid by the people who created and marketed the securities being graded. Give them a low rating, and there's always a chance they'll go elsewhere. Cut an existing rating, and you risk losing a lucrative business relationship.

As even one unnamed S&P client told an analyst at the company: "I mean, come on, we pay you to rate our deals, and the better the rating the more money we make?" the client wrote in an email reprinted in the complaint.

“How are you possibly supposed to be impartial?”

The lawsuit details how S&P—one of the more venerable names in American finance—internally developed stricter analytical standards as the problems became clear. But they weren't implemented, in part because the company believed it could send clients to its rival, Moody's.

Furthermore, if S&P produced a rating the issuers deemed too negative, the client could reject the analysis—greatly reducing the fee S&P would collect.

### 20/20 Hindsight

Nothing has yet been proven in court, so it's important to characterize the government's accusations as “alleged.” And it's worth noting that S&P's alleged victims include titans like Citibank and Bank of America, institutions not often described as naive.

For its part, [S&P responded](#) that it did nothing wrong, saying “20/20 hindsight is no basis to take legal action against the good-faith opinions of professionals.”

The company added: “Claims that we deliberately kept ratings high when we knew they should be lower are simply not true.” The company said that, in the past five years, it has spent roughly \$400 million “to reinforce the integrity, independence and performance of our ratings” and “introduced more stringent criteria” to obtain the coveted AAA rating.

But the reality is that reforms of credit rating practices have a sketchy record of success. In fact, many of the episodes detailed in the lawsuit occurred in 2007. That would be the year after the Credit Rating Agency Reform Act of 2006 was passed.

That law, critics say, had a fatal flaw. It required the SEC to oversee credit rating agencies, but it specifically precluded the agency from regulating the “procedures and methodologies by which any nationally recognized statistical rating organization determines credit ratings.”

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act mandated that the SEC form an Office of Credit Ratings. It's still a bit early to see how effective it will be, although it did send a report to Congress late last year discussing, in general terms, ways to strengthen the ratings system.

### The road ahead

By the summer of 2007—several months after the unnamed analyst did his David Byrne imitation—S&P (as well as other credit rating agencies) could no longer deny the obvious. Hundreds of securities got sweeping downgrades. Financial institutions had to record massive losses. The economy began to take on water.

In 2011, the permanent subcommittee on investigations of the U.S. Senate issued a massive report, “Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,” that castigated the way ratings on mortgage-backed securities were propped up until it was too late.

“The most immediate cause of the financial crisis was the July 2007 mass ratings downgrades by Moody's and Standard & Poor's that exposed the risky nature of mortgage-related

investments that, just months before, the same firms had deemed to be as safe as Treasury bills," reads the 639-page report.

The report added: "In the end, over 90 percent of the AAA ratings given to mortgage-backed securities in 2006 and 2007 were downgraded to junk status. When sound credit ratings conflicted with collecting profitable fees, credit rating agencies chose the fees."

It was a system that, according to the lawsuit, prolonged S&P's ride in the mortgage-backed market. But to use the title of another Talking Heads song, it also ultimately proved to be a road to nowhere.

<http://www.ethics.harvard.edu/lab/blog/279-burning-down-the-house>

# The Power of Disclosure: (What Power?)

[Ted Gup](#)

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As one who entered the ranks of investigative reporting in the immediate aftermath of Watergate, I took it as an article of faith that disclosure possessed a remarkable curative power. "Sunlight," as Louis Brandeis said, "is the best disinfectant."

Little more was needed to keep the ship of state - and those aboard it - - headed in the right direction. But now I am not so sure. I now have to make a distinction between "the ship of state" and the crew that mans it. In the first instant we are speaking of the institution of government; in the second the individuals upon whom it depends.

At the Edmond J. Safra Research Lab, I am just beginning to see the difference between institutional corruption (the ship of state) and individual corruption (the crew)—though I confess, I am still not a total convert to the Lessig-Thompson vision. But it is a helpful distinction and one which has changed my way of thinking about the potency of disclosure. Let me explain.

I am now of the belief that disclosure is not the panacea I once thought it was. Like certain antibiotics, it is good for some infections, not all. Disclosure is best suited when applied to instances of individual corruption, less suited for those of institutional corruption. Why? Because in most instances, what we define as individual corruption, outs an agent who, in pursuit of personal gain has gone beyond both the accepted bounds of his peers and public levels of tolerance.

Making the miscreant's actions public exposes him/her to public shaming and the condemnation of peers. The person is effectively shunned and stripped of his/her effectiveness for having betrayed the public trust. Such actions are almost invariably undertaken *clandestinely*, because the nature of the actions would not withstand public or peer scrutiny.

But institutional corruption is of a different character. The actions of an institution that has been corrupted need not—and indeed seldom are—undertaken in secret. Select actions may occur behind a veil, but there is no secret that in the aggregate such actions are taken. They have been routinized and have, in essence, become so systemized as to become the norm. And therein lies the weakness of disclosure. It only really works when it exposes that which is at variance with the norm.

Individual corruption renders an individual answerable for his or her actions. Institutional corruption is not about the identity or actions of individuals but about their actions in concert with one another. Individual corruption is often about particular actions taken outside the accepted realm. Disclosure often ferrets out the actions of a rogue player. It may or may not constitute a pattern of conduct. There is a "gotch ya" element to it.

Institutional corruption, by definition, is expressive of a pattern. And if we accept Professor Larry Lessig's definition of institutional corruption—that one of its hallmarks is a loss of public faith in the institution—then it implicitly suggests that the offending behavior is already known to the public. (A loss of faith is predicated upon the idea that there is some requisite knowledge of institutional behavior that has undermined that faith.)

For all these reasons, the power of disclosure is, to a significant degree, diluted or negated in the context of institutional corruption. The offending behavior is already known (or at least presumed in some inchoate form), it is reflected in the broader conduct of one's peers, and it is within the bounds of what has become systematized. In short, the mechanisms of shunning and shame have been disabled.

It might be interesting to think of the power of disclosure in the context of the Watergate scandal, arguably the most celebrated and demonstrative example of the power of disclosure, having brought down a president and ushered in a decade of sweeping political reforms. Is Watergate to be seen as an instance of individual corruption, or an example of institutional corruption? One might argue either way. On the one hand, it was an instance of individual corruption, peopled by a cast of characters who rather than reflecting the system, sought to subvert it. They were rogue players acting literally under cover of darkness, and their actions were not of such an embedded nature that either the preceding administration, nor its successor, conducted itself in that way. It was *sui generis*.

On the other hand, the gains to be gotten were less of a personal nature, than a political nature—discrediting the opposition and thereby enhancing one's own chances for electoral victory. Curiously, one might even suggest that a test for whether it is individual or institutional corruption that we are looking at, is "*what would be the effect of disclosure?*" If the response to disclosure is moral outrage, public condemnation and ostracism by one's peers, then it's a good bet we're looking at individual corruption. If the response is a collective sigh of disgust, a rolling of the eyes by one's peers, and a shrug of the public's shoulder, well, it's probably institutional corruption.

Another interesting question is "*what would have happened had there been no Watergate story?*" Might the individual corruption have then become so rooted as to morph into institutional corruption? And isn't that precisely why the Watergate story stands apart from so many other scandals—that absent disclosure, it might well have metastasized into institutional corruption? That is why the stakes were so high and why its historical preeminence is assured.

None of this is to suggest that disclosure is without value in the context of institutional corruption. Far from it. Though it may not expose individuals to public and peer criticism, it does call attention to the problem (and remind the public that it is a *problem*) and it does illuminate institutional conditions (as opposed to mere individual conduct). And it is the conditions of government and the democratic process that require attention. In the case of individual corruption, a single expose is often enough to hold that person to account. With regard to institutional corruption, a single act of outing is seldom, if ever, sufficient to bring about change. And that too distinguishes individual corruption from institutional corruption. In the former, disclosure seeks to bring about censure and accountability. In the latter, the object is reform. Disclosure, dogged and persistent, remains a viable and essential instrument in the quest for better government.

Still, there is a risk that disclosure of institutional corruption will further alienate the public from government and civic responsibility, that it will fuel the sense of resignation. Because the focus is not on individuals but systems, it may engender a sense of despair that nothing can be done. Already the public suffers from moral fatigue. The bar on what triggers public outrage has been continually raised to keep pace with the ever-expanding and insidious nature of money and politics, to the point where citizens are inured to virtually every disclosure.

Part of the challenge facing those who still believe that disclosure has a primary role to play—and I am one of these—is how to sensitize a public weary of such disclosures and not merely to add to the moral callouses that have formed in recent decades. In this context, I would argue that too much of disclosure is predicated upon the “what” and not enough upon the “why” and “to what effect.” By that I mean that we must find fresh and creative ways to document the subversion of the deliberative process and to show its impact on the lives of ordinary citizens. Narrowly defined, disclosures which go no further than documenting system disintegration and the infusion of dollars have failed to move the public and, I suspect, are not likely to do so.

For institutional corruption, disclosure alone may be insufficient. It is unlikely, in my view, that government is capable of reforming itself or freeing itself from its addiction to campaign funding. If reform is to come, it will come from without, not from within—from the public, and that will require more than tables and spread sheets recording the demise of representative government. It's not as if the public is unaware that their government has been diverted, if not outright hijacked, by campaign dollars. Public disdain for Congress could hardly be higher, but disdain has yet to produce reform.

In other words, I am not convinced that institutional corruption can only exist so long as there is an information failure, or conversely, that information is the antidote to institutional corruption. Would that it were so easy. I do not pretend to know what it will take to turn things around. I suspect there will be a role to play for political scientists, journalists, activists, artists, teachers, parents—the list is as expansive as citizenship itself. Institutions can rid themselves of individual corruption, but institutional corruption can only be dealt with by individuals acting collectively. (Almost by definition, one cannot expect an institution that has been corrupted to clean up its own act.) Disclosure is one tool among many to help mobilize citizens, but facts alone will not penetrate complacency or resignation. Disclosure writ broadly, one that identifies patterns, fleshes out the deliberative process, and links those to narratives that demonstrate public injury in the context of story (putting a face on facts), I believe, remains a formidable tool.

<http://www.ethics.harvard.edu/lab/blog/280-the-power-of-disclosure-what-power>

# The Slow Pace of Success in a “Do Something Congress”

[Paul D. Thacker](#)

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Perhaps no American institution is more important yet more hated than Congress. A recent poll found that [Congress has a 9% favorability rating](#), placing it lower than cockroaches, traffic jams, and the widely loathed Canadian rock band Nickelback.

In pointing this out to the congressional staffers I’m interviewing for my project at the Edmond J. Safra Research Lab, I always ask, “Is it fair that people hate Congress?” One staffer quipped in response, “If we polled the American public, even Hitler could get three percent.”

This antipathy is based on the perception that Congress doesn’t do anything. This message gets hammered home in the media with the “Do Nothing Congress” tagline and endless stories—some true, some not—about “bickering” and “failure to come together.”

Staffers feel the same way as the public, and they’re incredibly frustrated with the impossibility of getting anything done. The slow pace of the Hill was made perfectly clear to me a few Fridays back when I got an email from a reporter telling me that the government had [published the final rule](#) on the *Physician Payment Sunshine Act*. While working on the Senate Finance Committee for Sen. Chuck Grassley (R-Iowa), I worked with Senate lawyers to write the first draft of the bill, and then led the investigations of corruption in the medical industry that demonstrated the need to get the bill passed.

As I was reading that email, I wondered when we had really started working on the project. I couldn’t remember. I Googled the bill, then called a reporter.

“I can’t believe it,” I said. “It was more than five years ago that I went to the Senate Legislative Counsel and sat down with them to draft the bill.”

More than five years from Senate staffers having a productive idea to the time it started to affect policy. It was an incredible amount of work.

## The beginning of a five-year odyssey

The *Physician Payment Sunshine Act* requires companies to report to the federal government any gifts or payments worth \$10 or more that they provide to physicians. This information will be available on a public website so everyone can see if a particular doctor is getting goodies from drug companies. Instead of passing as a stand alone bill, it was incorporated into the *Affordable Care Act* (Obamacare) to rein in the rampant corruption in the drug industry, where scandal after scandal has exposed doctors with financial conflicts of interest.

It all began back in 2007, when *The New York Times* [reported on Anya Bailey](#), a teenager who was suffering horrific side effects from the drugs she was prescribed to treat her bipolar disorder. As the *Times* reported, the only evidence that the drug Seroquel that Anya was



taking actually worked came from a flimsy study sponsored by AstraZeneca. The lead author was an academic physician—Dr. Melissa DelBello.

A few sentences in the story caught my eye and got the ball rolling. I still remember walking into the office of the committee's Chief of Investigations and reading her this passage:

Dr. DelBello, who earns \$183,500 annually from the University of Cincinnati, would not discuss how much she is paid by AstraZeneca.

"Trust me, I don't make much," she said.

It seemed clear to us both that Dr. DelBello was being less than honest. To figure out how right or wrong we were, we called the chairman of her department to demand the conflict of interest forms she had filed with the university. We could hear the panic in his voice when he came to the phone. Since the story had come out he had already taken multiple calls on this, he told us.

Why, he wanted to know, did we want this information on a professor in his department? "You realize that if this type of information, if it becomes public, can destroy a person's career," he said. He added that it might cause a "misunderstanding" and that people might think that a doctor is corrupt if they are taking money from a drug company.

"We're worried about the same thing," I said. "People read this and get misled by reporters and sensational journalism. That's why we're calling you—to figure out how much money she's taking from the companies. That way we know all the facts and there's no misunderstanding."

After we got the financial information on Dr. DelBello from the university, I knew we had an issue with legs. The forms showed that Dr. DelBello was taking tens of thousands of dollars from drug companies. Before we went public I outlined what we wanted the bill to do and then met with Senate Legislative Counsel, to draft the actual language.

After I got a draft bill sent to me, I wrote a speech about what we had learned and [Senator Grassley read](#) it from the Senate Floor:

Dr. DelBello's study, which helped put Seroquel on the map, was published in 2002. That next year, she got more money than she has ever received from the pharmaceutical companies—at least that is what the documents that I have say.

In 2003, AstraZeneca alone paid her a little over \$100,000 for lectures, consulting fees, travel expenses, and service on advisory boards. In 2004, AstraZeneca paid her over \$80,000 for the same services.

*The New York Times* [reported on Grassley's speech](#), noting that he planned to introduce legislation to require companies to report this money they were giving to doctors. Grassley told the *Times* that he was simply holding doctors to the same ethical standards as elected officials who are required to report campaign donations.

A few months later, we [formally introduced the bill](#) with Sen. Herb Kohl (D-Wisc.) as a co-sponsor.

Nothing gets passed in Congress, and we had no idea if we could get this bill through. Big Pharma is a very powerful industry, and all the major players were fundamentally opposed to what we were doing. How could we get this done?

“You gotta be cynical to work on the Hill. Because it will crush you if you come in here hopeful, and thinking that change can happen. Because if change happens, it’s extremely slow.” (Senate Republican Staffer)

To lay the groundwork, we started talking with pharmaceutical companies, to see what they thought. In one early encounter, the vice president for a big company told us the bill would create huge expenses if it became law. As he explained it, companies provide all types of money to doctors, and these funds come out of different pots. A doctor may get taken out for dinner by a drug representative. The marketing department may pay the same doctor to give a talk. The research department may give him a grant for research. Each department is different and companies don’t maintain a central database to track how much money they give to each doctor.

“Do you want to go public with the argument that you can’t track all this money because you’re shoveling so much of it out the door to doctors?” I asked. “I’m just not sure if your shareholders would be happy to hear this.”

Still, this gave us a sense of the argument that pharma would use: the bill would create expensive regulations and drive up costs, hurting the public and potentially reducing access to lifesaving drugs.

To counter this line of attack, we launched a wide-ranging investigation into the scope of the problem. After talking to a variety of experts—people like Marcia Angell, the former editor in chief of the *New England Journal of Medicine*—and reporters who covered pharma, I put together a list of academic physicians seen as close to industry and who we thought were probably receiving industry money.

Sen. Grassley sent letters to these physicians’ universities asking for financial information these doctors had filed. At the same time, he sent letters to the nation’s largest pharmaceutical companies asking for a detailed list of payments they had given these same doctors.

But again, I didn’t know if this would work. So I thought of a different tactic to backstop the investigations and give us some sort of win. I didn’t want to spend months of time and have nothing to show for it. I had noticed that all these doctors were grantees of the National Institutes of Health (NIH), the federal agency that funds biomedical research. Even if we didn’t pass a bill, I reasoned, we could force the NIH to change its regulations and force doctors getting government grants to be more transparent about their ties to industry.

### The big push

Things changed dramatically in 2008 with President Obama’s election. He made health care reform a top priority, and the Finance Committee was put in charge of writing the Senate version.

By the summer of 2008, I had gotten the information that we were looking for from universities and pharmaceutical companies. I wrote reports on doctors at Harvard, Emory, and Stanford who had failed to report millions of dollars in pharmaceutical money to their employers. Each report was given to the press to create maximum public pressure on the medical community to support the bill.

We also held meetings with the NIH director to pressure him for better policing of grant management. At first, agency officials tried to ignore the need for reform, arguing that they were a science agency and not an enforcement unit. We reminded them—in letter after letter—that the \$30 billion Congress appropriated to the NIH belonged to the taxpayers, and that public money came with strings attached.

Heading into 2009 we detected a change in industry's position. The media was publishing frequent stories about doctors on the take, and the old excuses weren't panning out any longer. Pharmaceutical companies were agreeing that change was needed, and that "transparency" was right approach. NIH officials changed their tune and agreed to reform the rules for their grants.

Our sunshine language was attached to the healthcare bill working its way through Congress, and was eventually passed with the rest of the *Affordable Care Act* in 2010.

It was now up to the agencies to write new regulations and start to enforce the law.

We also continued to apply pressure to Obama's NIH chief, Francis Collins, to change the NIH conflict of interest policies for their grantees. He later met with our office to discuss how to do this. After months of discussion, his team finalized its drafts and sent them to the White House for final approval. These proposed regulations would require NIH grantees to report monies they received from industry and require employing universities to post these reports online. At the last minute, the White House stripped out the reporting requirements. The watered-down version became the new standard.

The department of Health and Human Services (HHS) began promulgating different regulations for the Sunshine bill. The new law had rule-writing deadlines that the agency was failing to meet. By this time I had left Capitol Hill, but staffers for Sens. Grassley and Kohl kept working and sent several letters to the agency and the White House demanding that the regulations get done. Sen. Kohl's staff had invested hundreds of hours of time on the bill: giving speeches to medical societies, holding multiple hearings on the Senate Committee on Aging, and taking scores of meetings with stakeholders.

A few months before Obama's 2012 reelection, the HHS regulations were sent over to the White House for final approval. They were finally released a few weeks ago.

It took more than five years to get it done.

Now that it's all over, I can tell you it was worth it. This bill will bring some balance back to the relationship between doctors and industry. We need them to work together—industry needs the insight from expert physicians to create the next generation of drugs and devices, and doctors need these products to save lives. But we cannot tolerate companies buying off doctors who put profit before patients.

Years from now, I think people will look back on these reforms—the Grassley/Kohl Sunshine Act—and realize that they made academic medicine better. Few people will know about the staff behind the scenes making it possible. Even fewer will truly appreciate the long hours and great deal of stress we went through.

Even when Congress gets something done, it takes an incredibly long time and years of dedication.

<http://www.ethics.harvard.edu/lab/blog/281-the-slow-pace-of-success-in-a-do-something-congress>

# Membership Has Its Privileges: Donor Perks and the Atlantic Council

[Ken Silverstein](#) and [Brooke Williams](#)

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The Atlantic Council, a Washington think tank chaired by Chuck Hagel, President Obama's nominee for defense secretary, released a list of foreign donors in response to demands from Republican senators, who blocked his confirmation vote last week.

In a letter addressed to Hagel, the Council's president and CEO, Frederick Kempe, a former columnist at *The Wall Street Journal*, defended the think tank's intellectual independence and outlined its ethical policies, including clearly and consistently disclosing funding from foreign governments.

Kempe's letter listed roughly 100 corporations and 15 governments that donated to the Council in the past five years. But the list in the letter was hugely different from the one on the think tank's website. Indeed, the Council's online disclosure was missing key funders, including Bahrain, Jordan, Sweden, Saudi Arabia, Taiwan and Kazakhstan. If it weren't for Hagel's nomination and subsequent spotlight on the think tank's funding, their support might still be secret.

The Council didn't disclose in the letter or on its [website](#) exactly how much money countries and corporations had given. As a nonprofit organization, it doesn't have to divulge details about where it gets its cash. This is especially problematic given that the Council invites donors to pay for and participate in specific projects—even those in which they have a financial stake.

Kempe's letter described the Council's "Intellectual Independence" policy: "The Council maintains clear policies to ensure its ethical and legal operation as [an organization]... which values its credibility and integrity as a generator of creative ideas," Kempe wrote. "All agreements with donors stipulate that the Council retains intellectual independence and control over any content."

Following the release of Kempe's letter, James Joyner, the Council's managing editor, took to the think tank's website to publish a blog post entitled "The Atlantic Council, Foreign Funding, and Intellectual Independence." "Like all organizations of its kind, the Atlantic Council has to fund its work by cultivating donors," he wrote. "But we've always placed the integrity of our work above the preferences of our funders. Indeed, under the leadership of Hagel and Kempe, we've recognized the potential for these relationships to confer an appearance of conflict and therefore outlined detailed policies for review of foreign government funding and intellectual independence."

The Council's claims of intellectual independence are hard to square with its own promises to big donors which can be found on its website. "The Council works with our partners to develop their substantive narrative and determine the types of tools and products, including event opportunities and co-branded publications, required to meet their goals and needs," says one fundraising pitch. Another invites companies to contribute to research and reports

that “will help position them as thought leaders and influence top leaders in government, business, the military, and academia.”

Kempe said during a phone interview that the Council does not advocate for donors and that “in the context of what you’re talking about, rewording [of the pitch] perhaps would be useful.” He said the donor list on the website must be outdated.

The pledge of intellectual independence is also hard to square with services the Council has rendered to at least one of its foreign donors, the government of Kazakhstan.

Kazakhstan is headed by [crooked dictator Nursultan Nazerbayev](#), who has declared himself president-for-life. The country’s rubber stamp parliament has granted him the permanent right “to address the people of Kazakhstan at any time” and to approve all “initiatives on the country’s development.”

The U.S. State Department’s latest report on global human rights cites [extensive problems in Kazakhstan](#). The most significant, among a very long list, were “severe limits on citizens’ rights to change their government; restrictions on freedom of speech, press, assembly, and association; and lack of an independent judiciary and due process, especially in dealing with pervasive corruption and law enforcement and judicial abuse.” Meanwhile, the oil-rich Kazakh government has in recent years spent millions of dollars on American lobbyists and PR firms to help improve and deepen its relationship with the United States.

Last year, the Atlantic Council hosted a [conference](#) on Kazakhstan. The conference was paid for by Chevron, which has vast oil [interests](#) in the country and is a [top-level](#) donor (\$100,000-and-up) to the Council, and the Kazakh government, Kempe acknowledged. He declined to say how much they contributed, “not because I don’t want to but because we’re not authorized to give numbers.”

Chevron and the Kazakh government are partners in a variety of [initiatives](#) in the country. While each certainly has its own, separate interests, this arrangement seems to violate at least the spirit of the Council’s policy that it will try “to ensure that any one project is not dependent on one government funder.”

Not surprisingly, the conference was essentially a love poem to Nazerbayev. During introductory [remarks](#) Hagel talked about “the partnership that evolved and grows and strengthens each day between our countries,” according to the conference transcript, and said the Kazakhs “were responsible for pulling together a very, very impressive country that has made astounding progress.”

Keynote speakers included Kenneth Derr, who was CEO of Chevron when it forged a partnership with Kazakhstan and is now the country’s Honorary Consul in San Francisco. “Under President Nazarbayev’s extraordinary leadership, Kazakhstan is now independent, secure and extremely prosperous,” Derr said, according to a conference transcript. Yerzhan Kazykhanov, Nazerbayev’s Minister of Foreign Affairs, was another keynoter. During his visit to Washington, the foreign minister [presented](#) several Americans, including Hagel, with state awards from the Nazerbayev regime.

“We chose all the speakers; we chose the subjects,” Kempe said. “If you look through the whole day of speakers, they’re hardly cheerleaders for Kazakhstan.” He pointed to Lorne Cramer of the International Republican Institute as someone who offered a critical

perspective. Yet according to the transcript, Cramer had this to say: "I will tell you, as somebody that deals in human rights and democracy, that there's a lot to praise in Kazakhstan."

A Council speaker acknowledged that Chevron had sponsored the conference but the think tank said nothing about donations from Kazakhstan, based on transcripts of the affair. The closest it came was when Ross Wilson, director of the Council's Dinu Patriciu Eurasia Center, told the audience he wanted to recognize Kazakh Ambassador Erlan Idrissov, "a friend of many of us, who encouraged the council to put together this retrospective and prospective look at Kazakhstan that we'll have today."

In conjunction with the conference, the Council released three issue briefs, a perk offered to big donors, for a certain price. In a fundraising pitch on the Council's website, they're described as a "succinct document analyzing a specific, relevant topic with an emphasis on recommendations for policymakers." All three briefs offered positive analysis about the Nazarbayev regime though none mentioned the financial support from either Chevron or the Kazakh government.

Roberts, who chaired a panel on US-Kazakh relations, wrote one of the briefs. "In looking at twenty years of independence in the former Soviet region of Central Asia, Kazakhstan stands out in most respects as a stable oasis in a desert of uncertainty," he wrote. "It is little wonder, therefore, that the most stable and fruitful bilateral partnership for the United States in the region over the past twenty years has been with the Republic of Kazakhstan."

What good is the Council's pledge of independence if the think tank remains dependent on money that creates a conflict of interest? How could anyone trust the independence of a conference on Kazakhstan paid for by Kazakhstan? In order to trust the research of an institution, the public must be able to trust its independence.

What all of this says about Hagel's fitness to lead the Pentagon is not clear. What is clear, though, is that the Atlantic Council—like so many other Washington think tanks—has a definition of "intellectual independence" that differs from typical scholarly institutions. Hagel, via his unpaid position atop the board, surely didn't invent this system, but he also doesn't appear to have stopped it.

(Note: A version of this story originally ran in the [New Republic](#).)

<http://www.ethics.harvard.edu/lab/blog/282-membership-has-its-privileges>

# Synergies Between Moral Philosophy and Institutional Corruption

[Donald W. Light](#)

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The felicitous occasion of Michael Sandel delivering the [inaugural Kissel Lecture in Ethics](#) on behalf of the Edmond J. Safra Center for Ethics provides a fit opportunity to advocate for the synergies that can occur by joining moral philosophy with institutional corruption theory in a sustained, mutually beneficial dialogue.

Sandel's lecture and recent work<sup>1</sup> center on how money and commercialization have and can crowd out or corrupt "moral virtues" such as civic duty and participation, democracy, honest-dealing and transparency, succor or duty to the sick or poor, compassion, loyalty, and trustworthiness. This focus nicely complements most of the work at the Center on the corrupting effects of money and commercialization of institutions that are supposed to support and advance one or more of these virtues.

Institutional corruption theory can give Sandel's work more power and scope into larger realms by considering organizational and institutional examples. There are also major, well-documented cases of how institutional corruption has destroyed a societal good that can give Sandel's arguments greater scope. For example, Blue Cross health insurance was set up in the 1930s to enable hospital care for seriously ill patients to be paid equitably through community-rated premiums on a non-profit, voluntary basis.<sup>2</sup> Commercial companies then began in the 1950s to undermine this societal provision of fairness by risk-rating and offering lower premiums to healthier groups. This increased the risks of the remaining pool in Blue Cross plans and forced them to raise their community-rate premiums, which then enabled the commercials to risk rate even more, by person, occupation, and specific illnesses. I spent several years in two campaigns to stop this form of institutional corruption, at least for a while.<sup>3-5</sup> The *Affordable Care Act* centers on restoring the fairness of the Blues but for everyone. The commercials, however, have kept in the law unfair discrimination against those at higher risk in provisions that no other affluent, capitalist country allows.

Professor Sandel pointed out that context and culture must be taken into account in assessing many moral dilemmas, conflicts, or actions. Several projects at this Center on institutional corruption involve in-depth detail on the context, culture, and countervailing powers at play in a given domain. Sociological and anthropological studies of how forms of structural corruption actually take place can contribute to deliberations in moral philosophy. These may include relationships of togetherness, friendship, and solidarity.<sup>6</sup>

In complementary ways, institutional corruption theory could benefit from drawing upon selected parts of moral philosophy. As Dan Wikler has pointed out, the claim that something is "corrupt" or "corrupted," or that one party is corrupting another must be anchored in moral principles outside of that claim.<sup>7</sup> In the case of big money corrupting democratic elections, this need is less obvious because big money in elections corrupts the democratic process by definition. As soon as big money becomes a factor, corruption begins. Thus even if the major donors were ideal philosopher-kings, and even if their priorities and values were



exemplary, the very institutional arrangements by which big money skews elections corrupts them.

In other realms, however, such as the professions, think tanks, banking, or the pharmaceutical industry, big money is not inherently corrupting. Defining which practices or institutional arrangements are requires an external moral purchase. Self-corruption may take place.<sup>8</sup> Consider the case of public housing. If we start with a moral commitment to provide housing for the poor (an argument that needs fuller development), how should it be arranged and funded? How shall builders be paid to construct it? In what ways do legal and institutional arrangements become “corrupt,” as distinct from inefficient or wasteful?

Finally, moral philosophy can help in the search for solutions to given cases of institutional corruption. It can provide depth and persuasive power. We can draw on a wealth of talent and experience, and a focus on Sandel here should not detract from the relevance of work by a number of distinguished moral and political philosophers at or near the Center.

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<http://www.ethics.harvard.edu/lab/blog/283-the-synergies-of-joining-moral-philosophy-with-institutional-corruption-theory>

# Physicians and the Pharmaceutical Industry: Where does this Story Begin?

[Kirsten Austad](#) and [Aaron Kesselheim](#)

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This blog post discusses the article "Changing Interactions Between Physician Trainees and the Pharmaceutical Industry" published in the February 27, 2013 electronic edition of the [Journal of General Internal Medicine](#). The study was conducted by former Fellow in the Lab on Institutional Corruption Kirsten Austad, Lab affiliates Aaron Kesselheim M.D. J.D. and Eric Campbell Ph.D., and Jerry Avorn M.D. and other members of the Division of Pharmacoepidemiology and Pharmacoeconomics in the Department of Medicine at Brigham and Women's Hospital and Harvard Medical School.

Within a week of its online-first publication the article received worldwide coverage, including [The Boston Globe](#), [Stuttgarter Zeitung](#), [Popular Science](#), [Pharmalot](#), HealthDay (in [English](#) and [Spanish](#)), and a host of medical and legal themed news portals and blogs.

It is well known that physicians have frequent interactions with the pharmaceutical and device industries. While some interactions are in the context of research collaborations, others are more promotional in nature, and may involve sponsored educational dinners or free product samples (Wazana, JAMA, 2000). While recent surveys suggest that the public is skeptical of physician-industry relationships (Consumer Reports survey, Aug. 2010), many doctors find these promotional relationships to be useful and deny that they influence medical judgment. Physicians' acceptance of industry promotion as a routine part of medical practice may have its roots in the fact that marketing interactions begin early in medical training.

Like all professions, medical school socializes students in to the role of doctor, and each stage of training presents unique opportunities for interactions with industry marketing representatives. First-year students are "pre-clinical," spending their time learning the fundamentals of their profession in a classroom setting where they may receive lectures from professors who also serve on speakers' bureaus. During third- and fourth-year they transition to immersion in the hospital environment where they begin to learn the practical aspects of patient care and may observe the daily interactions between their supervising physicians and industry representatives, including free meals at sponsored lunch talks. After graduation, trainees enter residency where they carry out the patient care responsibilities and may utilize industry representatives present in the clinical environment as resources to inform their prescribing.

In the past decade, many academic medical centers have implemented policies to shield trainees from promotional interactions with industry. These policies include banning free meals or other gifts, mandatory disclosure of teaching faculty members' conflicts of interest, and formal curriculum time devoted to learning about professional ethics. However, there is little empirical evidence to guide development of these policies and perhaps as a result, policies vary widely between institutions and there is no consensus on where efforts would best be focused.

Our study aimed to systemically examine how pharmaceutical and device industry promotional representatives interact with trainees over the course of their medical education, and how trainees view the role of industry marketing in medical education. We surveyed a large, random sample of first-year (pre-clinical) medical students, fourth-year (clinical) medical students, and third-year residents, representing all 121 U.S. allopathic (M.D.) schools. Demographics of our respondents compared favorably to the survey of graduating medical students conducted by the Association of American Medical Colleges (AAMC), which boasted an 83% response rate in 2010 (AAMC website), confirming that our sample was indeed representative.

Our results were surprising: despite the significant changes over the past decade, 33% of first-year students, 57% fourth-year students, and 54% residents reported accepting a gift within the past six months. Though this level of exposure is reduced compared with a more limited study of third-year medical students published in 2005 (Sierles et al, JAMA), this demonstrates that gift-giving is still prevalent. Receipt of gifts was common despite the fact that a minority of trainees felt it was appropriate for medical students and residents to accept gifts of less than fifty dollars in value (by year of training: 26% vs. 23% vs. 35%). Observing mentors' interactions with industry was also common, with 33% first-years, 59% fourth-years, and 53% of third-year residents reporting this occurrence. The frequency of trainees using industry for educational purposes also increased with training level across a variety of sources, including sponsored lectures, sales representatives, and promotional materials.

It is well-documented that most physicians believe they are less susceptible to influence from gifting than their colleagues (Wazana, JAMA, 2000). In our survey, all levels of training were more likely to report that their peers are influenced by accepting gifts from industry than they are swayed (52% vs. 33% for first-years, 46% vs. 36% for fourth-years, and 42% vs. 34% for third-year residents). Though this was not a longitudinal survey, we noticed a potential trend based on year of training for certain attitudes. For example, while 68% of first-year students reported that physician-industry interactions threaten the public's trust in doctors, only 55% of four-year students and 46% of third-year residents agreed with this contention. There are two potential mechanisms for such changes in attitude. One possibility is that as trainees learn clinical medicine through observation and emulation of mentors, they also absorb the views of the role models around them. Alternatively, if students accept gifts that are prevalent in the environment, they may subconsciously adopt attitudes that resolve the cognitive dissonance. Other research (Sah and Loewenstein, 2010) has suggested that perceived self-sacrifice is a powerful justification for residents in accepting gifts. Thus, since residents' work hours and financial strain due to loan payment are relatively worse than medical students', this could also mediate the attitudinal changes we observed.

Overall, students support policies regulating interactions between the profession and the pharmaceutical industry. Between 87 and 94% of trainees agreed with mandatory disclosure of professors' conflicts, though fewer (43-57%) felt that it was inappropriate for professors to have conflicts on a topic relevant to what they teach students. While most students felt that schools should ban the pharmaceutical industry from access to students in the pre-clinical learning environment (66-69.3%), slightly fewer felt that the same policy should apply to the clinical training sites (53-60.3%).

To explore how the learning environment influences trainees, we looked at whether responses were related to research intensity and strength of conflict of interest policy of the

respondents' medical schools. Amount of NIH funding to schools served as a surrogate for research intensity, and we found that trainees from medical schools with high research intensity were half as likely to have accepted a gift from the pharmaceutical industry in the preceding six months. This result may reflect the reality that many conflict of interest policies were crafted in response to concerns about safety of human subjects of clinical research, and thus research-focused academic medical centers were under more pressure to craft policies. Additionally, drug manufacturers may be more likely to cultivate relationships (facilitated by gifting) with trainees at less research-intensive schools who are more likely to become community practitioners.

To evaluate the impact of conflict of interest policy strength, we used each school's AMSA PharmFree Scorecard grades from 2008 and 2010, which rates academic medical centers from A to F based on eleven areas (including gifts, disclosure, and sales representative access to clinical areas). Interestingly, we found no association between respondents' medical school Scorecard grade and frequency of accepting gifts. Why might this be? Because the grade is a composite measure, it is possible that not all of the domains that contribute to the grade modulate students' exposure to industry, or their perceptions of interactions. Notably, a recent study (King et al, BMJ, 2013) that found that graduates of medical schools with strong policies prohibiting industry gifts were less likely to prescribe heavily promoted psychotropic medications (vs. clinically appropriate, inexpensive generic alternatives), as compared to those who trained in environments without such rigorous gift restrictions.

Another possible explanation for the lack of association that we found between survey responses and medical schools' PharmFree Scorecard score is that existence of a conflict of interest policy—even a strong one—is not enough. First, our data showed that a surprisingly low number of respondents (ranging from 10% of first-years to 24% of residents) reported understanding their schools' conflict of interest policies, suggesting that more trainees need formal orientations to their institutions' policies. Second, it is possible that school policies may be undermined by other aspects of the environment. According to Hafferty (Academic Medicine, 1994), the "hidden curriculum" denotes the norms and values learned through informal mechanisms such as off-handed comments made by attending physicians or observed behaviors of peers and mentors, and is thought to be an important contributor to development of professionalism. For example, a medical student may know that his school forbids accepting lunches from industry representatives but rationalize this behavior as appropriate and accept it himself after being told by a supervising resident "if you want to survive in the hospital environment, you take free food when you can get it." Trainees in an environment where a policy prohibiting gifts exists but is not adhered to by all faculty or affiliated institutions could paradoxically become more likely to accept gifts. Our survey indicates that there are lapses in compliance: only 29% of first-year students, 59% of fourth-year students, and 52% of third-year residents felt that their faculty complied with the policy "very well." This disparity between the formal policy and the implicit lessons taught via the hidden curriculum may mediate behaviors and attitudes.

The potential impact of the hidden curriculum is one of many questions arising from our data that merit further investigation. In one forthcoming project, we will consider how trainees learn about medications and explore their ability to correctly differentiate evidence-based treatments for common clinical scenarios. In the future, we also hope to conduct a follow-up study in which our survey respondents are re-contacted later in their professional development and results linked to their prescribing patterns. This longitudinal data will help

us further examine how various aspects of the medical school learning environment affect physicians' attitudes and behaviors relating to pharmaceutical and medical device industry promotion.

<http://www.ethics.harvard.edu/lab/featured/285-physicians-and-the-pharmaceutical-industry-where-does-this-story-begin>

# Institutional Corruption and Countervailing Powers

[Donald W. Light](#)

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By its very nature, institutional corruption (IC) occurs in a force-field of countervailing powers. Corruption at the organizational or institutional levels inherently involves a larger constellation of stakeholders who participate in or are affected by the corruption being studied. Beyond them are other parties with other priorities who shape or are affected by different forms of corruption. These include public opinion and trust if its deterioration leads to organized responses. Doing research on how countervailing powers interact with the corruptors and shape either the forms of corruption or reforms for integrity to end it would strengthen IC studies.

Montesquieu<sup>1</sup> first developed the idea of countervailing powers in his 1748 treatise about the abuses of absolute power by the state and the need for counterbalancing centers of power. In 1767, Sir James Steuart<sup>2</sup> contributed ironic observations on how the monarch's promotion of commerce to enhance its domain and wealth produced the countervailing power of the mercantile class that tempered the absolute power of the monarchy and produced a set of interdependent relationships. The *Federalist Papers* in 1787-1788 addressed the need to balance countervailing powers.

In modern times, "countervailing powers" was first conceptualized by John Kenneth Galbraith, who wrote "Power on one side of a market creates both the need for, and the prospect of reward to, the exercise of countervailing power from the other side."<sup>3</sup> This statement has four implications: that dominance by one party plays an important role; that dominance leads to imbalances, exploitations, or distortions; that a countervailing power may be latent in a given domain but organize into manifest forms in response; and that countervailing power is a dyadic relationship.

In contemporary economics, Galbraith's concept has become rather narrowly construed to refer to the ability of large buyers to extract discounts from suppliers. In sociology, however, it has been substantially expanded to posit three or more latent or mobilized countervailing powers in a contested field or domain, whose boundaries and relations they shape over time.<sup>4</sup> Each stakeholder also has its own rationale and basis of legitimacy.

This conceptual framework allows one to trace and diagram the historical changes among key stakeholders, take measure of their power, describe their alliances and contests for power, and document the effects on costs, products or services, scope, and culture. For example, in the early 20<sup>th</sup> century, American medical organizations came to dominate all other stakeholders through legal and economic rule-making which its members then exploited.<sup>5,6</sup> This very dominance increasingly prompted stakeholders like employers, insurers, and taxpayers to develop increasingly powerful countervailing strategies to limit the legal and economic dominance of the profession. Now something similar is happening to the pharmaceutical industry.

The state as a countervailing power deserves special comment. The countervailing powers framework does not depend on any one view of the state. For example, after World War II, the East German state eliminated all professional associations as countervailing powers that corrupted its Communist mission. In West Germany, the democratic state allowed the organized medical profession to exploit universal health care to maximize its income and control until the 1980s, when the state and insurers as countervailing powers allied to harness professional practice to the needs of an affordable, universal health care system. In pharmaceuticals too, dominance has prompted countervailing responses.

A central tenet of countervailing power theory is that dominance by one party in ways that corrupt the mission of a social institution and societal function of other parties will over time prompt them to organize and alter the balance of power. This appears to be happening to the pharmaceutical industry, which has (1) abused patents by developing “innovative” drugs that are usually little better than existing ones, (2) compromised medical science and knowledge through conducting randomized clinical trials in biased ways and hiding negative results, (3) compromised the integrity of medical journals by ghost-managing “scientific” articles slanted in favor of the sponsor’s drug, (4) tainted medical education through commercial influences, (5) corrupted the fiduciary commitment of physicians to their patients with commercial inducements, and (6) threatened the ability of countries to afford universal health care by charging exorbitant prices.<sup>7</sup>

Over the past 15 years, stakeholders have organized to curtail forms of institutional corruption. For example, (1) India is beginning to lead the developing world in limiting product patents and excluding variations like the “breakthrough drug,” Gleevec, whose patent protection was denied. 2) Researchers have organized their voice against biased science and suppressed or distorted findings, leading to an ever more complete set of stipulations for transparency and registries. 3) Medical journal editors have taken several countervailing measures to protect the institutional integrity of their journals against institutionally corrupting practices. 4) Organized medical students have been pressing rule changes to de-commercialize medical education. Actual prescribing practices are changing,<sup>8</sup> yet commercial influences and an informal culture persist.<sup>9</sup> 5) Medical and specialty associations have taken several measures to try to restore professionalism and public trust. 6) Most affluent nations and India increasingly assess the comparative effectiveness of new drugs and pay accordingly, thus countering the undermining effects of unaffordable prices on affordable, universal health care as a social institution. Through these countervailing responses, dominant financial, legal, and organizational practices that distort the goal of better health through universal access to beneficial services are being addressed with increasing force in ways that also contribute to defining what institutional integrity would mean.

One new countervailing power in institutional corruption is the organization of researchers and resources against it as an academic subject. Through the generous support of Mrs. Safra, the Edmond J. Safra Center for Ethics is developing a widening network of researchers across disciplines, a set of data tools, research methods, and substantive studies that together are inspiring other universities to follow its example of making institutional corruption an important subject of policy research.

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<http://www.ethics.harvard.edu/lab/blog/286-institutional-corruption-and-countervailing-powers->



# John Reed: On the Value of Values

[Gregg Fields](#)

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For those who study institutional corruption, one of the most confounding difficulties can be establishing its boundaries—particularly the tipping point at which it veers into the criminal variety.

The challenge is particularly vexing for those examining the aftermath of the 2008 financial crisis. Wall Street recklessness pretty clearly crashed the world economy. A host of civil complaints—and settlements—have outlined egregious behavior at banks, credit rating agencies and other financial players. Which begs the question: How is it possible that no crime was committed?

In [an insightful lecture](#) Thursday evening, sponsored by the Edmond J. Safra Center for Ethics, one of the most noted financial figures of his generation shared his insights on the subject. John Reed, the former Citigroup leader, who became chairman of the MIT Corp. in 2010, made clear his distaste for the ways Wall Street evolved through the years, nurturing activities that would lead to the financial collapse.

But, he added, that doesn't automatically translate to a criminal activity. "Did the industry become corrupt?" Reed said, speaking to a receptive crowd in Austin Hall. "Yes, in my mind."

## Crime vs. Corruption

Yet, he elaborated by noting that the corruption concerned the institutions' business models and corporate cultures. Ultimately, it resulted in the institutions becoming dependent on relationships that didn't serve the public interest. "I don't think it was largely a criminal thing," he said. "I think it was largely a corrupt thing."

What's the difference? Crime, obviously, relates to laws. Corruption of the kind Reed outlined relates more to values—though not the financial kind. (His lecture was titled, "Shareholder value vs. values.")

For instance, when he joined Citibank in 1965 the highly regulated industry "was almost a utility," he said. "It was a world, at the time, where the customer was first." Citibank didn't even have a formal budget, he said, and earnings were something of a corporate afterthought.

As he rose through the ranks, Reed himself became known as one of the industry's top innovators. Most notably, he revolutionized consumer banking by leading a relentless push in the 1970s to install ATMs at Citibank branches, with the rest of the industry racing to catch up. He retired from Citigroup in 2000.

In his lecture, Reed spoke of several factors that, over time, converged to create the shift in American corporate values that led to the financial crisis. One, the comparatively genteel world of finance became more cutthroat, he said. An example was, in the 1980s, the

widespread practice of “greenmail,” where outside investors would buy stakes in companies, then demand a premium to go away.

That led to a growing fixation on “shareholder value.” High stock prices could help thwart greenmailers. And companies began adopting compensation based on stock options—the theory being that management is rewarded if shareholders are. Compensation soared. In one case at his bank, he said, executives who were in line for a total of \$40 million in bonuses instead got options which ultimately were worth more than \$200 million.

### An engineered crisis

For banks, an additional factor was the rise of so-called financial engineering. Traditional lending is a low-margin business, with a limited upside potential. So increasingly they turned to new products like mortgage-backed securities, which offered greater returns. Over time, a proliferation of other financial products came on line.

Profits rose, and banker pay soared. But in the process, the historic banking culture—the values Reed encountered as a trainee in the 1960s—were altered. Bankers were now traders rather than lenders. “Instead of being customer-centered, you become salesmen who sell products to investors,” Reed said. “All the inducements were running in the wrong direction.”

In the years preceding the financial crisis, the prevailing values led Wall Street to market questionable products like derivatives and subprime mortgages. “The industry started inventing things that weren’t so good,” Reed said. “We created a garbage industry.”

In a question and answer session following his lecture, Reed acknowledged being at the center of an event that some critics say contributed to the financial crisis. In 1998, Citicorp merged with Travelers Group, run by financier Sandy Weill. Travelers Group was a financial conglomerate whose properties included a namesake insurance company and an investment house called Salomon Bros. It was billed in *The New York Times* as the largest corporate combination ever.

The merger of all these financial businesses led to the repeal of the Glass-Steagall Act, which historically barred traditional banks from engaging in the riskier activities of Wall Street investment banks. Glass-Steagall’s demise, some critics contend, unleashed banks and helped inflate the massive credit bubble that would later burst and usher in the Great Recession.

“I wouldn’t do the merger” today, Reed said. “It was a mistake. Not on business grounds, but a mistake on social grounds.” Of commercial versus investment banking, he added: “I do believe now there is no upside to putting these two businesses together, and a tremendous cultural downside.”

### The same players

He is a proponent of the proposed Volcker Rule. Part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Volcker Rule would re-build some of the old firewalls between investment and commercial banking. But the rule is yet to be implemented, bogged down by fierce industry opposition. “Anyone who says you can’t do it is just lying,” he said.

After retiring from Citigroup, Reed was named interim chairman of the New York Stock Exchange in 2003 after its previous chairman, Richard Grasso, resigned in a controversy involving his compensation. Reed agreed to do the job for \$1.

Despite the passage of Dodd-Frank in 2010, Reed acknowledged not a lot has changed. For one thing, the people who led Wall Street before largely lead it now. "I was quite surprised the CEOs and boards continued as they were before," Reed said.

Industry reforms have languished. Reed suggested one problem is Dodd-Frank itself. It is so big, and so vague, that the ability of regulatory institutions to implement it is effectively blunted. Credit "the power of the lobbyists," Reed said, adding: "It's very much in their interest to have legislation that runs 10,000 pages."

<http://www.ethics.harvard.edu/lab/blog/287-john-reed-on-the-value-of-values>

# Lobbyist's Progress: An Interview With Jeff Connaughton

[Sheila Kaplan](#)

Time was, Washington lobbyists followed a certain protocol at political fundraisers. They'd drink the bourbon, eat a few crab cakes, surrender their checks and move on. Anyone familiar with the form knew better than to ask a lawmaker for a favor while money was on the table—that's what the morning after follow-up call was for.

To Jeff Connaughton, former lobbyist, White House lawyer, and Senate staffer, the disappearance of that small restraint is not a good sign.

"It used to be verboten to bring up an issue at a fundraiser," said Connaughton in a recent interview. "Of course they'd call the next day. But, over the years, primarily because Congress is so pressed for time and the need to raise huge sums of cash, it's literally become the Senator or Member going around the table, one-by-one, 'What's your issue?' How can anyone feel good about how that must look to the American people?"

Connaughton takes aim at the political money chase, the role of lobbyists on Capitol Hill, and the infinite influence of the financial services industry in *The Payoff: Why Wall Street Always Wins*. The book, published [\[Prospecta Press\]](#) last September, also traces Connaughton's personal story: from idealistic college student spellbound by a visit from Joe Biden to the University of Alabama, to jobs as a Biden fundraiser and staffer, to the Clinton White House, and then through the revolving door to cash in on his experience by co-founding one of the most lucrative bipartisan lobby shops in Washington.

Along the way he raised hundreds of thousands of dollars for Biden, Clinton and other Democrats, and made a small fortune for himself, acquiring the accoutrements of the successful lobbyist's life: house in Georgetown, speedboat on the Chesapeake, bespoke suits, and a nagging sense that he was part of a corrupt system.

Over the decades, Connaughton remained loyal—if not close—to Biden; with a political allegiance that he readily admits was less out of personal affection than the certainty that in Washington one must be branded as close to a powerful elected official, and the Delaware Democrat would be a most lucrative connection. He worked on Biden's 2008 presidential campaign; then, when Biden was named as Obama's running mate, worked on the pre-transition team. Following the election, Connaughton served briefly as part of Biden's vice presidential transition team.

But incoming President Barack Obama had launched, Connaughton wrote, an "anti-lobbying jihad," refusing to accept lobbyists into his administration (except for the ones he did accept, like Goldman Sachs lobbyist Mark Patterson, who served as chief of staff to Treasury Secretary Tim Geithner). As a consequence, Connaughton contemplated continuing his work at Quinn, Gillespie & Associates, where he could boast of close ties to a sitting vice president. But Ted Kaufman, Biden's longtime chief of staff, who had just been appointed

to fill out the rest of Biden's Senate term, had a different idea and offered Connaughton a chance to go back through the revolving door, this time into public service.

In the foregoing months, Lehman Brothers had declared bankruptcy and the Dow had plunged. As Connaughton writes, "I was livid about the financial crisis and Wall Street's role in it. Ted was too. The economy was imploding because of Wall Street excess (and likely: malfeasance), and in the run-up to the financial meltdown the ruling class in Washington had done nothing to stop it." They decided to spend Kaufman's two-year term fighting to make Wall Street accountable for the crisis, and passing structural reforms that would prevent another one. So in 2009-10, Connaughton served as U.S. Senator Ted Kaufman's Chief of Staff.

There were some small victories, but overall, Connaughton's time in the Senate left him heartsick from the government's failure to prosecute Wall Street fraud and enact financial reforms to protect Americans. He attributes much of this failure to the revolving door ("if you work your way up and become a key government official—in Congress or the executive branch," he writes, "you can start test-driving Porsches in your final weeks in office.") He also attributes the failure to our current system of funding campaigns, which gives tremendous clout to those, like the financial services industry, with the resources to make or break lawmakers and candidates.

It's a system under which Connaughton got rich. While it's impossible not to note that, like many political whistleblowers, Connaughton didn't complain about the system until he had socked away a small fortune; it's also impossible not to give him tremendous credit for his leap back into public service at a time when he could easily have cashed in on his relationship to Biden, and become one of the most bankable lobbyists in town.

Instead, he worked with Kaufman on Capitol Hill, trying his best to take on the financial giants. And then, at the close of Kaufman's term, Connaughton left Washington. He moved to Savannah, Georgia, far away from Washington—which he writes, continues to "attract thousands of idealistic, energetic young people from across the country and lead[s] many of them to make compromises that [draw] them deeper into a corrupt system."

He recently appeared on an episode of PBS Frontline, "The Untouchables," during which he criticized Justice Department leaders. He continues to advocate for tougher financial sector regulations, and for lessening the impact of money in politics.

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Connaughton spoke to Lab Fellow Sheila Kaplan earlier this month. The following is an edited version of the interview:

SK- Why did you write this book?

JC- "I've tried to lay my career for people to pick through it and draw whatever conclusions they want. It feels personal in some ways and in other ways it doesn't. I felt the best thing I could do was write the most truthful account of Washington as I experienced it.

"I stayed away from using the word corrupt, because it's not well-defined, and I can't empirically verify it regardless (who needs to, as I think, on Wall Street issues especially, the thing speaks for itself). Instead, I trained my sights on myself, on what I called the

"diabolical tugs" I sometimes felt during my career, and tried to be my own worst critic, as symbolic of how bad things have become in D.C. over the past 25 years."

SK- In your book, you call former Senator Christopher Dodd (D-Conn.) "Machiavellian," and raise questions about the influence of Wall Street donations on his policies.

JC- "It was just common knowledge that Dodd was using his Banking Committee chairmanship to help fund his long-shot presidential campaign. ...At the same time, in 2007, while Dodd and his family literally were living in Iowa as he campaigned, he chaired only four hearings that came close to touching on the brewing financial crisis issues." [The Center for Responsive Politics, which tracks campaign contributions from Federal Election Commission records, reports that securities and investment firms were Dodd's number one donor, with \$ 1,378,048 in contributions between 2005 and 2010. Dodd, now a lobbyist, declined to comment for this blog.]

"He was one of the most popular Senators. He's a great guy, everybody likes him. That is part of the Washington story. There is this social glue that holds everybody together. ...David Brooks once wrote a column about how the elites in Washington never police other elites, there is too much of a social consequence."

SK- You co-founded one of the first bipartisan lobby shops. How did it work?

JC- "It did stay sequestered, we never pooled our campaign contributions. The Democrats decided who they would do events for, and the Republicans did the same.

"There are corporations who for decades in Washington have been sprinkling grant money around. Not just to think tanks, but to every kind of advocacy group, not-for-profit, that you can think of; to develop the ability to have multiple points of entry into the dialogue.

"You constantly look for third-party validators. ... [We would say,] 'Who can we get that it is not the voice of the client to validate our point of view, or come close to our point of view, or deliver our message?' You'd call them [academics] and the first question out of the academic's mouth would be 'is this going to be a retainer situation?'

"Recently, I was talking to a senate democratic staffer who had just attended the Aspen ideas festival, and he was describing to me the kind of people who were there, who he had dinner with, all huge corporate money. ... There wasn't a single representative of consumer groups or public interest groups. He was on his way to the Democratic Convention, where he had been invited to all sorts of corporate-sponsored parties. These staffers often move through a corporate-funded bubble, and so it's no surprise that they get more information from special interests than the public interest. And then the next phase of their career after working for Congress is too often to join the corporate bubble makers."

SK- Tell me about Obama's anti-lobbying campaign, which you describe in the book. It didn't seem to last long.

JC- "I thought it was a cynical and ineffective approach. He was demonizing lobbyists, who are just in the middle between special interests and government. Why can Obama talk to Bill Daley while he was at JP Morgan, and have dinner with Daley, take contributions from

Daley, and eventually hire Daley to be his chief of staff, but not take money from or hire Bill Daley's lobbyist? It makes no sense at all.

[Obama's financial reform policies] "reflected the world view of Wall Street technocrats who had been brought in to the Obama administration from the beginning. This man who had been elected president on a change platform, when it came to Wall Street issues, was all about appointing disciples of Bob Rubin such as Larry Summers and Tim Geithner—the very architects of the financial crisis—and ensuring continuity with the bailouts and bank-friendly policies. It's no wonder that reformers in Congress made such little headway, because these Administration officials were adamantly opposed to true structural reforms."

SK- On your first presidential campaign in 1987, you used what you called the "Amway" approach to fundraising. Tell me about that.

JC- "I think fundraising has long been about incentivizing captains to bring in sub-captains, and reward each captain, above a growing pyramid of fundraising totals, with greater access to the candidate and a more concrete connection to campaign leadership. It's actually imperative to run a disciplined operation, one that keeps people motivated and incentivized that the more they do, the more recognition and access they'll get...the more likely they'll feel pride in telling their friends they have a genuine relationship with the candidate."

"Twenty five years ago, I'd practice my fundraising pitch on my sister, and it's still a running joke between us. I'd say, 'Roger, for \$50,000 I can get you dinner with the senator in his house. For \$25,000, I can get you dinner with the senator ...not in his house. For \$5,000, you and I can have lunch and maybe the senator will drop by... but I doubt it.' And yet people responded to this, to the idea that it's far better to have dinner with the senator in his house than not in his house."

"I remember going to the 2004 Democratic convention in Boston. I was walking into one of the VIP events and I heard someone behind me muttering, 'I raised a million dollars for the campaign and I can barely even get to see Kerry. ...For Gore, if you raised half a million, you got treated like a king.'

"The best people, who can really raise money, are people who do business with a lot of subcontractors; people who have a rolodex of people they do business with, and you can imagine how the phone call goes. It is nothing about, 'Let me spend 20 minutes telling you the virtues of the candidate and 20 minutes on why I believe he's going to win.'

"The conversation is 'Write me a check to Smith for president. Do it for me.' And the person on the other end of the phone is in no position to say no. If you had to actually convince someone your candidate would win and be a great president, in most campaigns you'd never raise any money."

SK- You were disappointed with Obama on money and politics issues?

JC-"A true reform movement can only come from a presidential campaign, and that is what is so historically disappointing about Obama. He did have a moment in time and represented a promise. ...He couldn't single-handedly get money out of the system, but he could have stood up to elite interests. Certainly when it came to Wall Street, he should have done that.

After all, this was a devastating financial crisis that severely damaged the livelihoods of tens of millions of Americans. And yet, in my view, his abject failure to stand up to Wall Street has highlighted the power of money in D.C., and made even more people disillusioned."

<http://www.ethics.harvard.edu/lab/blog/290-lobbyists-progress>



# The Fiscal Fallout: A View From Below

[Daniel Weeks](#)

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When Congress closes its doors this week for the Easter recess, Senators and Representatives will return to their constituents "[armed with excuses](#)" that explain away the latest fiscal fiasco. For some in Congress, cutting [\\$85 billion](#) (14 percent) from discretionary programs largely aimed at helping those in need is simply necessary medicine. For others, sequestration should have been avoided, but now that it has come it's time to just move on. Still others maintain the cuts were overdue. And all agree the other side is to blame.

The pattern is a familiar one by now. Viewed from the inside, when budget bombs explode in Washington, DC, the flashing lights are merely camera bulbs, the fumes are what comes out of politicians' mouths, the smoke is from the lobbyist's cigar. The real effects are not felt at either end of Pennsylvania Ave: they are reserved for ordinary Americans who struggle to make a living outside the corridors of power and struggle to make their voices heard inside.

I am not much better than the political elite. I follow the budget debates from a place of relative detachment, confident in the knowledge that I am shielded from the shrapnel by my professional job and degrees. Like the politicians who put us in this fix, I often view the fiscal fallout abstractly: How many billions are we from achieving fiscal balance? What do the expert models and projections have to say? What's the ten year plan?

But not this time. When sequestration took effect on March 1st, I was far from home, in America's "homeless capital" of Los Angeles on a poverty research tour by Greyhound bus. With tape recorder in hand and a poverty-line budget of \$16 a day on which to eat and sleep and meet my other needs, I hoped to gain a more personal understanding of how life is lived in the lower echelons of American society after the Great Recession, and what it means for the promise of equal citizenship in our democracy.

Four short weeks in poverty is hardly enough time to grasp the complex conditions of those who live the life each day, but it was hard enough for me. Unlike those I interviewed, I could choose to say goodbye to such basic insecurities as not knowing when my next meal would come or where I'd lay down my head—and I did, returning to the safety of my middle class life as I write these words. Nevertheless, as an American citizen and a person of faith, I am shaken by what I saw and challenged by the conviction that poverty is far more stubborn and institutionalized than I once thought, especially in light of the recent fiscal fallout.

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Take Skid Row, "ground zero" of homeless L.A., where I spent two restless nights alongside several thousand of the city's homeless people earlier this month. Although the weather is mild, the sidewalks are wide enough to make your bed, and the police show little interest in putting you in jail (so long as you stay out of the trendier neighborhoods nearby), life is not

easy for the [quarter-million people](#) who are homeless in L.A. in a given year. Their numbers are set to rise because of the sequester, as the U.S. Department of Housing and Urban Development (HUD) [cuts back low-income housing assistance](#) for some 125,000 individuals and families nationwide.

For block after block in this homeless colony, the sidewalks are a jumble of bedrolls, faded tents, and cardboard creations. Homeless men and women—some on crutches or wheelchairs, some wearing military fatigues or prison attire—rest in the shade or push shopping carts piled high with the extent of their earthly possessions. While veterans already comprise as much as [twenty percent](#) of the city's homeless population, their numbers will likely rise as well when [federal funding for veterans](#) to transition into nonmilitary work is cut by the sequester.

Inside the windowless concrete shelter where sixty-odd homeless people and I are admitted for the night, the staff gets down to business. After a pat-down and search of our belongings, we're shown to the back where supper is a modest serving of macaroni along with a hotdog bun (no butter) and a handful of iceberg lettuce (no dressing). Ten minutes later, we're moved to the sleeping dorm where a few dozen cots (badly stained) are arrayed six inches apart awaiting the evening catch.

Silently, we take our places and prepare to pass the night with a borrowed blanket (no pillows) and what few belongings we may have brought along. On the cot to my right, an older black gentleman is audibly distressed—one of the estimated [25 percent of L.A. homeless](#) who suffer from mental illness, including post-traumatic stress. Chances are good he is also among the [half-to-three quarters](#) of homeless who are not receiving mental health or other public benefits to which they are entitled. Neither the other shelter occupants nor staff seem to notice.

In a corner of the dorm next to the bathroom, a '90s vintage TV provides the evening entertainment; there is not a book, phone, or computer in sight. Come 8pm, the lights are turned off without warning and all I can hear is a roomful of heavy breathing and the sounds of cops and robbers on TV.

Sometime around 3am, I notice a few early risers gathering up their things to catch the bus to work (as I've learned in other cities, the line forms early at the temporary employment agency). Indeed, a [majority of Los Angeles' homeless](#) are either currently employed or were employed within the last year, further evidence that low-wage work does not pay enough to live a decent life. Making matters worse, nearly [4 million long-term unemployed](#) will see their benefits cut under the sequester, according to the Department of Labor.

At 4am, the lights are turned back on and people silently gather up their things. Breakfast is a fruit cup and two slices of white bread (no butter) served in a paper bag as we exit the shelter and go our separate ways into the cool, dark morning. Another day in the land of the down-and-out.

Although sequestration is never mentioned by the homeless people with whom I passed the night, its effects will soon be felt in places like this when federal funding for emergency shelters is cut and an estimated [100,000 homeless people](#) are sent back onto the streets. Add to that the countless other federal and state programs that are not specifically geared at homeless people but on which they and millions of other low-income citizens rely—like

foreclosure prevention services, nutrition assistance for infants and mothers, job training and jobless benefits for the unemployed—and the risks to the already-insecure are greater still.

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These and other challenges that I encountered in my research point to more than mere intransigence on the part of our political leaders; they point to a lack of democracy at home. [Mounting evidence](#) in [political science](#) and other fields shows that socio-economic status profoundly affects the amount of political power a citizen commands. As a [recent study](#) found, when the interests of affluent Americans diverge from their low-income counterparts, the latter are completely overlooked in the policymaking process. It seems economic and political inequality are increasingly one-and-the-same.

Against this backdrop, we see that poverty is more than an economic or social concern. It is embedded in the very structure of our society and grounded in an unjust distribution of political power. Put differently, poverty is a democracy problem and the poor have lost their place at the table of American democracy.

To political leaders today, it seems to matter little that poor people walk the streets of our nation's capital and sleep on benches on Capitol Hill and outside the White House gates (I spent a chilly night in each place and do not wish to return). Indeed, in every state and community in the land, poor people clear the trash, pick the crops, man the gates, mend the clothes, mind the children, tend the aged, and deliver the goods that keep America going. They are ubiquitous. They are indispensable. Yet they are silent.

As many have argued before me, budgets are more than mathematical equations: they are moral expressions of who we are and who we seek to be, as individuals, families, communities, and a nation. This Easter season, let's hold our elected leaders to a higher standard—for the sake of neighbors in need and our democracy.

<http://www.ethics.harvard.edu/lab/blog/291-the-fiscal-fallout-a-view-from-below>

# Whale-Sized Institutional Corruption: Regulatory Capture and the JP Morgan Derivatives Scandal

[Gregg Fields](#)

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"It's a complete tempest in a teapot." JPMorgan Chase CEO Jamie Dimon on its London Whale trading losses, April 13, 2012

Clearly, Jamie Dimon has no gift for meteorology. When he made his infamous "[tempest in a teapot](#)" comment, the brewing storm of multi-billion dollar losses on derivatives at JPMorgan might more accurately have been described as a trans-Atlantic hurricane.

In a withering report released earlier this month, the Senate Permanent Subcommittee on Investigations paints a portrait of a multi-trillion dollar financial institution that gambled wildly on risky derivatives, freely rewrote their value to minimize reported losses, then doubled down on its bets when the red ink began to spew. All of this occurred under the allegedly watchful eye of American regulators.



Sen. Carl M. Levin (D-MI)

For many, the report was a sobering reminder that, five years after the economic crisis, reining in risky trading by banks is at best a work in progress. "Our investigation brought home one overarching fact: the U.S. financial system may have significant vulnerabilities attributable to major bank involvement with high risk derivatives trading," Sen. Carl Levin, the Michigan Democrat and chair of the subcommittee, [said in an opening statement](#) at a hearing on March 15, one day after the report was released. "The four largest U.S. banks control 90 percent of U.S. derivatives markets, and their profitability is invested, in part, in their derivatives holdings, nowhere more so than at JPMorgan."

(Some very quick background: In early 2012, JPMorgan's chief investment office—or CIO—in London "placed a massive bet on a complex set of synthetic credit derivatives," according to the report. These trades were "so large in size that they roiled world credit markets." The phrase London Whale was reportedly a nickname for a JPMorgan trader named [Bruno Iksil](#), known for making huge bets on derivatives. Some co-workers also reportedly called him Voldemort.)

In reading the massive report, ([click here to download](#)) it is impossible to miss the role that institutional corruption—in the form of regulatory capture—appears to have played in enabling the London Whale scandal to occur.

[Regulators in Captivity](#)

The theory of regulatory capture is most often linked to [George Stigler](#), a Nobel-winning economist. It refers to the process by which regulatory agencies come to be “captured” by the industries they are overseeing. From there, serving the needs of the industry takes precedence over protecting the public.

In the case of JPMorgan, it appears to have worked like this: JPMorgan’s chief regulator was the Office of the Comptroller of the Currency. But as a practical matter, the report contends, JPMorgan called the shots. “The OCC tolerated resistance by JPMorgan Chase to regulatory requests and failed to establish a regulatory relationship that mandated the bank’s prompt cooperation with OCC oversight efforts,” the report reads.

The subcommittee examined more than 90,000 documents in the course of its investigation, and the report runs 300 pages long. Most of the attention has focused on how the trades by the bank’s CIO—followed by an increasingly frantic salvage effort—went horribly wrong, yet undetected by the OCC. But while the report levels plenty of criticism at JPMorgan, it also castigates the OCC for disastrous neglect of its regulatory duties.

“Over the past two years, the OCC failed to notice or investigate bank reports of CIO risk limit breaches, failed to realize when monthly CIO reports weren’t delivered, failed to insist on detailed trading data from the CIO needed for effective oversight, and failed to take firm action when the bank delayed or denied its requests for information,” the report says.

### Establishing Boundaries

How could an agency seemingly as powerful as the OCC be captured by an industry? It helps to remember that JPMorgan isn’t your typical bank. It has assets of \$2.4 trillion. At several points, the report suggests, the company successfully convinced the agency it was overstepping its mandate. “Along the way, at times, bank personnel lectured OCC examiners about being overly intrusive,” the report notes.

Often, the bank would resist giving out information to regulators. Conversely, after some examiners complained, it responded by burying them with a database of 60,000 derivatives contracts that examiners found incomprehensible.

“While the OCC’s difficulty in obtaining information offers additional proof of the bank’s unacceptable conduct, they also highlight, once again, the OCC’s failure to establish an effective regulatory relationship with JPMorgan Chase,” the report found.

And on some occasions, when the numbers revealed an inconvenient truth, the bank forgot to report them. Because the actual value of derivatives can be difficult to determine, sometimes the numbers got “tweaked” to make the losses appear smaller.

All too often, the OCC simply took the bank’s word for it. “Ultimately, the OCC’s excessive trust in the bank allowed the bank to avoid scrutiny... and was a central reason for the OCC’s failure to challenge the unsafe and unsound derivatives trading activity,” the report says.

The OCC was so successfully kept in the dark that it learned of the enormity of JPMorgan’s problems from news stories that began appearing in early April of last year. “The OCC told the subcommittee that it was surprised by the stories and immediately directed inquiries to the bank to obtain more information,” according to the report. For reasons that aren’t

entirely clear, the OCC accepted JPMorgan's assurance that everything was fine. The OCC "actually considered the matter closed in late April," the report concludes.

### While You Were Out

It helped that, at times, the OCC appeared to be asleep at the switch. For instance, JPMorgan did tell the OCC when the trading loss reached \$1.4 billion, big enough to trigger alarms. The regulatory response: nothing. It seems the examiner who normally reviewed that report "was then on vacation, his subordinates failed to notice the size of the loss and no one made any call to the bank to ask about it," the subcommittee found.

JPMorgan's London Whale scandal isn't the only recent evidence of regulatory capture by Wall Street's financial institutions. Another is the failure of Washington to implement the so-called Volcker Rule, named for former Federal Reserve Chairman Paul Volcker. The rule would theoretically restrict banks' ability to trade in derivatives with their own capital—so-called proprietary trading—although conducting such services for clients would be permitted.

The Volcker Rule is contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act passed nearly three years ago. And it might have prohibited some of the London Whale trading. But the rule is yet to be adopted, in part because of relentless resistance by major banks. In fact, Dimon has been among its staunchest critics. (Dimon has acknowledged he was "dead wrong" when he made the tempest in a teapot comment, however.)

In May of last year, the OCC got a new comptroller—Thomas Curry, formerly a board member at the Federal Deposit Insurance Corp. and former commissioner of banks for Massachusetts. According to the subcommittee report, OCC officials initially assured him the JPMorgan losses were no big deal. Curry begged to differ.

Curry is seen by some as the reformer the OCC needs. Others don't seem so sure. In a February hearing, [Sen. Elizabeth Warren](#) pressed banking regulators on the dearth of prosecutions stemming from the 2008 banking crisis. "We do not have to bring people to trial," Curry said. "We have not had to do it, as a practical matter, to achieve our supervisory goals."

What's important to remember, Sen. Levin said at the recent JPMorgan hearing, is that regulatory failure like that exhibited in the London Whale saga must end. Regulatory capture, after all, is an insidious form of institutional corruption. More than a mere economic theory, it's a threat to the wellbeing of millions of Americans.

"When Wall Street plays with fire, American families get burned," Levin said. "The task of federal regulators, and of this Congress, is to take away the matches. The whale trades demonstrate that task is far from complete."

<http://www.ethics.harvard.edu/lab/blog/292-whale-sized-institutional-corruption>

# Understanding Conflict of Interest Networks

[Sebastián Pérez Saaibi](#) and [Juan Pablo Marín Díaz](#)

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Social Network Analysis can be used to understand a wide variety of systems such as research, biological or technological networks. In particular, it is a great tool to observe and analyze conflicts of interest and assess the risks that arise in the evolving relationships between individuals or institutions. By using these tools, one could not only analyze patterns but also understand observed behaviors in networks of individuals.

In this blog post we will show how *Social Network Analysis* can be used to understand conflict of interests. For this purpose, we will use a real example of the network formed by the Management Board of the 50 largest non-financial companies in Colombia. We will describe several properties related to the [topology](#) of this network, as well as the possible implications of these metrics.

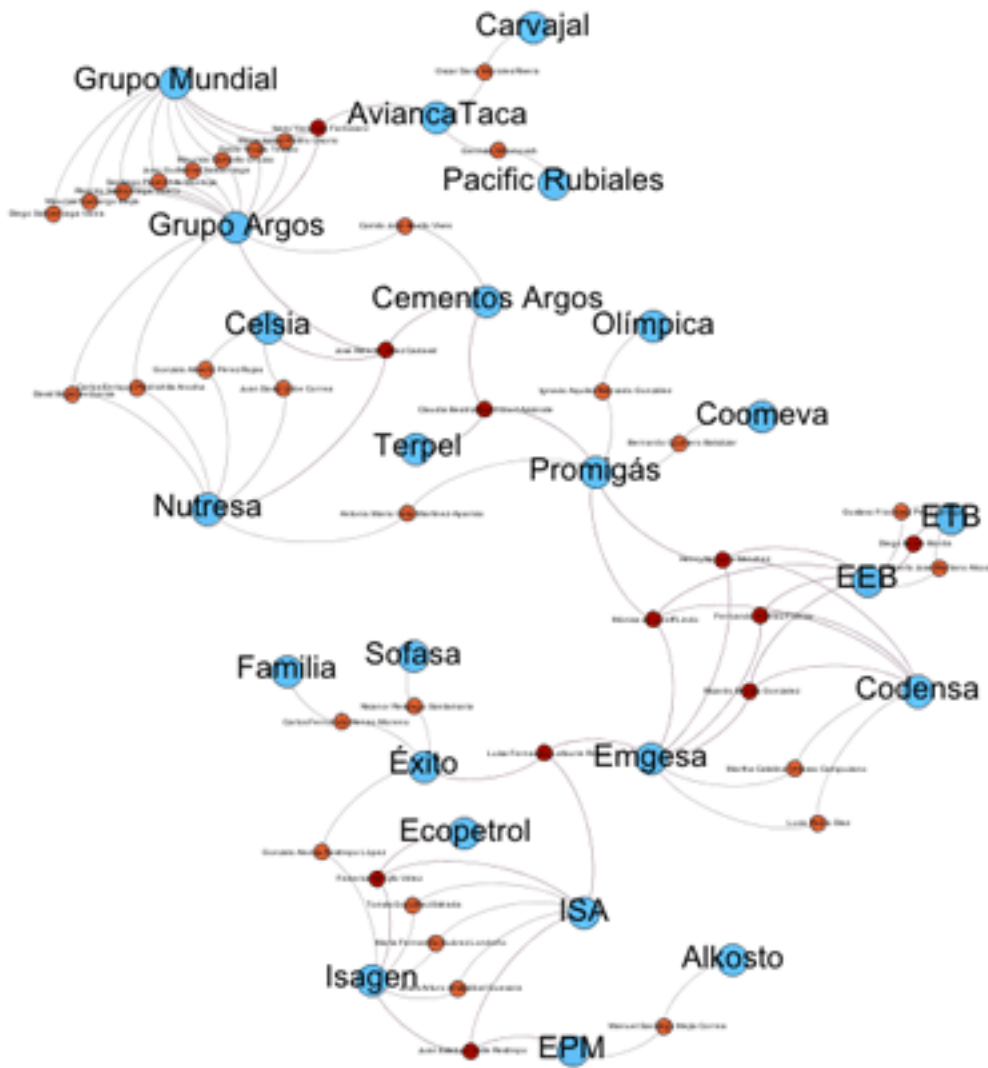
The original idea and diagnosis of the companies network was published in a joint effort of [aentrópico](#) and [La Silla Vacía](#). A brief description can be found [here](#) and the original piece (in spanish) can be obtained [here](#).

The main idea is the following: The most important connections inside the 50 largest companies in Colombia are revealed and explained. Starting with a demographical stratification of the different companies, we explored some important aspects of their DNA, including education levels of their board members as well as their female representation levels. A network view of the participation of highly connected individual across several boards is presented on the [article](#).

A subset of the complete network is shown below and will serve for demonstration purposes of how *Social Network Analysis* can be used to understand conflict of interests. In this network companies are depicted as blue nodes while board members are orange. [Centrality](#) of a node is illustrated by increasingly darker tones of orange.

As this is an [affiliation network](#), it can be represented as a [bipartite](#) graph. This will be the focus of our analysis.

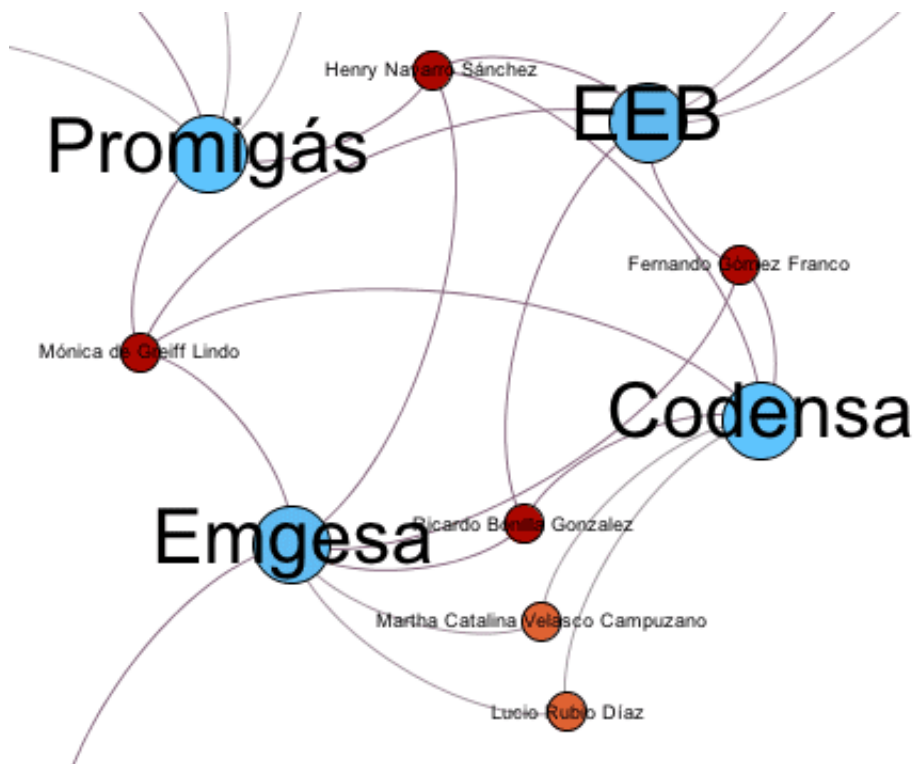
Management board networks







Triadic closures



Note that in the network of Colombian companies we can notice two types of *clusters*:

The first type, as shown in the previous example, is formed because of the similarity between companies (e.g. *Grupo Mundial* and *Grupo Argos*).

However, other clusters can be formed due to the presence of highly connected individuals. That is the case of Mónica de Greiff, Henry Navarro, Fernando Gómez and Ricardo Bonilla who are all linked to each other by simultaneously belonging to the management board of four different companies (Promigás, EEB, Emgesa, Codensa).

*Clusters* or closed communities are resistant to outside influences. Hence behavioral changes like the adoption of a new technology or the modification of an existing social norm can be slowed down and even blocked by the boundaries of a densely-connected community.

However, if there are incentives to adopt behaviors from neighbors, things can change dramatically and [cascading effects](#) can emerge. Given the appropriate conditions, certain behaviors can easily propagate through the network. This is the case of corruption incidents, where generally incentives to change the prevailing social norm tend to be much higher when these changes can benefit all the individuals in the network.

By using peer pressure, one could promote adoption of behaviors inside a community, enhancing the diffusion of a certain social norm for all individuals of the network.

Conflict of interest emerge mainly in *bridges*, where the structural balance of a group or community can be compromised because of emerging behaviors pushed by adjacent communities. Sources of stress are often related to unbalanced triangles, where among 3 individuals, 2 adopt a behavior but the third one is still reluctant. However unbalanced triangles are not the norm since people try to minimize them by either changing their behaviors or breaking up links.

This post aims to be the starting point for a discussion on future research of conflict of interest based on *Social Network Analysis*.

### Network Science Glossary

**Affiliation network** Two mode networks that allow one to study the dual perspectives of the actors and the events (unlike one mode networks which focus on only one of them at a time).

**Bipartite graph**: A graph that does not contain any odd-length cycles.

**Bridge**: An edge whose removal would lead to two distinct components. An edge is a local bridge whenever it is not in a triadic closure.

**Cascading effect**: An unforeseen chain of events due to an act affecting a system.

**Centrality** The various types of measures of the centrality of a vertex within a graph determine the relative importance of a vertex within the graph.

**Cluster**: Individuals that have a lots of connections with each other forming a closed community. This behavior has been observed in several networks: diseases, gossip, technology, etc.

**Triadic Closure**: The property among three nodes A, B, and C, such that if a strong tie exists between A-B and A-C, there is a weak or strong tie between B-C.

**Topology**: The arrangement of the various elements (links, nodes, etc.) of a network.

<http://www.ethics.harvard.edu/lab/blog/293-understanding-conflict-of-interest-networks>

# How the Fed Came to See the Light: The Growing Role of Transparency in Monetary Policy

[Gregg Fields](#)

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In 1913, Louis Brandeis, a future Supreme Court justice, wrote an article for *Harper's Weekly* that argued forcefully for greater transparency in government. "Sunlight," he said, "is said to be the best of disinfectants."

As it happens, 1913 is also the year the Federal Reserve Act was passed.

But the newly created central bank didn't seem to share Brandeis's esteem for open governance. Shrouded in mystery, the powerful and surreptitious Fed produced a league of investigative economists known as Fed-watchers. The rare utterances by the Fed and the Federal Open Market Committee—the arm that sets rates—were said to be written in a dialect called FedSpeak, each word scrutinized for hidden meaning. Books about the Fed had titles like *Secrets of the Temple*, a 1989 bestseller by William Greider.

The closed-mouth approach was emulated by central banks around the world. As Montagu Norman, who became governor of the Bank of England in the 1920s reportedly said: "Never explain, never excuse."

That philosophy was firmly in place when Janet Yellen began work as a staff economist at the Fed in 1977. It was a time when "the conventional wisdom among central bankers was that transparency was of little benefit for monetary policy and, in some cases, could cause problems that would make policy less effective," Yellen, now vice chair of the Fed, told the Society of American Business Editors and Writers [in Washington on Thursday](#), April 4.

Much has changed, in no small part due to the financial crisis, when a besieged Fed had to reassure a panicked world. Communication and transparency would play a vital role in stabilizing the global economy. That newfound openness continues, and Yellen made clear she embraces the Fed's greater transparency. In today's world the Fed doesn't just say what it has done, it outlines what it plans to do.

"The effects of monetary policy depend critically on the public getting the message about what policy will do months or years in the future," she said.

## The next Fed chief?

Yellen's views on transparency are important for a couple of reasons. One, as Brandeis suggested a century ago, transparency can be an effective deterrent to institutional corruption. While there's room for debate, there is no question that the secretive Fed, as an institution, has often been criticized for policies that seemed to favor banks over people. Furthermore, some have argued that its failure to contain the asset bubbles in things like real estate contributed to the banking crash. (The Fed's dual mandate is to stimulate employment

and contain inflation—policy goals that often clash. Fed members who prioritize job creation are known as “doves” while inflation fighters are referred to as “hawks.”)

Whether the criticisms are justified isn't the entire point. The simple fact is that the public often didn't know much about Fed policies that directly affected them.

Yellen's views are also noteworthy because she is considered the front-runner to replace Ben Bernanke when his term expires next year. If that should happen, there's every reason to believe the Fed would continue on a path toward greater transparency. (In terms of policy, she is known for being a “dove.”) Married to Nobel laureate George Akerlof, she would be the first woman to lead the Fed.

“But it isn't just Yellen's second X chromosome that makes her interesting,” John Cassidy, author of *2009's How Markets Fail: The Logic of Economic Calamities*, [wrote recently](#) in *The New Yorker*. “In a field noted for its conservatism and adherence to free-market orthodoxy, she has long stood out as a lively and liberal thinker who resisted the rightward shift that many of her colleagues took in the eighties and nineties.”

To be sure, the Fed's move toward transparency was glacial. In 1994, for instance, the FOMC began issuing bulletins when it changed policies on interest rates. But no details as to why were provided. In the early 2000s it began providing its views on the economic outlook.

But the need for clear and prompt communication went into overdrive when the Great Recession slammed the world economy. Suddenly, the Fed had to communicate with a world that was fearful and angry. When cutting rates to zero provided limited relief, the Fed had to invent, and explain, new policies. An example is the so-called “quantitative easing,” where it tried to stimulate the economy not by lowering rates but by pumping liquidity into banks.

### Crisis management

“The situation in 2008 and 2009 was like nothing the Federal Reserve had faced since the 1930s,” she said. “Beyond the task of describing the new policies, extensive new communication was needed to justify these unconventional policy actions and convincingly connect them to the Federal Reserve's employment and inflation objectives.”

The result was a Fed that embraced transparency with the vigor it once resisted it. In 2010, Bernanke asked Yellen to lead a newly created subcommittee on communications. In 2011, Bernanke took the unprecedented step of holding press conferences after the FOMC's quarterly meeting. They are streamed live on the Internet. It was, at the time, considering a revolutionary break with tradition.

In early 2012, the FOMC released a statement outlining its longer-term goals and monetary policy—detailing, for instance, how it planned to let interest rates remain at record lows several years.

In the process, Yellen said, transparency was transformed from an experiment in accountability to a vital policy tool. That, she said, serves the public interest. For example, it takes the guesswork out of deciphering the Fed's long-term goals and strategies, reducing market uncertainty. “It's a revolution in our understanding of how communication can influence the effectiveness of monetary policy,” she said.

### No simple solutions

Clearly, transparency is no economic cure-all. Today's unemployment report—which showed just 88,000 new jobs created last month—shows the recovery is far from complete. Furthermore, financial regulators have come under fire for the sluggish pace at which the Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in 2010, is being implemented.

When I asked Yellen about Dodd-Frank, she said the sheer size of the mandate—the law is over 2,300 pages long—has created quite a logjam.

“It has been an enormous challenge to implement all that is in Dodd-Frank,” she said. The Fed made a list after the law passed, she said, and identified 257 separate projects required by Dodd-Frank. Furthermore, adopting financial rules requires a great deal of time-consuming cross-agency cooperation, both in Washington and around the world. “We're working with regulators all around the globe to see if we can move together jointly,” she said.

Looking ahead, Yellen said it's possible that an improved economy may eventually take the urgency out of Fed communications. “But I hope and trust that the days of ‘never explain, never excuse’ are gone for good, and that the Federal Reserve continues to reap the benefits of clearly explaining its actions to the public,” she said.

<http://www.ethics.harvard.edu/lab/blog/294-how-the-fed-came-to-see-the-light>

# Wheel of Fortune: As Regulators Spin Off Duties, Ex-Regulators Cash in as Consultants

[Gregg Fields](#)

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In 2008, shortly after becoming chief of staff for the newly elected President Obama, Rahm Emanuel pondered the implications of the crumbling economy and [pronounced](#): “You never want a serious crisis to go to waste.”

It would appear that a select core of consultants employed by federal banking regulators took his advice to heart. A riveting Senate subcommittee hearing this week revealed how the foreclosure crisis may have wreaked unfathomable pain on millions of Americans, but for banking consultants certified by regulators, it meant a multi-billion dollar payday.

From an institutional corruption standpoint, the so-called Independent Foreclosure Review, initiated in 2011, bears scrutiny from several angles. From a revolving door position, the consulting firms who raked in huge fees are brimming with former regulators and other insiders. On the issue of transparency, what the consultants actually found remains largely undisclosed—even though the information is in the hands of regulators who ostensibly serve the public. As for conflicts of interest, there’s the subject of whether regulators’ first loyalty is to the public or the institutions they oversee. And there are unsettling symptoms of dependence corruption: The banks were paying the consultants who were examining them. Finally, there’s the overriding issue of just why regulators are doling out contracts rather than do the job themselves.

What’s clear is that this unprecedented effort to funnel public oversight functions to profit-driven firms on a massive scale was rife with problems that precluded achieving the primary public policy goal—assisting distressed homeowners. In a [report released](#) earlier this month, the Government Accountability Office listed a litany of issues and advised that “the foreclosure review process offers an opportunity for the regulators to leverage this experience to help ensure that similar difficulties are better addressed in future efforts.” It was the second time the GAO issued a report critical of the foreclosure review.

## Hope and Promise

Time will tell if the GAO’s hopes are realized. But first, some quick background on the promising beginning when the foreclosure review effort was announced.

In 2011, 14 large mortgage servicers—including most of the country’s major banks—were ordered by the Federal Reserve and the Office of the Comptroller of the Currency to hire the consultants to review foreclosures filed in 2009 and 2010. The mission: look for legal errors, shoddy paperwork and other problems, to determine possible damages. Sampling was allowed, to ascertain the error rate.

“These comprehensive enforcement actions, coordinated among the federal banking regulators, require major reforms in mortgage servicing operations,” [John Walsh](#), acting Comptroller of the Currency at the time, said. “These reforms will not only fix the problems we found in foreclosure processing, but will also correct failures in governance and the loan modification process and address financial harm to borrowers.”

No question, many of the consultants hired knew banking—they were in fact former regulators themselves. Perhaps the most prominent consultant was Promontory Financial Group, founded by Eugene Ludwig, who formerly headed the OCC in the Clinton administration.

Though it was only founded in 2001, Promontory has quickly become known as a Washington power player. Just recently it also hired [Mary Schapiro](#), who left as head of the Securities and Exchange Commission last December. Press reports regularly refer to Promontory as a “quasi-regulator” for its role as a conduit between government and bankers.

Regulators initially wanted the job done in 120 days. In fact, it’s a task that will never be completed. The Independent Foreclosure Review was scuttled prematurely in January, and a settlement with most of the banks, covering 90 percent of the cases, was announced. The agreement was touted as valued at \$9 billion. However, homeowners are actually only entitled to \$3.6 billion in cash, the rest of it in things like advice on avoiding foreclosure.

Regulators had let it be known that some recipients would get up to \$125,000. But this week the Fed and OCC issued [a payout schedule](#) that showed a bare handful of people will receive that amount. Most of the recipients had mortgage servicing issues, but didn’t face foreclosure. For the majority of those the payment is just \$300.

At Thursday’s hearing of the Senate’s subcommittee on financial institutions and consumer protection, both regulators and consultants defended their reviews, though acknowledging certain flaws. But Sen. Elizabeth Warren, the Massachusetts Democrat, said the process smacked of cover-up.

### Little Specific Information

Warren said she and Rep. Elijah Cummings, a Maryland Democrat, had made 14 specific requests for documents from the OCC and the Fed since January. “You have provided only one full response, three partial or minimal responses and no responses to nine requests,” Warren said. “You’ve provided little specific information, such as the number of improper foreclosures.”

Sen. Sherrod Brown, an Ohio Democrat who chairs the subcommittee, said that the role of former regulators as consultants raises the troublesome issue of revolving door syndrome. Even if consultants and regulators mean well, the constant flow of regulatory talent to lucrative jobs at shops like Promontory produces what Brown called “cognitive capture.” In other words, the adversarial element of the banker-examiner relationship is supplanted with more symbiotic thinking. With “the influence of the revolving door, bright-line rules become all the more important,” he said.

Besides its former regulators on staff, Promontory’s advisory board includes Alan Blinder, the highly regarded Princeton economist and former vice chair of the Fed, Arthur Levitt, the



former chief of the SEC, and Stephen G. Thieke, who was executive vice president of the Federal Reserve Bank of New York in the 1980s before becoming a managing director of JPMorgan. The company's co-founder, Alfred Moses, was once special counsel to President Carter.

Such close ties might call into question the influence the independent consultants have with regulators. But Daniel Stipano, the OCC's deputy chief counsel, maintained that's a non-issue.

"In all of these cases, the OCC considers the qualifications" of the consultants, Stipano said at the hearing. "The OCC also oversees and monitors the work of the consultants."

But that system failed—badly—during the Independent Foreclosure Review, both sides agreed, in one of the hearing's few moments of consensus. Consultants testified that it was immediately apparent that the 120-day deadline was unrealistic for reviewing 4 million home loans. Some consultants began sending work abroad, Brown said.

"We had a history of requiring banks to retain consultants in the past," said Richard Ashton, deputy general counsel for the Fed. With foreclosures, "we thought that model could be adopted. What we found out, in practice, was the scope was so extensive it just was not effective."

Brown, meanwhile, repeatedly asked why, if the program was so badly flawed, billing was allowed to rise to \$2 billion before the plug was pulled. "I don't think that decision was driven by compensation being paid to consultants," Stipano, of the OCC, said.

### The Outsiders

The Senate hearing was titled, "Outsourcing Accountability?" And its focus on outside consultants reflected a growing reality that has institutional corruption implications. Specifically, regulatory agencies are increasingly reliant on consultants because they lack the institutional resources to do the job themselves. This has the effect of introducing a profit-oriented constituency into an oversight function that is purportedly accountable first and foremost to the public.

"The problem with having the OCC do the job itself is, it's just beyond the means" of any banking agency, Stipano said. He said the agency might have needed to triple its staff to handle the foreclosure reviews, something that wasn't feasible.

After a recess, Brown returned to a situation that hinted at what students of institutional corruption sometimes call dependence corruption. The dynamics: The consultants are there at the behest of the regulators. But they're actually the client of the banks, who are paying the fees. (At Thursday's hearing, PricewaterhouseCoopers, one of the lead consultants, said it billed over \$400 million conducting foreclosure reviews.)

"You work for the banks, they pay you, but you're supposed to represent the public interest," Brown said to several consultants who'd been asked to testify. "That's almost an inherent, automatic conflict of interest." It's a pattern that resembles the highly criticized pre-crisis pattern with credit rating agencies, which gave glowing ratings to toxic mortgage securities being offered by their clients.

Konrad Alt, managing director of Promontory Financial, conceded there's an issue. "There is an inherent conflict, and you are right to focus on it," he said. But he added that, "there are checks, and the primary check is regulatory oversight. We met with regulators constantly."

### Clearly Not Transparent?

Warren, however, added that conflict of interest concerns extend to regulators as well. When the foreclosure review was announced in 2011, it was hailed as an effort to bring relief to besieged homeowners. But in practice regulators appear to be siding with banks, she said. As one example, consultants gathered data on foreclosures that appear to have violated laws. But the OCC is keeping that and most other information collected to itself. Given the dearth of details, it's impossible to judge whether the settlement is fair or not, Warren said.

Stipano, the OCC official, said revealing information like error rates on foreclosures would violate confidentiality agreements it has with financial institutions, although it could occur in the future.

"So you've made the decision to protect banks, but not to help families that have been foreclosed illegally," Warren said. "You know individual cases where banks violated laws and you're not going to help the homeowners. Without transparency we can't have any confidence in your oversight or that the markets are functioning properly at all."

<http://www.ethics.harvard.edu/lab/blog/295-wheel-of-fortune>

# Capital Opportunities: A Watchdog Journalist's Take on Washington's Legalized Corruption

[Gregg Fields](#)

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[Charles Lewis](#) didn't plan a career as a crusading journalist in Washington. In fact, he had planned on going into politics himself. The Delaware native arrived in D.C. in 1974, as an intern for the late Sen. William Roth, a Republican.

The Watergate scandal was cresting, and it sparked a disenchantment that steered Lewis to reporting. "I didn't really become obsessed with corruption," Lewis said Thursday night, in [a lecture sponsored by the Edmond J. Safra Center for Ethics](#). "But I began to notice patterns."

His journalism career included stints at ABC News and the 60 Minutes news program. But even as his career flourished, the former Eagle Scout became unsettled by a growing belief that Washington—and corporate journalism—operated by rules that all too often provided cover for abhorrent public governance. And one recurring pattern he noticed was that typically no laws were broken. "Most of the problems seemed to be legal," he said.

In 1989, Lewis left TV and founded the [Center for Public Integrity](#), one of the pioneers of the nonprofit investigative journalism movement. "I don't necessarily recommend walking out of your job not knowing what you're going to do next," Lewis, who funded the startup himself, said. "But that's what I did."

The CPI has since won innumerable awards and salutations, and Lewis himself received a prestigious MacArthur Fellowship in 1998. But the CPI will perhaps forever be best known for revealing how the Clinton White House rewarded major donors with stays in the Lincoln bedroom.

"We are the skunk at the garden party," he acknowledged to *American Journalism Review* in a 2005 profile. The article noted that he got his start poking at power early, with a high school newspaper column that anonymously took administrators like the principal to task.

## Reporting For Duty

When he founded CPI, Lewis was as frustrated with the clubby world of inside-the-Beltway journalism as with questionable conduct by government officials. An example: the dearth of reporting related to the Iran-Contra scandal. In Iran-Contra, high officials in the Reagan administration secretly sold arms to Iran in part to covertly raise money for funding Nicaragua's Contra rebels, which Congress had explicitly barred.

"Most reporters found out about it from the Attorney General announcing it," he said. The scandal led to the indictment of several top Reagan administration leaders, including Defense Secretary Caspar Weinberger. Weinberger would be pardoned by President George

H.W. Bush prior to trial. Although the scandal dates back more than 25 years, the reality is that the coverup continues, Lewis said. “We still don’t have all the Iran-Contra documents,” he said.

Lewis left the executive director’s job at CPI in 2005 and is currently a professor at American University in Washington, where he is executive editor of the [Investigative Reporting Workshop](#).

In his talk, Lewis emphasized that, in most cases, egregious conduct by Washington’s officialdom isn’t illegal. That’s the problem. “The thing that bothers me is this word corruption,” he said. “Most people think it means illegal. It doesn’t mean that, if you look it up. You can call it systemic corruption. I call it legal corruption.” (And for the record, the Edmond J. Safra Center prefers the term “institutional corruption.”)

### Around We Go

An example of the kind of corruption Lewis was referring to: the unrelenting revolving door, where government officials leave to work for much bigger salaries at entities they formerly regulated. When the CPI looked at the U.S. Trade Representative’s office, it found that 47 percent of people who quit went to work for foreign governments or corporations. In another case, he found that 80 percent of departing employees from the Superfund hazardous waste cleanup program left for jobs with contractors to the Environmental Protection Agency.

Besides the revolving door, he found that regulatory capture, a common institutional corruption syndrome, is very real in Washington. The U.S. Forest Service, for instance, was “basically shilling for the timber industry.”

And the conflicts of interest arising from campaign contributions were symbolized when Congress refused to toughen food inspection standards—pleasing powerful agribusiness interests—despite rising numbers of E. coli infections. “Funny, that legislation requiring the USDA to do it just never made it out of committee,” Lewis said.

Furthermore, a close examination of defense spending showed it primarily went to companies that gave lavishly to the political process, and frequently employed former military officials to do their bidding. “Essentially, what we found was 40 percent of all defense contracts have no competitive bidder,” he said. “There’s all this transparency issue.”

### Money Changes Everything

It is the defining role of money in Washington which Lewis finds the most intriguing. For instance, when magazine publisher Malcolm Forbes ran for president largely on a “flat tax” platform, Lewis took Forbes’s financial disclosure forms to an accountant. The conclusion: a flat tax would cut Forbes’s tax bill in half.

On a broader level, Lewis concluded that all the money funneled to candidates simply undermines democracy. “I noticed that the presidential candidate who raised the most money the year before the primaries was getting the nomination every time,” he said. “It meant money was dictating our choices even before there was a single vote.” He later added: “Money and power go together—always.”

That conclusion led to "The Buying of the President," a series of books, beginning with the 1996 campaign, that document the financial forces that determine who occupies the Oval Office. His assessment: "We have a really fundamentally broken system here." In Washington, he said, "we always say it's the most expensive election in history—until the next election."

Despite having reached some somber conclusions regarding Washington corruption, Lewis actually spoke with a gentle and self-deprecating tone. He acknowledged not having the answer to the institutional corruption problems plaguing Washington. "It's not enough to throw the bums out in the next election," he said. "It's actually a much more endemic problem."

But he did offer a theory as to why Frank Capra never made a sequel to *Mr. Smith Goes To Washington*. "It becomes a Stephen King movie," he quipped.

<http://www.ethics.harvard.edu/lab/blog/296-capital-opportunities>

# Just Asking: An Appeal for Voluntary Disclosure

[Brooke Williams](#)

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Scholars at these think tanks have attracted media attention as experts on everything from China's defense spending, to drones and oil pipelines, to new toll lanes and Medicaid. Just in the past week, they've collectively released dozens of policy and research papers. They're shaping decisions that impact our day-to-day lives.

But who is funding their work? At 16 of the top 50 think tanks in the country, as ranked by James McGann for his [report](#) at the Think Tanks and Civil Societies Program at the International Relations Program, University of Pennsylvania,<sup>1</sup> it's tough to say. Unlike others on the list, they don't disclose donors. Indeed, some promise anonymity.

To be sure, the 16 think tanks vary widely, from a shop in Los Angeles advancing a free market, libertarian agenda, to a progressive group in Washington, D.C. whose executives have ties to the Obama administration and are among the most frequent visitors to the White House. However, they all have two things in common: they're considered to be among the most influential think tanks, and they don't provide the public with details on where they get money.

So we asked.

On April 16, we mailed letters to the top executives of 16 think tanks asking them to voluntarily disclose a list of any corporations, corporate foundations, and foreign governments that donated in the past five fiscal years, and how much these entities had given the think tanks. We will provide updates on their responses.

These letters are part of an ongoing [project](#) at the Edmond J. Safra Center for Ethics that is examining how corporations and foreign governments donate to think tanks and shape public discourse and policy and from behind the scenes, often leaving the public in the dark about how and why they're involved. In addition to asking, we are gathering data on corporate and foreign government donors from tax filings and other records in an effort to make at least some of the information publicly available.

Although more narrow in scope, this type of request worked well for author Stephanie Epstein and Charles Lewis, founder and then-executive director of the [Center for Public Integrity](#), a nonprofit journalism organization in Washington, D.C, for "Buying the American Mind" in 1991. They asked a handful of think tanks to disclose donations from the Japanese government or interests. Five think tanks reported receiving \$5.4 million in donations from Japanese interests between 1985 and 1990. Epstein found that those

receiving that funding were the same think tanks promoting policies favorable to Japanese interests.<sup>2</sup>

Most think tanks in this country are nonprofit organizations, and the law does not require them to disclose donors. Even so, many do. While following up on the letter we sent, we've asked some of the 16 institutions why they choose not to disclose.

At the [Competitive Enterprise Institute](#) in Washington, D.C., which seeks to advance "principles of limited government, free enterprise, and individual liberty," Sam Kazman, general counsel for CEI, says it is about protecting the privacy of donors who don't want to be named. He pointed to five Supreme Court rulings, as well as several from lower courts, addressing "the importance and the constitutionally-protected status of donor confidentiality."

"If you think about the situation in the South in the 1950s, you can imagine what the impact of compulsory disclosure would have meant for groups like the NAACP," Kazman said.

Kazman said CEI does not accept money from foreign governments.

[The Center for American Progress](#), a progressive think tank in Washington, D.C., takes credit for shaping national debate on its website, but does not say who is paying for it.

CAP spokeswoman Andrea Purse said CAP "follows all financial disclosure requirements with regard to donors."

"Our policy work is independent and driven by solutions that we believe will create a more equitable and just country," she said.

At the [National Bureau of Economic Research](#) in Cambridge, Massachusetts, President James Poterba said scholars must disclose all sources of funding in every paper it publishes. Period.

That said, he acknowledged NBER does not reveal the names of donors who contribute to its general operations. The most recent tax filings show nearly 82 percent of \$33.3 million NBER received in 2010 was in government grants. Poterba said the remaining \$6 million came from foundations, corporations and individuals, which the organization does not name.

NBER is different from many other think tanks since it does not take positions or make policy recommendations, though Poterba said he certainly hopes lawmakers are reading the papers.

Poterba said our request for voluntary disclosure has caused his organization to consider, "Should we be doing something different here?"

"We'll certainly think about this question," he said.

At the [American Enterprise Institute](#) in Washington, D.C., unnamed corporate donors can “gain access to the leading scholars in the most important policy areas for executive briefings and knowledge sharing.”

“We respect the privacy of those who choose to contribute and therefore we do not publicly list donors,” AEI spokeswoman Judy Mayka said in an email.

At the [Manhattan Institute for Policy Research](#) in New York City, donors who give \$25,000 can “engage in one-on-one meetings with Institute Scholars,” among other things. Spokeswoman Lindsay Craig, said in an email that the think tank doesn’t name them because “donor information is private.”

<http://www.ethics.harvard.edu/lab/blog/297-justask>

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[1] “2012 Global Go to Think Tanks Report and Policy Advice,” James G. McGann, Ph.D., Director, Think Tanks and Civil Societies Program, University of Pennsylvania, page 49

[2] “Buying the American Mind: Japan’s Quest for U.S. Ideas In Science, Economic Policy, & the Schools,” Stephanie Epstein, Center for Public Integrity, chapter IV, pages 36, 37



# Exploding Influence: How Lax Oversight Won by Industry Lobbyists Lessens Safety

[Sheila Kaplan](#)

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The Boston Marathon bombers may have acted alone. The owner of the deadly West, Texas fertilizer plant did not.

Explosions rocked two American cities last week. In Boston, the Marathon bombing killed three people and wounded dozens more; and in West, Texas, a blast and fire at a fertilizer plant killed at least 14 people and injured at least 170, according to news reports.

In each case, investigators mobilized. In Boston, the city shut down while law enforcement authorities hunted for a suspect—ultimately finding a bloody trail that led to his hiding place in a dry-docked boat. (The other suspect was killed earlier in a firefight with police.)

In West, where the disaster at Adair Grain Inc.'s fertilizer plant blew the roof and walls off a nearby apartment complex and carved a crater in the town, investigators are still trying to figure what happened, and who is to blame. When they do, it's likely that trail will lead to Washington, D.C., and a suspect called institutional corruption.

Three excellent news articles show why.

As Bloomberg News reporters Mark Drajem and Jack Kaskey [reported on April 19](#),

“The Texas plant that was the scene of a deadly explosion this week was last inspected by the Occupational Safety and Health Administration in 1985. The risk plan it filed with regulators listed no flammable chemicals. And it was cleared to hold many times the ammonium nitrate that was used in the Oklahoma City bombing.”

“For worker-and-chemical safety advocates who have been pushing the U.S. government to crack down on facilities that make or store large quantities of hazardous chemicals, the blast in West, Texas, was a grim reminder of the risks these plants pose. And they say regulators haven't done enough to tackle the problem.”

The reason is suggested later in the story—by President Barack Obama. As Drajem and Kaskey wrote, “During his campaign, Obama promised to 'secure our chemical plants by setting a clear set of federal regulations that all plants must follow.' Just days before the election he mentioned it as an example of where government regulation is needed, despite industry pressure.

“Well, I think it's a classic example of special interests lobbying,” Obama told MSNBC television. “There has been resistance from the chemical industry.”

U.S. Senator John Cornyn (R-Texas), told Bloomberg News he was 'confident' the blast would lead to a review of the government's chemical plant safety rules," Drajem and Kaskey reported.

But stronger oversight of the industry will face continued resistance.

In an article published last week, entitled "[Fertilizer trade group opposed stricter security rules](#)," Jim Morris, an incoming Edmond J. Safra Lab Fellow and a senior reporter for the Center for Public Integrity, a non-partisan investigative reporting group, wrote that like many, "the Fertilizer Institute, a trade group, has extended its condolences to the people of West, Texas." Morris continued, "The Washington-based institute, however, has lobbied against legislation that would require high-risk chemical facilities—including some of its members—to consider using safer substances and processes to lower the risk of catastrophic accidents and make such facilities less inviting to terrorists."

According to Morris, Senate records show the institute has spent \$7.4 million on lobbying since 2006. On its website, Morris reported, the organization notes that it supports existing rules enforced by the Department of Homeland Security and opposes any expansion of the rules "to mandate inherently safer technologies."

In a 2011 letter to the chairman and ranking member of the House Homeland Security Committee, the institute and nine other groups maintained that "America's agricultural industry has limited resources available to address all security related matters and it is very important that those resources are spent wisely to coincide with the appropriate level of risk for each particular facilities. . . ." Morris reported. He also noted that after 9/11, the Environmental Protection Agency drafted legislation to steer companies toward disaster prevention, but that the Bush White House opposed it.

And, in [an article published by the Sunlight Foundation](#), a DC-based nonprofit group that advocates greater government transparency,<sup>1</sup> staff writer Lindsay Young blames Congress and the special interests that target it for lax oversight.

"Consider the Agricultural Retailers Association," Young wrote, "a trade group whose members include suppliers of pesticides and fertilizers, and the Fertilizer Institute, which bills itself as the voice of the fertilizer industry."

"Since 1998, the specific issues that appear most frequently in their lobbying disclosure reports are bills dealing with the safety and security of chemical facilities. During that period, the Agricultural Retailers Association has spent a cumulative \$2.9 million on lobbying while the Fertilizer Institute has spent even more, some \$14.4 million," she wrote.

Young wrote that, in its lobby disclosure form on file with the Senate, "the Agricultural Retailers Association clearly states its opposition to EPA regulation of fertilizer safety. The group listed 'Work with EPA to clarify their new Emergency Planning and Community Right-to-Know Act interpretation of fertilizer retailer to exclude facilities that blend fertilizer,' among its specific lobbying issues."

She also noted that West Fertilizer Co., where the explosion took place, was a retailer that blended fertilizer—although she quoted Richard Gupton of the Agricultural Retailers Association saying that neither Adar Grain nor West Fertilizer are members.

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Today the White House announced that President Obama and the First Lady will attend a memorial service for the West, Texas, victims.

<sup>1</sup> Professor Lawrence Lessig, director of the Edmond J. Safra Center for Ethics, is a member of the Sunlight Foundation's advisory board.

<http://www.ethics.harvard.edu/lab/blog/298-exploding-influence>

# Insider Accounts of Institutional Corruption

[Garry C. Gray](#)

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I have a vivid memory of the moment when I discovered that a company I worked for was scamming people in the name of the local wheelchair basketball association.

I was fourteen years old and my job was to phone people in the community to ask if they'd like to support the association by purchasing coupon books. It seemed like a win-win, and I remember that many people were happy to help out. Rarely was anyone suspicious enough to ask how much of the proceeds the association actually received. As soon as I said the words "wheelchair basketball" I had primed them into the spirit of giving, or otherwise declining regretfully. I eventually discovered from another employee that the association received only 10% of the funds. I was appalled.

The whole business model depended on people making the good-hearted assumption that the wheelchair basketball association would be receiving a substantive portion of the proceeds. There was no doubt in my mind that coupon book sales would have been dismal had we openly and directly disclosed their meager 10% cut. Nevertheless, I realized that the "good worker" could shrug off remarks that the practice was unethical, by citing the fact that everything was legal, or pitching the "they didn't ask" argument. But no amount of insight or rationalization could alleviate the uneasy feeling in my gut that only we, the insiders, knew what was going on, and the public trusted us.

My employment there didn't last long, but it did have lasting effects on my research years later. Becoming an insider seemed to be the ultimate strategy to examine the research questions I was asking. It was the ideal way to generate understanding about implicit and normalized behaviors inside organizations, and the ways that local cultures influence everyday decision-making. However, as researchers, the methods we select are a function of time, resources, access, and training, as well as ethical considerations that guard against possible harms to research subjects. In other words, in many—if not most—cases, it is not possible for scholars to become true insiders who can generate insights first-hand through a combination of experience, immersion, and direct observation, as inspired by Bronislaw Malinowski and Margaret Mead in their early ethnographic studies.

Alternatively, the insider account offers another path to discovery. Insider accounts can be extremely fruitful, especially if the researcher is skilled at palpating the contours and nuances of the insider's opaque world. This is what Lawrence Lessig strived to do when he interviewed Jack Abramoff as part of the "[In the Dock](#)" series at the Edmond J. Safra Center for Ethics at Harvard University. Corruption in Congress, particularly as it has manifested in the interactions between lobbyists and public officials, has become a systemic

problem that extends far beyond Abramoff's individual behaviors. Abramoff was an insider willing to talk about this.

Abramoff's insider accounts have provided a lens for analyzing the rationalizations, patterns of interactions, and insider tricks of the trade that are used to perpetuate the social organization and structure of institutional corruption in lobbying and Congress. In my recent article, [Insider Accounts of Institutional Corruption: Examining the Social Organization of Unethical Behaviour](#) published in the British Journal of Criminology (2013), I draw on Abramoff's insider accounts to not only provide this analysis, but also to demonstrate the use of insider accounts as an empirical pathway into examining the world of professional misconduct and unethical behavior.

Although insider accounts are not representative, they do reveal structures, loopholes, and contexts that are conducive to unethical behavior. The article describes five techniques that Abramoff employed to his advantage: 1) the creation of fronts through non-profit organizations and advocacy groups, 2) indirect gifting, 3) revolving doors of employment, 4) corrupt riders, and 5) creating conditions to rationalize unethical behavior. Drawing on the weaknesses of the system, he actively established and exploited dependencies by members of Congress and their staff. These actions, he explained, are widely practiced and constitute a system of institutional corruption that is still operating today.

Whereas the formula that telephone solicitors might use is relatively straight-forward to understand, Abramoff has described a series of complex and nuanced techniques designed precisely to obscure unethical behavior from the public eye. One of the difficulties of researching unethical behavior is that these practices are often embedded within seemingly lawful institutional activities. The scholar must then consider how it might be possible to discover, tease apart, and disrupt these less visible normalization patterns of unethical behavior.

Insider accounts, while difficult to obtain, provide key insights into the subtle and often taken-for granted routines of professionals. They can make visible practices that insiders may enact unreflectively, but which an outsider analyzing the account may be able to discern. In this way, they can be a window to sophisticated and insidious modes of institutional corruption that threaten the integrity of our public institutions, and the trust they depend on for continued legitimacy.

<http://www.ethics.harvard.edu/lab/blog/299-insideraccounts>

# Institutional Corruption and the Big Bang Theory

[Gregg Fields](#)

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Like long-ago explorers of the Nile, those searching for the source of institutional corruption face a complicated task. Downstream, it's comparatively easy to spot the currents of cash, conflicts and captured regulatory agencies.

But where are the headwaters? This week, a proposed banking reform law provided valuable insight into how the process starts.

The bill unleashed a series of explosive reactions from Wall Street, where it was viewed as an invasion of their economic ecosystems. Powerful trade and lobbying groups, plus a recently minted industry-funded study, blasted the proposal. And in Congress, where financial industries are the number one donor, there was a deafening silence—not one co-sponsor signed on, according to the [Financial Times](#).

So while the fate of the proposal remains uncertain, and its merits or lack of them can be honestly disputed, its hostile reception provided a rare glimpse at the moment of conception for a process that in the past gave rise to institutional corruption. Exhibit A would be the regulatory failures prior to the 2008 economic collapse.

Exhibit B might be what hasn't happened since. Five years after the crisis, safeguards against future publicly financed bank bailouts are yet to be instituted, amid perpetual Washington infighting and industry lobbying that totaled \$482 million last year, according to [opensecrets.org](#). By leaving taxpayers vulnerable to funding future bailouts, the public interest clearly hasn't been served—a key indicator for institutional corruption.

"If big banks want to continue risky practices, they should do so with their own assets," said bill co-sponsors Sens. Sherrod Brown, an Ohio Democrat, and David Vitter, a Louisiana Republican, [in a prepared statement](#). "Our bill will ensure a level playing field for all financial institutions by ending the subsidy for Wall Street megabanks to have adequate capital to back up their liabilities."

## TBTF, The Sequel

The legislation in question is nicknamed TBTF, for Terminating Bailouts for Taxpayer Fairness Act. It's something of a playful acronym because it takes aim at another TBTF—the so-called too-big-to-fail regulatory policy. Too big to fail holds that some banks are so systemically important that allowing them to fold would imperil the economy. Critics contend it's a license to, economically speaking, drive recklessly.

The battle for hearts and minds began in earnest Wednesday morning, when Brown and Vitter announced their proposal in an op-ed in *The New York Times*. "Progressives and conservatives can debate the proper role of government, but this is one principle on which we can all agree: The government shouldn't pick economic winners or losers," they wrote.

Too big to fail was the justification for government bailing out banks in 2008. The new law would require banks to raise their levels of capital, or net worth. That wouldn't end too big to fail. But it would theoretically diminish the chances of bailouts because banks would have more resources to weather a downturn. The capital standard would be most rigorous, at 15 percent, for banks over \$500 billion in assets: JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs and Morgan Stanley, according to [Federal Reserve figures](#).

"Our number one goal is to protect taxpayers from financial risks and the best way to do this is by implementing a systemic solution, increasing the minimum amount of capital the mega banks are required to have," Vitter said. (Under the bill, the U.S. would also walk away from the international Basel III banking reform measures.)

Almost immediately came the response from the Securities Industry and Financial Markets Association, or SIFMA. Among other things, it questioned whether banking regulation was the responsibility of the Senate. Reforms regarding too big to fail have been mandated by the Dodd-Frank Act, it noted. And abandoning Basel III "would be an abdication of U.S. leadership," it said.

"We should focus on completing the remaining rulemakings mandated by Dodd-Frank instead of enacting new legislation that would undermine the U.S.'s standing in the global financial system," [SIFMA said](#).

### How Things Don't Work

It's worth questioning, however, whether relying on Dodd-Frank is essentially voting for the status quo. The law passed nearly three years ago, and has become something of a poster child for institutional inertia. According to the [Davis Polk law firm](#), which tracks Dodd-Frank, 63 percent of the law's rulemaking deadlines haven't been met.

In some cases, critics say the 2,300-page Dodd-Frank law corrupts the regulatory process by scattering oversight of banks among an almost unlimited number of agencies. These include the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Federal Reserve, the FDIC and the Commodity Futures Trading Commission. Regulatory capture is easier because banks can play one agency against another as they adopt inter-agency rules. Also, regulators are often outgunned by industry. SIFMA, for instance, has successfully sued the CFTC—which Dodd-Frank charged with regulating derivatives, without allocating any resources—to overturn new rules that got adopted.

The financial industry is also developing an arsenal of intellectual capital that makes the case against reforms. On April 9, a leaked draft of the Brown-Vitter proposal appeared in news reports. On April 10, the Clearing House Association, a trade group owned by the world's largest commercial banks, released a fortuitously timed study by Oxford Associates. It concluded that raising capital standards for banks could mean a significant drop in economic growth—perhaps a loss of 1 million American jobs over nine years.

"We urge policymakers to carefully consider the economic and employment tradeoffs as they debate further increases to bank capital levels," said Paul Saltzman, president of the Clearing House Association.

Curiously, the industry-funded study's findings clash with previous studies by organizations like the International Monetary Fund and the Bank of England. The [IMF's 2012 study](#)

conceded tighter regulation might increase banks' costs. "Yet banks appear to have the ability to adapt to the regulatory changes without actions that would harm the wider economy," the IMF study said.

In explaining the disparate conclusions, the Clearing House said, "Oxford sought to improve upon the assumptions of prior studies to better align them to the economic and regulatory reality in the United States."

The dueling studies aren't the only conflicting narratives. For instance, several critics on Wednesday described the proposal as a "bank breakup" bill, even though it doesn't call for that.

### Good-Bye To All That

Ultimately, some Washington insiders were already writing the bill's obituary. Sen. Tim Johnson, chairman of the Senate Banking Committee, has previously said he believes Dodd-Frank should be implemented before Congress tackles other financial regulatory issues, according to Bloomberg. The [opensecrets.org](http://opensecrets.org) website ranks securities and investment firms first in campaign contributions to Johnson, who's from South Dakota, while commercial banks are third.

Furthermore, the ranking Republican on the Senate Banking Committee, Mike Crapo of Idaho, recently told Bloomberg he believes capital requirements are the job of regulators, not Congress. Crapo's top two contributors are JPMorgan and Goldman Sachs, according to [opensecrets.org](http://opensecrets.org).

Curiously, the one point of consensus regarding the bill was that too big to fail should be scrapped. "We continue to believe that no institution should be too-big-to-fail and that taxpayers should never again be put at risk in a future financial crisis," SIFMA said.

But Brown and Vitter noted that, while Washington dithers, banks deemed too big to fail are actually getting bigger. According to Brown, the four biggest banks are today \$2 trillion larger than before the crisis.

<http://www.ethics.harvard.edu/lab/blog/300-bigbang>



# Bad Apples and Dirty Barrels: Outliers and Systematic Institutional Failures

[Susann Fiedler](#)

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In 1999 three psychologists followed up on a fraud scandal involving Rene Diekstra, a world-famous Dutch clinical psychologist, by investigating the question of how psychologists in the Netherlands were affected by the scandal. In a paper published under the title, "[Framed and misfortuned: identity salience and the whiff of scandal](#)," the authors show that Dutch social psychologists were more affected when they put themselves (i.e. as being a psychologist) in the same category as Diekstra (Stapel, Koomen, & Spears, 1999).

Ironically, one year later the first author of this paper will sit in his kitchen and create a data set proving an outcome that he predicted but didn't find when running the experiment with actual participants. In so doing, Diederik Stapel laid the foundation for becoming "the biggest con man in academic science" (see for an extensive report the [New York Times Magazine](#)). The article details the extent of Stapel's fraud and how he first crossed the clear boundaries of scientific ethics. As of publication [Retraction watch](#) reports 51 retracted articles that are assumed to be based on his fabricated or manipulated data sets, which have been cited 1,334 times overall (see Google Scholar). The [official report](#) of the committee investigating Stapel concludes that for another 13 papers fraud cannot be ruled out, and therefore more retractions are expected.

Though entitled "[The Mind of a Con Man](#)," the piece is more than just a story of a bad apple willing to break the ethical rules of his guild. It is also a story about the dirty barrel of science, characterized by an ill-defined incentive system which does not ensure that science is in a Popperian way self-correcting. Not only did it take over 10 years to uncover his fraudulent research - because the current scientific machinery leaves many blind spots for scientific misconduct - but science as an institution also unintentionally encourages proceedings that undermine the goal of accumulating knowledge. As bad as the behavior shown by Stapel is for the image of science, the real threat to the overall scientific contribution are the decisions every single researcher is making on a daily basis. The incentive system presents itself as a clear social dilemma. On the one side, personal payoffs (e.g. publications, funding, income, and career chances) are not necessarily related to the publication of solid and replicable findings, but to the marketing of surprising and statistically significant findings. On the other side, the scientific community as well as the broader population maintains the notion that the published research results are a portrayal of true effects in the real world. Seeing the preferential publication of research confirming previous results and reaching statistical significance (see for a current estimation of the extend of the problem Fanelli, 2012; Francis, 2012; Renkewitz, Fuchs, & Fiedler, 2011), and the degree of freedom accorded to researchers (Simmons, Nelson, & Simonsohn, 2011), let us allow this myth to die fast. The culture of competition for funding, jobs, recognition and fame introduces conscious and unconscious biases within the research process.

On a daily basis, every scientist has to make choices concerning research designs, analysis methods and reporting. Following Popper's idea of the scientific method, researchers should

thereby propose “ bold hypotheses, and [expose] them to the severest criticism, in order to detect where we have erred” (Popper, 1974).<sup>i</sup> Unfortunately, researchers concern themselves instead with how they can get their research published, whereby publishing often requires hiding the messiness of the real world, through skillful data analysis and incomplete reporting of results, in favor of a compelling and easily understandable story. The behavior stimulated by these incentives is seen in a study published by John, Loewenstein, and Prelec (2012), where 36% of the responding researchers admitted to having at least once made use of one of the questionable research practices put forward by the authors.<sup>ii</sup> The behaviors described by the authors skirt the line of unethical behavior and are part of a grey area previously not defined transparently enough as scientific misconduct.

The extent to which the results in psychology and other behavioral sciences are corrupted by these behaviors is still not clear; that they are corrupted, is. Currently, [new ideas](#) are being developed to increase the trustworthiness of our results again,<sup>iii</sup> and psychologists are overcoming their paralysis introduced by the fraud scandals<sup>iv</sup> and [replicability problems](#) by actively addressing the challenging issues.

By rewarding the scientific value of ideas and the quality of the methodological execution of research, instead of sexy results that might not be replicable, we reduce the discrepancy between the collective goal of accumulating knowledge and the personal goal of job security and success. In so doing, not only is the incentive for fraud reduced but the mind set of each single researcher is changed. By creating incentives for contributing a solid and trustworthy finding, a scientific environment as promoted by Popper will be fostered wherein the goals of the individual researcher and those of society become once again aligned.

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<sup>i</sup> Popper asks here not *if*, but *where* we have erred.

<sup>ii</sup> Similar findings are reported by [Daniele Fanelli \(2009\)](#) and [Feld, Necker, and Frey \(2012\)](#)

<sup>iii</sup> Researchers in the field of psychology estimated the likelihood of replicating a published finding at 53% ([Fuchs, Jenny, & Fiedler, 2012](#))

<sup>iv</sup> Since the Stapel scandal broke, two more cases of scientific misconduct have become public (please find the story [here](#))

<http://www.ethics.harvard.edu/lab/blog/301-bad-apples-and-dirty-barrels>

# Performing the Job of a Congressional Staffer: Informing the Public Without Endangering Your Boss

[Paul D. Thacker](#)

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A few weeks back, [I wrote a piece for Slate](#) calling out President Obama for not living up to his pledge to provide a more transparent government. In the process, I noted that several nonprofits have been ignoring the President's failure in this matter, with one even coming to aid the administration when Congress has demanded information during a federal investigation of a failed program called Fast and Furious.

Why a small nonprofit would feel the need to rush to aid the most powerful man running the world's most powerful country is beyond bizarre. But the partisan nature of Washington sometimes fouls people's thinking.

Specifically, Congress has been demanding documents explaining why the Department of Justice—perhaps guided by the White House—provided false and misleading information to the Senate Judiciary Committee, whose staff were investigating Fast and Furious. Providing false and misleading information to Congress [can result in prosecution](#).

The Fast and Furious investigation [has been called "partisan"](#) by self-appointed watchdog Melanie Sloan who runs Citizens for Responsibility and Ethics in Washington (CREW). Ms. Sloan later [filed an ethics complaint](#) against Representative Darrell Issa (Rep-CA) when he released portions of documents sealed by a court. At the time, the administration was stating that officials in Washington knew little, if anything, about the program, and to prove them wrong, Representative Issa released documents that had the signature of officials in Washington who approved the failed program.

Still, the White House would not disclose all the information requested by Congress, forcing the House to find the Attorney General in contempt of Congress. The whole issue has now moved to the courts where the House and Department of Justice will litigate whether the documents must, in fact, be turned over to Congress.

This back and forth between Congress and the administration is fascinating because it provides a lens into how congressional staffers investigate possible wrongdoing, doing so without running into their own legal problems.

## Fast and Furious: A Failed Program

First, some history: in early 2010, agents with the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF) met with investigators working for Senator Charles Grassley (Rep-IA). In these meetings, they explained that their agency was part of a bizarre attempt to track weapons into Mexico by letting them fall into the hands of gun traffickers. The Senator then

sent a letter to the Department of Justice asking for an explanation. Some months later, the Department of Justice responded with information that was false and misleading.

At this point, the investigation had to begin following two tracks. First, congressional investigators wanted to understand why the administration was running a program that allowed guns into Mexico. Second, investigators working for Grassley had to figure out why the administration was lying. Was it just a mistake, or were officials in Justice trying to willfully hide something from Congress? The answer to the first question eventually became pointless when the administration shut down the Fast and Furious program.

However, Congress persisted in asking questions about the false letter that Justice sent Senator Grassley. Justice [later withdrew that letter](#), but did not offer enough documents to explain why they had sent it in the first place.

Because Republicans are in the minority in the Senate, Grassley eventually exhausted his ability to demand documents from Justice. However, Republicans are in the majority in the House, meaning Representative Issa could send subpoenas to Justice demanding internal documents explaining why Justice lied.

To make the point that officials high in Justice probably knew what was going on at the time Fast and Furious was running, Issa put information from Fast and Furious wiretaps in the congressional record, noting that these wiretaps were signed off by top Justice officials. Someone inside Justice [apparently leaked](#) the wiretaps to Issa's staff. In response, Melanie Sloan filed an ethics complaint against Issa complaining that [he may have violated the law](#) by releasing these court sealed documents.

But is this true?

### Protecting Your Boss and Advancing an Agenda: How Staff Release Documents and Information

The power of Congress to investigate is implied rather than stated in the Constitution. But the media is incredibly important to this process because without the media, you cannot apply pressure to an agency or company. To advance this agenda, staff regularly release information to the media, operating under the ["Speech or Debate Clause."](#)

This process of releasing information is shrouded in much secrecy, and even discussions between lawyers who represent Congress can lead to different opinions about what can be released and how. But the main ways to release information without incurring a lawsuit include: speaking from the floor and placing information into the congressional record, speaking during a Committee hearing and putting documents into the Committee record, or releasing information through official Committee action. Official Committee action is difficult to describe in detail because official action invariably includes reviewing the Committee rules, which vary across Committees.

A few examples should illustrate this process.

In the mid-nineties, Representative Henry Waxman (Dem-CA) received documents that were apparently stolen during litigation with tobacco companies. The documents showed that tobacco companies had manipulated nicotine levels. To make the information public and [protect himself from possible reprisal](#), Mr. Waxman published the documents in the

congressional record. Nonetheless, the companies attempted to compel Mr. Waxman to disclose who leaked him the documents. That subpoena was later quashed as Mr. Waxman [was protected by “speech or debate.”](#)

In a separate matter, I once wanted to release information, while on the Senate Finance Committee, regarding a physician who had taken enormous sums from several pharmaceutical companies, unbeknownst to the federal government, which was supporting his research. To ensure that Senator Grassley would not be compromised by a defamation lawsuit, we published the information during a Committee hearing. A reporter later wrote a front-page story on the information, [creating support to pass legislation called the Sunshine Act.](#)

In another case, the Committee wanted to make public information about a potentially dangerous drug. The information we had included documents from the drug company. Again, to protect against any possible legal retaliation, we published the information in a committee report, which is an official Committee action. The report was later covered by the New York Times and multiple other outlets, including Good Morning America. Just last year, the Washington Post published a front-page story on drug industry support for medical research that referenced multiple documents in that report. Again, those documents were under court seal.

However, Members can run into problems when disclosing information. The one example legal counsel discusses most often with staff concerns Senator William Proxmire (Dem-WI). In the mid-seventies, Senator Proxmire began giving out [“Golden Fleece”](#) awards—prizes he granted to federal research projects that he felt were goofy and a waste of taxpayer dollars. But one time, he screwed up.

In the late seventies, the Senator gave a Golden Fleece to Ronald Hutchinson, a scientist given a \$500,000 federal grant to study why monkeys clench their jaws. Giving the award from the floor of the Senate wasn't enough for Senator Proxmire. He later sent out a press release and gave interviews on the topic. [Mr. Hutchinson sued the Senator and his staffer for libel](#), pointing out that the press release and public statements weren't protected by speech or debate. The suit went all the way to the Supreme Court in *Hutchinson v. Proxmire*, with Hutchinson winning a \$10,000 judgment against the Senator.

A couple years later, House Counsel Stanley Brand told the Washington Post that, when he advises Members on how to protect themselves against lawsuits for making controversial statements, he tells them, “Make it on the floor, don't repeat it and if someone asks you about it, don't talk about it.”

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In fact, no action was taken against Mr. Issa for releasing the wiretap information he was given by a whistleblower inside Justice. And when I contacted his office, a staffer told me that the matter never resulted in any action.

<http://www.ethics.harvard.edu/lab/blog/302-congressionalstafferinformingpublic>

# Banking on Tomorrow: Why Today is Never Good for Financial Reform

[Gregg Fields](#)

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Ever since the economic crisis, there has been one point of broad agreement: banking reform is needed. There is even a 2,300-page law, the Dodd-Frank Wall Street Reform and Consumer Protection Act, which demands it.

But the crisis occurred five years ago. Dodd-Frank is about to turn three. And yet, political and regulatory gridlock in Washington has resulted in surprisingly little progress toward overhauling how banks look, act, or are overseen.

The biggest banks, whose implosion produced the Great Recession, are today even bigger. The top four institutions have added [nearly \\$2 trillion in assets](#) since Washington bailed out Wall Street in 2008. And their profits have soared even as the rest of the country endures one of the most tepid economic recoveries in recent history.

This week, a conference organized by the Federal Reserve Bank of Chicago compellingly illustrated why financial reform remains, at best, a work in progress. As speakers from government, industry, and academia spoke, the only clear consensus was that no one agrees on how to proceed. The stalemate has produced the kind of public policy paralysis that is frequently an indicator of the phenomenon known as institutional corruption.

Thomas Curry, who heads the Office of the Comptroller of the Currency, the primary regulator of national banks, said the sheer size of the mission is part of the problem. Dodd-Frank, he noted, requires some 200 new regulatory rules to be written—most of which haven't been, according to Davis Polk, a law firm that tracks the law's progress.

Dodd-Frank demanded 70 studies of the law's impact. And there are more than 1,000 other provisions of Dodd-Frank that will directly affect financial institutions, Curry said. "Carrying out these mandates has been a major preoccupation for the regulatory agencies," he said. "The job is still not complete; important rule writing remains."

## Unfinished Business

Indeed, one of the most glaring unwritten rules is the one named for former Federal Reserve Chairman Paul Volcker. The Volcker Rule is designed to prevent banks from gambling with their own capital on risky investments like derivatives, those complex instruments whose ability to plunge in value pushed banking to the brink. Once considered a crowning achievement of Dodd-Frank, the Volcker Rule remains—well, conceptual.

What's taking so long? At least part of the problem appears to be that, in Washington today, there is no end to the number of agencies that regulate financial services. Different sectors of the banking industry are regulated by the OCC, the Federal Reserve, the FDIC, the SEC, the Commodity Futures Trading Commission, and Congress. Furthermore, there is the wild

card of federal courts, where an agency's rules can be legally challenged—and frequently are overturned.

Turf wars among agencies, and the deep pockets of an industry that spends more than \$9 million a week on lobbying, according to [opensecrets.org](http://opensecrets.org), can produce protracted paralysis, Curry acknowledged.

"A certain amount of professional disagreement among agencies is inevitable," Curry conceded. "Before and during the financial crisis, it was sometimes the case that one agency identified a risk that it thought warranted joint action, and others disagreed. Sometimes, that meant action was not taken in a timely manner. We can't let that happen again."

Dodd-Frank supposedly takes a step in a unifying direction by forming the Financial Stability Oversight Council, which comprises the country's top financial regulators. But critics have questioned if it will diminish political influences on regulation, since the FSOC's chairman, by law, is the U.S. Treasury Secretary, a political appointee.

And on a practical level, there is ample evidence of endless inter-agency inaction on Dodd-Frank reforms. An example is the "too big to fail" policy, where some banks are deemed too crucial to the economy to be allowed to collapse.

The reckless behavior that brought on the banking crisis produced calls to end "too big to fail." But no one seems to know how to do that, and the language of Dodd-Frank is so complex that even academics who study the law disagree on whether it ends "too big to fail" or, in fact, codifies it.

### Too Big To Jail?

The diffusion of regulatory power virtually precludes a unified response to the problem. Furthermore, U.S. Attorney General Eric Holder, in a comment earlier this year, suggested that big banks can't be reined in by government without risking collateral damage to the rest of the economy.

"I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if we do prosecute—if we do bring a criminal charge—it will have a negative impact on the national economy, perhaps even the world economy," he told a Congressional committee in March. In further hints at the daunting dogmatic divides crimping reform efforts, some speakers at the Fed conference, which is focused on so-called Systemically Important Financial Institutions, or SIFIs, said size isn't the problem, anyway. "It is essential that the concept of 'too big' be distinguished from 'too big to fail,'" said Rodgin Cohen, a partner at Sullivan & Cromwell law firm and a widely influential figure in financial and regulatory matters. "It should be recognized that 'big is bad' represents a departure from every other sector," he added. "In no other industry are the largest entities subject to greater requirements because of their size."

And the reality is that, even when regulators want to take actions that would protect the public, their institutional powers have been curtailed by a couple of decades of feverish deregulation. Mary Schapiro, who headed the SEC until late last year, related a personal example. During the crisis, a money market fund sponsored by the doomed Lehman Bros. investment house became illiquid, sparking a panicked run throughout the entire money



fund industry. Calm was restored only after the Treasury stepped in with a temporary liquidity guarantee for investors.

### Speak Up

To Schapiro, the episode revealed a clear need to impose reforms on money funds—such as requiring greater capital cushions against losses. But her idea went nowhere, drawing fierce opposition from the industry. She abandoned the idea when three of the five SEC commissioners sided against her. “I have long said I consider money market reform to be an important unfinished business,” Schapiro, who now works for Promontory Financial Group, a kingpin consulting firm in Washington, said Thursday.

While Schapiro ultimately failed at reforming money market funds, she indicated she didn’t regret going to battle. “When regulators identify a potential systemic risk . . . we must speak up,” she said.

<http://www.ethics.harvard.edu/lab/blog/304-banking-on-tomorrow>

# The Shadow Knows: Ben Bernanke Battles Non-Bank Banks

[Gregg Fields](#)

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In the years since the economic crisis, so many Wall Street acts of galling greed and endless avarice have been brought to light that they've lost their ability to shock.

Nevertheless, from an institutional corruption perspective the roots of the debacle are still somewhat shrouded in mystery. How could regulators have not detected the tsunami about to crash into shore? How could the relatively insignificant market in subprime mortgages bring down financial titans that, economically speaking, had towered over the world for decades?

In an insightful speech on Friday, May 10, Federal Reserve Chairman Ben Bernanke provided fresh perspectives into the regulatory failures that preceded the crash, and outlined his agency's efforts to revitalize financial oversight. His remarks touched on several topics familiar to students of institutional corruption, such as the need for transparency and the proper enforcement authority, and resources, for regulators.

The bottom line, he added, is that there is no substitute for constant vigilance. It's a marked contrast to the pre-crisis years, when Washington—where financial industries are among the most dominant campaign donors and lobbyists—turned a blind eye toward abuses that would later wreck the economy.

"Systemic risks can only be defused if they are first identified," Bernanke said, speaking at a conference organized by the Federal Reserve Bank of Chicago. "That said, it is reasonable to ask whether systemic risks can in fact be reliably identified in advance; after all, neither the Federal Reserve nor economists in general predicted the past crisis."

## Out of the Shadows

Bernanke took the helm at the Fed in 2006, on the eve of the worst financial crisis since the Great Depression. His tenure has been marked by an abrupt departure from historic Fed protocol. Traditionally, the agency was notoriously secretive. Under Bernanke, Fed monetary policy and economic goals are regularly relayed to the public. Bernanke's predecessor, Alan Greenspan, virtually never gave interviews. Bernanke holds quarterly press conferences. "He has led the Fed to new levels of responsiveness and transparency," Charles Evans, president of the Chicago Fed, said.

While transparency is often considered an antidote to institutional corruption, however, Bernanke's open style has its critics, as does his policy of near-zero interest rates—an effort to revive a moribund economy. "The time has come for the Fed to recognize that it cannot stimulate growth and that a stronger recovery must depend on fiscal actions and tax reform by the White House and Congress," Martin Feldstein, Harvard professor and chairman of the Council of Economic Advisers under President Ronald Reagan, wrote in *The Wall Street Journal* this week.

As Nobel laureate Paul Krugman put it in *The New York Times* on Friday, May 10: “For whatever reason, many people in the financial industry have developed a deep hatred for Ben Bernanke.”

### Obviously Not Transparent

Of course, some may view the financial world’s dislike of Bernanke as a good thing. Prior to the collapse, the cozy relations between Wall Street and Washington appear to have contributed to regulatory capture, characterized by the frenzied deregulation of banking.

In his talk, Bernanke said one explanation for the regulatory shortcomings preceding the crash was a lack of transparency. Specifically, much of the financial risk was created in the world of what’s called shadow banking. The definition of shadow banking is often debated, but typically refers to organizations that perform financial functions but are outside the regulated banking system. Hedge funds, insurance firms, and money market funds are often cited as examples.

In the years prior to the crisis, the shadow banking system thrived, growing from an estimated \$26 trillion in assets worldwide in 2002 to \$62 trillion by 2007, according to the Financial Stability Board, an international regulatory body.

By way of contrast, commercial banks in the U.S. have assets of roughly \$13 trillion, according to the Fed’s most recent statistics. The shadow banking system’s growth, Bernanke said, is at least partly attributable to the fact that “financial activities tend to migrate from more-regulated to less-regulated sectors.”

Although shadow banking is perfectly legitimate and performs vital financial services, it operates without the explicit guarantees of federally insured banks. But in an era of deregulation, investors didn’t seem to realize the difference. Meanwhile, shadow banks and those backed by the government became tangled in an interconnected web that ultimately ensnared both, Bernanke said.

“Investors were lulled by triple-A credit ratings and by expected support from sponsoring institutions—support that was, in fact, discretionary and not always provided,” Bernanke said. “When investors lost confidence in the quality of the assets or in the institutions expected to provide support, they ran.” Panic ensued.

### Complexity Theory

Bernanke’s comments reveal just how complex the issue of institutional corruption is when it comes to modern financial regulation. For instance, while there has been a great deal of emphasis on what regulators failed to see, the systemic risks of shadow banking flourished in places where regulators weren’t allowed to look.

Additionally, in a world where money moves over the Internet, it isn’t clear how regulators can hope to keep regulated banks and shadow banks from commingling. And of course the role of government backing raises the risk of moral hazards. FDIC insurance, for instance, was supposed to protect depositors. Yet, the bailouts of Wall Street actually protected shareholders, private investors, insurance firms like AIG and even most bank executives, very few of whom lost their jobs. (Virtually none have been prosecuted.)

As for the future, Bernanke held out hope that new powers granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act will enhance regulators' ability to shine lights into shadow banking's darker corners.

Specifically, it creates the Financial Stability Oversight Council, which comprises the top financial regulators. The theory is that this will bolster inter-agency cooperation and reduce the regulatory squabbling that has been known to occur.

Furthermore, the FSOC is allowed to designate non-bank companies as a Systemically Important Financial Institution, or SIFI. As such, it would be subject to stricter regulatory scrutiny. (As with almost everything involving Dodd-Frank, however, progress is slow. The SIFI designation process is underway, Bernanke said.)

Furthermore, the Fed is stepping up—and recalibrating—its monitoring of financial institutions. It is now placing greater emphasis on systemic risks, the kind that could bring the whole industry crashing down. Historically, it focused on the health of individual institutions.

Whether this will eliminate the kinds of regulatory failures that preceded the economic crisis isn't known. Nevertheless, the efforts appear to reflect the recognition by the Fed that oversight as practiced previously simply didn't work.

"This new regulatory framework is still under construction, but the Federal Reserve has already made significant changes to how it conceptualizes and carries out both its regulatory and supervisory role and its responsibility to foster financial stability," Bernanke said.

<http://www.ethics.harvard.edu/lab/blog/305-the-shadow-knows>

# Diagnosing Institutional Corruption

[D. James Greiner](#)

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According to [petwave.com](http://petwave.com), “Dogs infested with sarcoptic mites will present to the veterinarian with a history of the sudden onset of intense itchiness, and probably also with red, raw skin sores and thick crusted areas caused by self-trauma from the dog’s effort to alleviate the itchiness.”<sup>1</sup>

The problem is, of course, that lots of things can cause dogs to scratch too much, including allergies, hormonal imbalances, fleas, ticks, and perhaps most intriguingly, boredom.<sup>2</sup> So how would a veterinarian know that sarcoptic mites are the problem, meaning that Fido needs a topical cream to kill mites as opposed to, say, an extra walk every day or a new tennis ball? There are apparently a few intriguing<sup>3</sup> or disgusting options,<sup>4</sup> in addition to the more straightforward idea of examining skin scrapings from the dog under a microscope to see if mites are visible. But in practice, vets actually use few of these methods to detect sarcoptic mites. Instead, vets diagnose the affliction by instructing the dog’s owner to apply a topical cream that kills mites, then observing if the dog’s scratching problem resolves in the next two weeks or so. If it does, the vet concludes that mites were at issue. If it does not, then the vet searches for another cause.

I confess that when I reviewed the materials for Professor Christopher Roberson’s recent presentation to the Lab on “Blinding as a Solution to Institutional Corruption,” I did not immediately think of the mange. Nevertheless, the point of this blog post is that those of us who care about institutional corruption might learn something from vets, and that Professor Robertson’s lecture shows us how this is so.

Stepping back for a moment, how do we know whether an institution is corrupt? Begin by returning to the definition of institutional corruption that Professor Lessig offered at the Lab’s creation, namely, an economy of influence that weakens the ability of the institution to further the institution’s purpose.<sup>5</sup> A classic form of corruption occurs when an institution created to serve one purpose alters its procedures or its output so as to serve, at least partially, a second purpose; the second purpose might be money or funding. So, in an example that Professor Robertson uses in one of his papers, the institutions of biostatistics and pharmacological investigation are in part designed to figure out whether medical treatments, particularly drugs, improve health. But under the current system, pharma companies fund such research, and they want studies of drug effectiveness to produce positive results. As biostatistical and pharmacological researchers compete for funding, they may produce results that are more positive for pharma companies than the underlying science would support.

So, we (think we) know what institutional corruption is, or at least we have a rough idea. Now, the hard part: For any institution or set of institutions, how do we know whether corruption (so defined) is present?

I can think of three ways to diagnose institutional corruption; there are probably others. The first is one that Professor Lessig employed in his 2009 inaugural lecture for the Lab: examine closely what an institution says or does (*i.e.*, the institution’s actions or outputs). If those

actions or outputs are “incorrect,” then we might suspect that institutional corruption is to blame. In the Lab’s inaugural lecture, Professor Lessig provided us with at least two governmental decisions, the level of added sugar in a balanced diet and the responses to global warming, as examples of “easy public policy question[s] that the government gets wrong.”

This method of diagnosis is unquestionably helpful, but it has drawbacks. The primary drawback is that it assumes that we know what the correct answer is. Thus, it tends to be helpful in settings in which the right output for an institution is, as Professor Lessig suggests, “easy.” On the level of added sugar example, it is obvious that a balanced diet is not one in which 25% of caloric content comes from added sugar, and if the Food Nutrition Board says that 25% is fine, we might suspect institutional corruption.

When Fido scratches to the point of creating “red, raw skin sores and thick crusted areas,” Fido might have mites.

In many other settings, however, the right answer can be less clear or perhaps even unknowable. Process theorists, for example, believe that good public policy cannot or should not be defined by measuring governmental outputs against a correctness scale, but rather by whether the processes that gave rise to those outputs are in some sense just. One need not go this far to believe that looking only at an institution’s outputs could make it difficult to distinguish corruption from insufficient technical expertise, bad judgment, bad management, insufficient enforcement power, alternative theories of justice, or any other reason that an institution might not produce the outputs that an observer sniffing for corruption believes to be correct. Further, why should we trust the observer’s sense of what is correct over the institution’s? The observer itself may be responding to inappropriate (corrupting) incentives, or might itself suffer from any of the other pathologies mentioned above. The point here is not that examining institutional outputs is unhelpful, but rather that this method of discerning whether corruption is present has limits.

A second method of diagnosing institutional corruption is to examine the institution’s innards closely. Professor Lessig’s 2009 inaugural lecture for the Lab again provided us with an example of this method. In the sugar example above, Professor Lessig documented how the ultimate decision by the Food Nutrition Board to adopt a definition of a balanced diet that included 25% added sugar came after an additional sugar industry insider became a member of the voting body.

If one looks closely at Fido’s skin samples, one might actually see sarcoptic mites.

This methodology, too, has limits. Corrupting influences, like sarcoptic mites, can sometimes hide well. Sometimes institutions disclose the fact that they are hiding things, citing reasons, mostly bad but some good, for keeping what they do secret. As a Department of Justice litigator, I occasionally argued that a court could not and should not compel public disclosure of documents that would reveal an agency’s deliberative processes on the grounds that public disclosure of deliberations would chill the frank exchange needed for good decision making. Such an argument might hold some water; one might ask, for example, whether an open and honest debate would result if Harvard Law School’s tenure deliberations were available online. In other instances, institutions become good at hiding what they hide. And secrecy can make it hard for an observer to see corruption at work.

Meanwhile, in other situations, information about potentially corrupting influences is hard to collect, either because those in the best position to collect it have are the alleged corruptors (would we expect big pharma to make the amount of money it spends on payments to and perquisites for doctors readily available?) or because the information's disperse nature makes it hard to gather (would we expect that anyone would know how much money particular industries contribute to campaigns in all 50 states, including at the municipal level?).

A third method of diagnosis is what the opening paragraph of this post illustrated, diagnosis by treatment. How do we find out if an institution is corrupt? We imagine the nature of that corruption and specify an intervention that would combat it. We then intervene in the specified manner. If the institution changes in some way, say, by altering the nature of its outputs, then we might guess that the institution was corrupt (and that, as a bonus, we might be on to a way to counteract the effects of the corruption). Note that the intervention could take several forms. It might prevent the corruption from occurring in the first place, meaning the intervention gets at the root cause. Or the intervention might address some element on the causal pathway from the corrupting influence to an institutional outputs, meaning that the intervention not eliminating the corruption but is rather rendering that corruption ineffective.

When Fido gets better after his owner rubs mite-killing salve on his skin, we conclude that Fido had mites.

Back to Professor Robinson's recent presentation. Several of Professor Robinson's papers explore the concept of blinding as a solution to corrupting influences. Litigation expert witnesses should receive assignments, produce reports, and communicate with clients through neutral intermediaries.<sup>6</sup> Industry should conduct research on the effectiveness of medical treatments through the NIH.<sup>7</sup>

But, say the institutions at issue, we are not corrupt. There is no problem to solve. Yes, money flows, but everyone needs money to live, and the money does not influence our outputs. Litigation expert witnesses insist that they are as pure as driven snow, and the litigators that hire them frequently contest the standard narrative that their experts are "whores"<sup>8</sup> who will say anything for money (the other side's experts are a different matter, of course). Statisticians who evaluate drug or medical device effectiveness contend that they follow the numbers, nothing more or nothing less (regardless of the fact that the numbers show that industry-funded studies reach results more favorable to industry than do independently funded studies).

It is not enough to give contentions of purity the back of one's hand. Everyone *does* need money to live. And it is not easy to see how we will stretch tax dollars to fund expert testimony, pharma research, political campaigns (all the way down to the local level), and all of the other areas in which, say, money *might* exercise a corrupting influence. Diagnosis by treatment is an additional option here. If decision makers of a particular type appear vulnerable to the corrupting influence of knowing the source of funds received (note that ordinarily it is the knowledge of who paid, rather than the payment itself, that can corrupt), then use the following method: blind some such decision makers, leave others unblinded, and compare results. (Note that one would do best to randomize the blind here, but that touches on a different set of issues regarding implementation.) If the blind has no effect,

then one might question whether knowledge of the source of payments is in fact corrupting this type of decision maker.

Diagnosis by treatment has its drawbacks. It is an alternative source of information, not a panacea. In particular, intervening in the world and collecting results is time-consuming, complicated, and hard. Who willingly participates in an experiment designed to see if she is corrupt? At present, almost all of my research time consists of setting up, running, and analyzing the results of randomized control trials in the field. The hardest part of field experiments is persuading people to engage in them. And none of my RCTs are explicitly and overtly designed to diagnose institutional corruptions. With corruption as a motivating factor in an RCT proposal, the persuasion necessary in any rigorous field operation becomes that much harder.

Yet my view is that those of us who care about institutional corruption are, at present, underutilizing the method of diagnosis by treatment. Few diagnostic methods have a comparable potential to resolve arguments about the existence vel non of institutional corruption. Field operations may be frustratingly slow and hard to do, but they are necessary if we are to prove when corruption exists in the face of protestations that we are hunting hobgoblins.

A suggestion to Professor Robinson: Change the title of the presentation to “Blinding as a Diagnosis Method and as a Solution to Institutional Corruption.”

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1. <http://www.petwave.com/Dogs/Dog-Health-Center/Skin-Disorders/Sarcoptic-Mange/Diagnosis.aspx>

2. <http://pets.webmd.com/dogs/guide/dogs-and-compulsive-scratching-licking-and-chewing>

3. Apparently, one can rub the edge of the dog's ear while watching for a reflex scratching action in its hind legs. <http://www.petwave.com/Dogs/Dog-Health-Center/Skin-Disorders/Sarcoptic-Mange/Diagnosis.aspx>. It is hard to believe that this method would have high diagnosticity.

4. It would be better, perhaps, not to inquire too closely regarding a technique that bears the moniker “fecal flotation.” <http://www.petwave.com/Dogs/Dog-Health-Center/Skin-Disorders/Sarcoptic-Mange/Diagnosis.aspx>.

5. <http://www.ethics.harvard.edu/images/resources/pdfs/d3.pdf>, page 3.

6. Christopher T. Robertson, 85 N.Y.U. L. Rev. 174 (2010).

7. Christopher T. Robertson, The Money Blind, 37 Am. J. L. & Med. 358 (2011).

8. J. Morgan Kousser, Are Expert Witnesses Whores? Reflections on Objectivity in Scholarship and Expert Witnessing, Pub. Hist., Winter 1984.

<http://www.ethics.harvard.edu/lab/blog/306-diagnosing-institutional-corruption>



# Good, Clean Data

[Brooke Williams](#)

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In our recent story for [The New Republic](#), Ken Silverstein and I examined think tank scholars who simultaneously work as registered lobbyists. We knew of situations worth examining: a resident think tank fellow also representing Polish oil interests, and the director of a homeland security program lobbying for defense contractors, to name a couple. But we wanted to go beyond the anecdotal and gain context. Was this part of a larger system in which registered lobbyists have access to think tanks from the inside?

Due to limited and dirty data, trying to answer this question turned out to be a challenge. Think tanks only disclose officers, directors, trustees, key staff, and top five highest paid employees in annual filings to the Internal Revenue Service. And while most think tanks list scholars and staff online, they're in various formats. Some are [behind search engines](#) or listed on a [bunch](#) of separate web pages.

As a part of my long-term project, I am grabbing names of scholars and staff listed online, then cleaning, parsing, and importing them into a database, which I will be making freely available in a searchable, meaningful way. But for this story, I stuck with data from tax filings, when they were available, for the 25 top think tanks as James McGann ranked them in his [report](#) for the Think Tanks and Civil Societies Program at the University of Pennsylvania.

I downloaded the names of think tank people from [Guidestar.org](#), which has digitized the IRS Form 990s. However, since the original files were .pdfs, the data required cleaning, standardizing, parsing, and verifying before they could be linked to lobbyist records.

The name field contained unwanted spaces, characters and punctuation, as well as misspelled names. At least one person was missing. Once I trimmed the spaces and removed punctuation, titles, suffixes, and prefixes, I researched people whose names appeared to be misspelled to ensure the data were correct and consistent.

It's worth noting the IRS began releasing 990s in a digitized format this year—and other journalists have already made them easily searchable. But unfortunately, the digitized data don't include names of directors, officers, trustees, and key employees.

Once the think tank names were ready, I downloaded registered lobbyist data and prepared them for a cross-check. This required parsing a name field and performing integrity checks on the results.

When the two data sets were ready, I linked the name fields by first and last name and began examining the results. I didn't include the middle name because it wasn't always in both data sets. One by one, I verified or eliminated.

First, taking into account different filing periods, I queried for those people listed in both data sets during the same years—as we were only interested in those cases. I removed instances where the person was a registered lobbyist for the think tank itself.

Next, I verified whether they were indeed the same person. (As it turns out, some think tank executives and registered lobbyists share seemingly uncommon names.) This required varying levels of research, from reading online biographies and making phone calls, to scouring federal records showing prior government positions. Next, I verified in the paper versions of the 990s and lobbying disclosure reports that each individual was, in fact, listed on the think tank's rolls and registered to lobby simultaneously.

In the end, as our article described, the data showed at least 49 people have simultaneously worked as scholars, officers, trustees, and directors at think tanks while registered to lobby on behalf of outside clients. Especially given the limited scope of data for this analysis, the number suggests there will be plenty more potential conflicts of interest to examine once we cross-check the rest.

In the meantime, it seems even one example is significant. The Center for American Progress says it has implemented a "no lobbyists" policy in response to our *New Republic* story. Stay tuned for the next one.

<http://www.ethics.harvard.edu/lab/blog/308-goodcleandata>

# Institutional Corruption: Linking and Learning from Regulatory Capture

[Donald W. Light](#)

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This is the third in a set of blogs devoted to strengthening the concept and theory of institutional corruption (IC). A previous blog urged that IC would be greatly strengthened by [drawing on moral philosophy](#) to establish a normative, external foundation for both defining when IC is occurring and for developing legitimate reforms for institutional integrity.

A second blog pointed out that all IC occurs within a dynamic, historically changing field of [countervailing powers](#) (C-Ps) and therefore an adequate account of IC needs to include the identification of those C-Ps and how they are affecting IC. These usually include corruptors, the corrupted, and those affected in multiple ways.

Could IC also benefit from linking to regulatory capture, a much older and richer concept and body of work? And how could we show the relevance of IC to economists, political scientists, and policy-makers involved in capture thinking? This question is particularly relevant because [The Tobin Project](#) is actively trying to update and strengthen capture theory and research. What follows is a short, limited review and reflection that needs to be more extensive.

In his [“Short, Inglorious History”](#) of regulatory capture, Richard A. Posner defines it as the “subversion” of agencies by regulated firms, “turning the agency into their vassal.” Posner maintains that capture differs from regulation intended by a legislative body to serve the private interests of firms, a distinction that I will argue would be dealt with more effectively if capture theory were to draw on IC theory, because ruling out legislative intent rules out the core contribution of Thompson and Lessig on ways in which industry captures or corrupts Congress and the legislative process. If capture theory confines itself to forms of subversion or control that occur only *after* a group of firms or an industry uses millions of dollars and hundreds of lobbyists to create an economy of influence that helps legislators to “see” things their way and set up regulations to enhance their wealth or power, then capture theory misses the main act of how a set of concentrated stakeholders frame regulation. Further, capture alone is value neutral—it may be good or bad from a given stakeholder’s point of view. Corruption clearly indicates that something worthy or good has become “tainted” or “morally debased,” to use words in the dictionary, or made to no longer function properly, as when a file is corrupted.

Further on, Posner writes about George Stigler and economists’ view that regulation is something that an industry purchases. By “purchases,” they must mean through institutional practices that corrupt the democratic process, such as those described by [Larry Lessig](#) and by Mal Salter in his book on [Enron](#). Once again, IC theory has a breadth and normative base that capture theory lacks, though this economic view implies that capture includes the legislative framework as well. IC theory also applies to many institutions that are not involved in regulation. For these reasons, IC theory is more comprehensive and inclusive than capture theory. If IC research and analysis were to include the historically dynamic

account of countervailing powers, it would address Posner's complaints that capture theory is rather static in its outlook. Posner concludes glumly that "the term 'regulatory capture' should be retired." Here we have reasons for why it should be subsumed and revitalized, rather than retired.

Capture theory offers some insights for IC, and perhaps the central one comes from Mancur Olson, that public interest and passion for regulatory reform is diffuse and short-lived, and the resulting public benefits (like less pollution) are diffuse. But the effects on those regulated are concentrated, as are their efforts to alter or bend or corrupt the program (public housing) or regulatory institution (EPA) that is aimed at creating a public good. Olson's theory implies that capture is inevitable. Is Institutional Corruption inevitable too? One implication is that even were Congressional elections to be publicly funded, the concentrated interests of companies that pollute, or construction companies that build public housing, or drug companies that provide drugs, would still find plenty of ways to alter, bend, or corrupt democratic procedures and legislation to advance their interests. This implication of Olson and this school of thought warrant discussion.

Another set of interesting distinctions can be found in Daniel Carpenter's essay on [Corrosive Capture](#). He defines *regulatory capture* as raising entry barriers, such as licensing. This excludes those who are not, or cannot be licensed. Changing FDA rules from allowing new drugs on the market unless the staff raised an objection before 1962, to requiring prior testing and approval, would be another example of raising entry barriers that privilege one set of products and producers over others. I would recommend calling this *entry capture* and save "regulatory capture" for a broader use.

"Corrosive capture" consists of actions that weaken regulatory oversight and independence once entry barriers have had their effects. In recent decades, we've seen "capture" evinced in the weak application (or non-application) of regulatory tools. Corrosive capture can also occur through "boundary manipulation" and the revolving door syndrome. Two other interesting forms are the federal pre-emption of state regulatory bodies or rules, and enabling companies to choose the regulatory setting they prefer through "regulatory arbitrage." This strategy is key to keeping the EMA (European Medicines Agency) weak, because companies can always choose any one of the European state regulatory bodies instead of the EMA, and if it approves their new drug, all other countries must accept that decision, [even if the drug has few benefits](#) and is very expensive. One can see here how corrosive and regulatory (or entry) capture blur together so that the distinction needs further discussion. But the idea of corrosive capture brings capture theory rather close to corruption theory and suggests a need for dialogue.

A third distinction made in the Tobin Project work is *cultural capture* that shapes the assumptions, terms, and accounts that all parties come to accept. As I pointed out in a general essay on [strengthening IC theory](#), this kind of capture or corruption is the most powerful and least developed. For example, industry has succeeded, through story after story, in having most Congressmen and regulators believe that new drugs benefit patients so that the goal is to approve them as quickly as possible. Nevermind that 90 percent of new drug products are found to be little or no better than existing ones. Nor evidence from rigorous, quantitative studies at Harvard and Yale that faster reviews lead to significantly more products having serious side effects. Once the premise and account is taken for

granted as accepted truth, facts to the contrary get ignored or discredited. Senator Sherrod Brown has called this “cognitive capture” — capturing people’s minds.

If Institutional Corruption is to gain wider use and recognition, it needs to be more embracing and inclusive. The Tobin Project is broad and includes work on preventing capture, similar to work at the Edmond J. Safra Lab on preventing corruption or investigating exemplars of institutional integrity. Perhaps an invitational workshop at which IC and capture scholars explore shared interests would benefit both groups.

<http://www.ethics.harvard.edu/lab/blog/309-institutional-corruption>

# Bangladesh: Savar Solutions and Fast Fashion may not be Compatible

[Heather White](#)

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Please watch the [original footage](#) that accompanies this blog post.

In the aftermath of the Rana Plaza fire there has been a lot of finger-pointing as to who bears the majority of the blame for the disaster that left over 1,100 workers dead.

Most professionals working in the garment industry will agree that routine violations of health and safety laws are the norm in the lowest GDP countries in Asia producing for America's favorite brands.

The \$20 billion dollar question is whether consumers are going to continue to reward American corporations for doing business in derelict factories where their "business partners" (to use Disney's term) give their workers the kind of choices presented to the Rana Plaza workers that fateful day: "Go to work in a building that has been condemned and closed by the local police, or be penalized one month's salary." (It is interesting that a bank also located in Rana Plaza followed police orders and closed.)

What kinds of pressures are imposed on factories in Bangladesh that factory owners literally force their workers to risk death in order to get shipments delivered on time?

The pressure of Fast Fashion imposed by buyers for American companies is one of the causes.

Our favorite U.S. brands are engaged in a new business model called *Fast Fashion* that was first pioneered by Chinese factory owners operating outside of Florence, Italy 10 years ago. Using illegal trafficked workers from China who had been snuck into the country (they paid \$13,000 to scary middlemen called snakeheads who guided them step by step overland from Central China). Chinese factory owners would accept an order from local Italian garment firms and not stop production until the order was completed. Most factories employed 50 workers or less, which meant there were no shift replacements. Workers put in 30+ hours at a time and people literally died at their sewing machines. Don't ask what happened to their bodies, that discussion is for another day. But there's a saying in Italy, "No one from China ever dies here." Meaning if a Chinese worker dies in Italy, someone else immediately appears to take their identity papers and their name, and if they die, someone else appears, and so on.

In today's globalized economy what works well in one part of the world may catch on elsewhere, and fast fashion or *pronto moda* worked extremely well in Italy. In fact it succeeded to the point that experts credit it with saving the textile industry in Tuscany during the downturn in the 1990's.

There you have the historical origin of the term *fast fashion*; and fast fashion is a big part of the problem in Bangladesh's apparel industry.

In the past ten years American brands happily adopted the *FF* model of quicker turnarounds, using digital technology to squeeze lead times from 9 months from order placement to production in Asia to store delivery in the U.S. to 90 days and less. Some retail firms now claim they can get goods ordered and on store shelves in five weeks.

H&M reports they now have 12 seasons a year and many other brands now have 8 seasons. This causes chaos at the factory level. One of the managers at a \$30 billion American apparel company I interviewed for my Edmond J. Safra research said “ The buyers allow the factories to squeeze labor as a variable cost since they can’t adjust shipment schedules. This makes mandatory overtime violations much worse.”

A third party auditor for one of the European companies that has signed the recent Savar accord (to improve factories in Bangladesh) said, “They give their suppliers the OK to violate local overtime laws as long as the factory agrees to participate in an “engagement process”. Nothing changes, which is exactly what they want—business as usual. I eventually became disgusted.”

The level of fast turnaround wreaks tremendous pressure on factories—who are fined by the Buyers if they ship even one day late. Yet Buyers claim the right to change designs and colors up to days before production begins with no allowances for later delivery, even when new materials have to be purchased to meet the change demands. The time pressure causes the factories to require overtime from workers to meet the deadlines. The overtime hours often go beyond the legal maximums for which workers are often not paid. The O/T wasn’t originally calculated in the cost of the goods, which are already at razor thin margins, and the Buyers refuse to pay a penny more.

The system of order chargebacks to already squeezed factories in the world’s lowest GDP countries also hinges on the unethical. American apparel buyers have already ferreted out the lowest cost suppliers in the world’s poorest nations, yet they insist on further discounts if shipment is a day late—for any reason. So this is another pressure on factory managers in Bangladesh who cannot afford to lose even an hour of production on the tight schedules imposed by foreign buyers.

The above scenarios give some idea of the time pressures imposed on Bangladesh factories scrambling to meet the demands of buyer-imposed fast fashion. But that isn’t the extent of the demands, because global brands now require world-class working conditions as well, at least on paper, to meet the expectations of consumers and stakeholders.

Against this backdrop we find the social auditing industry in Bangladesh, which is taking a lot of heat right now for this recent disaster, the earlier Tazreen fire and also the Ali Enterprises fire in Pakistan.

When factoring in fast fashion, does one really expect that safety measures and legal compliance are going to be a supplier’s priority, if they cause shipment delays?

Prior to the onset of fast fashion, Bangladesh’s record on labor standards was already near the bottom globally, which didn’t dissuade U.S. apparel firms from entering in record numbers.

However, the demands of the anti-sweatshop movement in the U.S. required that some attention be paid to Codes of Conduct and improving supplier standards. A newly emergent

social audit sector, comprised mostly of for-profit firms, was happy to oblige and the sector has grown into a multi-million dollar industry, despite the UN's John Ruggie stating, "We keep hearing now, from just about everywhere... Monitoring doesn't work. Just about everyone, at least off the record, will tell you that monitoring doesn't work because people cheat."

In Bangladesh the millions would have been better spent on exterior fire escapes.

A review of my archived social audit reports from Dhaka factories going back to 2007 reveals widespread conflicts of interest and corruption between auditors and factories. The big winners however are ultimately the U.S. brands, whose local profit margins far exceed those of local manufacturers or the commercial monitoring firms.

In Bangladesh, most NGO advocates will tell you that factory auditing generally leads to no interruption of the business model, no matter how many negative audit reports are generated or alarm bells sounded. That doesn't mean that auditors don't shake down factories for payments on a regular basis, threatening to issue a negative report if thousands are not paid to a designated third party not connected to the audit firm. (One of my reports states "All transactions are done in cash and members of senior staff were seen carrying cash out in jute sacks." Think burlap bags filled with money. )

In general, sourcing guidelines gave plenty of leverage to factories and auditors to play with time for years. A U.S. \$400 billion company's ethical sourcing tool allowed factories with "orange assessments" to continue operating for two years up to receiving a fourth orange assessment, at which point order placement was to be stopped. But in reality, few brands will commit to working with any factory for a period as long as two years.

One of the reports states about the orange assessments, "This gives the auditors an opportunity to negotiate with factories for kickbacks for the buyer's orders to continue. Factories prefer to pay a smaller sum to the auditors rather than investing in improving labor standards. This practice is common because it deals with the disorder immediately and the factory is able to continue its normal operations/orders. In the process, compliance is no longer a priority."

Continuing normal operations in every case trumped requiring minimal fire safety standards. Despite 6-8 stories being the average height of garment factories in Dhaka and its environs, there are almost no exterior fire escapes. Video footage of surrounding factories reveals that despite 15 years of scrutiny by American brands of their Bangladesh suppliers, not one six-story factory had an exterior fire escape. No factory should have passed any audits, or been given two years to make improvements when failing on this most basic life-preserving measure.

It remains to be seen whether this latest consortium being formed by American and European buyers will have an effect, while continuing both *fast fashion* business as usual and average wages to workers of less than 20 cents per hour.

<http://www.ethics.harvard.edu/lab/blog/310-bangladesh-savar-solutions-and-fast-fashion-may-not-be-compatible>



# The Perils of Public-Private Partnerships

[Jonathan H. Marks](#)

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Imagine, for a moment, that you are a local public health official. Budgets are tight. Childhood obesity is on the rise. And there is no playground in the heart of your city. When a story appears in the local paper about the need for such a playground, a fast food company comes to the rescue.

Their vice-president for nutrition and public policy calls you, and offers to give you \$100,000 for the construction of a playground. The VP emphasizes that the money will not come directly from the company, but from a charitable foundation the company recently established. There are only two conditions, the VP assures you, and neither is onerous. There will be a bronze plaque at the gate to the playground saying that it has been constructed with a donation from the foundation and with the support of the company. And you have to smile for a photograph with the VP while you each hold a corner of a large blown-up image of the donation check.

You are a thoughtful public health official. You've read the literature on childhood obesity. You know exercise is important and that a playground is likely to be beneficial for the city's most vulnerable children. But you also know that many public health experts believe that fast food is a major contributor to the rise in childhood obesity. You feel uncomfortable about the proposed partnership, but you also find it hard to resist.

## What do you do?

This is not just a hypothetical question—one that ethics professors like me pose to their students in order to promote class discussion. (And, yes—it does prompt a great discussion!) It is also the kind of question faced by many public officials—particularly at the local level, in city governments and public school systems. When these officials look to leaders at the national level for guidance, they see that the partnership model has been embraced by the federal government. Most notably, U.S. Secretary of Agriculture Tom Vilsack has said that “[b]y partnering with USDA, corporations win, USDA wins, and the American consumer wins. That's a win-win-win situation!”<sup>1</sup>

I believe that such a characterization downplays the significant ways in which the missions of potential public and private partners diverge. These tensions create serious potential perils for the public partner, and they should not be glossed over or ignored.

In my recent working paper for the Edmond J. Safra Center for Ethics at Harvard,<sup>2</sup> I push back against the partnership as a default paradigm for interactions between government and industry, and offer some guidance to public health officials contemplating public-private partnerships related to food and health. In the paper, I don't provide a definitive answer to the kind of question posed above. Rather, I offer some tools that might help public officials as they grapple with this challenge.

I invite these officials to think systemically about potential partnerships, and with sensitivity to the threats they present not only to integrity and trustworthiness (often described as attributes or properties of an individual or institution), but also to trust and confidence (often described as attitudes toward individuals or institutions.)

When you adopt such an approach, the potential perils become readily apparent. Will the construction of the playground burnish a brand that the food company uses to market the kinds of energy-dense foods and beverages that public health experts believe play a significant role in rising levels of childhood obesity? Worse still, might the partnership confer a “health halo”—or positive health association—that increases consumption of those products? (This is sometimes described as a “secondary” gain or benefit for the industry actor, even though this partner may have intended to achieve precisely that effect.) Such a partnership might rightly be considered to undermine the mission and integrity of the public official for whom the promotion of public health should be the primary goal. But even absent these effects, the arrangement might undermine trust and confidence in the official and his or her agency. A loss of trust and confidence in one area might undermine an agency’s work in other areas too.

In my paper, I explore a couple of examples at the local and national level that vividly demonstrate these hazards. One involves a \$10 million donation to the Children’s Hospital of Philadelphia from a foundation established by the American Beverage Association, just as the city council was considering a soda tax proposal.<sup>3</sup> The other involves the USDA and its role in a series of partnerships with fast food chains that were designed to increase the amount of cheese on several menu items. This led to a headline in *The New York Times*: “While Warning About Fat, U.S. Pushes Cheese.”<sup>4</sup>

These examples underscore the importance of looking for tensions first, rather than synergies, when public health officials are considering public-private partnerships. Such officials should think not only about the systemic effects of such partnerships, but also the cumulative effects of their relationships with industry. (In my paper, I offer further guidance about how they might begin to conduct such an assessment.)

Partnerships with industry will be most tempting for public officials when they are designed to achieve a goal that is central rather than peripheral to the official’s mission. But if a public health official has insufficient resources to achieve a core objective, s/he should be both frank and vocal about the lack of public funding. I recognize that, in the current economic and political climate, legislators are likely to resist calls for additional funding. But it would be a mistake to downplay the perils of public-private partnerships in order to avoid those conversations, no matter how difficult they may be.

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# Further Disclosure

[Brooke Williams](#)

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In April, we [asked](#) 16 think tanks to voluntarily disclose the names of all corporate and foreign government donors. Some of the results are in, and they range from disheartening to promising.

Knowing who funds think tanks is important, because many are helping to shape public policy as trusted, independent research institutions while at the same time catering to private interests. In donor pitches, many of the most influential think tanks in this country put a price on everything from public policy papers to meetings with lawmakers.

So far, 11 think tanks have responded to [our letter](#) and subsequent phone calls and emails. One promised to release a donor list within the next few months, two assert they already disclose funders, and the rest say it is not the public's business.

The [National Bureau of Economic Research](#) in Cambridge, Massachusetts, plans to publish a list of all corporations that contribute to its general operating budget in July.

James Poterba, president of the think tank, said in a [letter](#) that he spoke with the board of directors, and there was "general agreement that the NBER should move to a complete-disclosure regime." He said they are notifying donors first. The think tank doesn't receive donations from foreign governments, he said, and scholars list funders in each paper published.

"I am grateful to you for drawing my attention to an issue that our organization had not considered in some time," he said.

At the [Center for Strategic and International Studies](#), Andrew Schwartz, senior vice president of external relations, said the think tank already discloses donors.

"We're not obligated to do it but we are very transparent about who funds each report and study," he said in an email. "It is listed in each work we produce."

He did not respond to questions about whether or not CSIS discloses all donors or just some, and if this includes any foreign governments.

"Just as another aside for your reference," he wrote, "we have recently had a successful building campaign and plan to publicly acknowledge the donors to our building in this new setting at the appropriate time when we move in and get settled."

Think tanks that declined to turn over donor details include the Center for American Progress (you can check out their internal, [confidential list](#), thanks to Lab fellow Ken Silverstein), American Enterprise Institute, Hudson Institute, Center for the National Interest, Manhattan Institute, Competitive Enterprise Institute, and the Independent Institute.

[The Reason Foundation](#), based in Los Angeles, pointed to the fact that it annually publishes a [list](#) of donors who gave \$1,000 or more in its magazine. The list, however, includes donations from “Anonymous” at each level of giving.

Also on Reason’s list of contributors is Donors Trust, a group that enables anonymous giving to free-market think tanks. An examination of tax filings shows Donors Trust and its sister organization, Donors Capital Fund, have given to 9 of the 16 think tanks we contacted requesting voluntary disclosure.

The letters are part of my ongoing [project](#) at the Edmond J. Safra Center for Ethics, in which I examine how corporations and foreign governments donate to think tanks to try and shape public discourse and policy from behind the scenes, thereby leaving the public in the dark.

<http://www.ethics.harvard.edu/lab/blog/303-furtherdisclosure>

# Dispatch from Chile: The Ethics of Health Priority Setting, or Searching for True North Without a Compass

[Adriane Gelpi](#)

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Imagine that you are the Minister of Health for Chile, a middle-income country with a nearly universal health system. You face a predicament that pops up regularly. The Chilean health system provides a politically popular package of health interventions to meet the medical needs of its citizens. At the moment, 80 conditions are covered, leaving those suffering from other conditions without access to care for their serious medical needs. You would like to add another benefit to the existing package of services, but the Minister of Finance has given you a hard ceiling on the budget. You cannot add a service without subtracting another, a politically perilous move.

So the task before you is to decide how to allocate the available health resources in the best way possible. But questions immediately arise: how do you define “best”? Many goals for this allocation could be reasonable. For example, you may decide to focus on outcomes, including maximizing overall health gain, controlling expenditures, addressing diseases with high prevalence, a concern for social justice, a focus on vulnerable populations, or investment in capacity.



What should be covered? What will not be covered? More fundamentally, on what criteria will you base your decision? And once you know what substantive criteria will matter, how will you structure the *process* of allocating new benefits? Then once made, how will you justify the decision you reached?

As this example shows, ethical issues enter questions about health resource allocation at every stage of deliberation.

In fact, given the life and death consequences of health care issues, asking such questions about health resource allocation really amounts to a more wrenching question. In the words of economist Victor Fuchs, health priority setting asks, "who shall live?"



*Participants at the Conference on Ethics of Priority Setting, March 22, 2013.*

### Conference in Chile: Ethics of Priority Setting in Health

Growing recognition of priority setting for health as an ethical concern has motivated countries to seek out guidance. For that reason, in late March 2013, Professor Norman Daniels and I found ourselves on a long overnight flight from the snowy early spring of Boston to the sunny early autumn of Santiago.

Daniels, a philosopher at the Harvard School of Public Health, and I, a Safra Lab Fellow and PhD Candidate in Health Policy and Ethics, were traveling to Chile to lead a two-day conference on the "[The Role of Ethics in Priority Setting for Health](#)," co-organized by the Chilean Ministry of Health and Carla Saenz, PhD, Regional Bioethics Advisor of the [Pan American Health Organization](#).



Held at the United Nations in Santiago, the conference brought together a wide range of attendees: from academics to physicians to Ministry of Health officials to bioethicists to economists. Attendees also came from abroad: one from Argentina, another from Peru. All showed up driven by an interest in thinking through how countries could make better and fairer decisions about health coverage.

Many Ministers of Health have no training in public health ethics in general, or priority setting in particular. In part, this reflects the broader fact that the ethics of priority setting for health is a nascent field. While understandable, this knowledge gap is not benign; it has real-world implications. If health ministers lack the analytic tools to evaluate the ethics of allocation decisions, it is more likely that ethical concerns will play a limited role in setting priorities for health systems. Expanding training in public health ethics, through conferences such as this one, will arm ministers with more tools to fully analyze the problems they face.

## Structure of the Conference

The first morning Daniels and I opened the conference. We each delivered a distinct, but coordinated, keynote address: first, Daniels presented a broad overview of the need for an ethics of fair priority setting, and I built on this theoretical foundation by describing some real-world challenges that will arise when implementing any new process of fair policymaking.

Dr. Ximena Aguilera, one of the architects of Chile's benefits package, provided an overview of the plan's origins and historical evolution. Demand for expanded services, and the political gains that accompany such expansions, make it tempting to add more and more treatments. Yet without a corresponding increase in the budget, expanding the number of covered diseases would lead to shallower and worse treatment options. Nonetheless, political penalties would follow from the removal of any intervention from the existing list.

The next two days of sessions centered on group discussion of three case studies, developed by officials from the Chilean Ministry of Bioethics. Through the case studies, conference participants wrestled with specific and pressing policy issues facing the Chilean Ministry of Health.

Two of the cases discussed:

- *Rare Diseases*: should governments cover treatment for diseases that affect only a tiny portion of the population? Many of the existing treatments for such conditions are extravagantly costly and may have limited efficacy. Why should such patients suffer because they have the bad luck to get a rare disease? Many of these diseases lack effective treatments because of the lack of pharmaceutical incentives to invest in research and development. Should the government subsidize such research?
- *Beds in Intensive Care Units*: By law, Chilean hospitals now allow all patients, regardless of whether they are covered under private or public insurance, to receive care at the closest hospital. This system has led to unintended problems, as publicly covered patients who end up in private hospitals often remain there once the acute period is over because there are insufficient ICU beds in the public hospitals. The government absorbs the higher costs of treatment in a private hospital.

## Many Questions, Few Answers

Two cross-cutting themes emerged from the discussion of the cases are worth mentioning:

### *Searching for Shortcuts: Human Rights and Cost-Effectiveness Analysis*

Faced with one of the difficult cases, many participants asserted that human rights should dissolve the predicament. Given that Chile recognizes a human right to health care, one professor of public health argued that providing the patient the care he has a right to is the only ethical choice. What other conclusion would we draw?

Such comments reflect the common temptation to rely on what many seem to view as objective measures, such as cost-effectiveness analysis and human rights, to answer the hard



questions about priority setting quickly. Both approaches share a single pre-defined goal: in the case of cost-effectiveness, the goal is maximizing QALYs; in the case of human rights, the goal is to ensure the protection of certain legal entitlements.

In Latin America, the right to health is often enshrined in the constitution. Thus, many in the audience seemed to view human rights as a trump card, and a solution to priority setting issues. Yet this fallback to human rights language can be a way to avoid acknowledging the need for tradeoffs. It is not a criticism of human rights theory to note that it does not answer all the questions about how real-world Ministries of Health should face real-world problems, such as staying within a budget. No human right to health care will magically expand the budget or allow all pressing medical needs to be covered.

Ethical evaluation and justification is still necessary, regardless of one's commitment to human rights or the results of a cost-effectiveness study.

### *Citizen Participation and Advocacy*

A second topic of vigorous discussion concerned the proper role of the public in the priority setting process. There was consensus in the group on the facts: they all agreed that in Chile certain powerful advocacy groups had effectively leveraged their might to get their pet disease covered by the benefit package.

For example, one speaker described how the Chilean Multiple Sclerosis Association bypassed the standard decision-making process to obtain coverage for MS. As a well-funded and organized group, they knew how to repeatedly “knock on the door” of the Ministry. They requested multiple hearings about the need to cover MS. Over time, these arguments bore fruit and MS was added to the list of covered conditions.

Yet opinions diverged about how to interpret the influence of special interest groups on the priority setting process. There is no problem, one high level official argued. “This is a good thing because the public should be able to express their voice, and in this case their voice resulted in getting their demands met. This is democracy.”

When asked if the MS example offered a good model for citizen participation, one official answered, “Yes. It is important that the citizens have a voice.”

Others, including me, expressed concern at this positive spin on the MS case. Even worse than its ad hoc nature, the case of MS clearly reflects the direct connection between money and social power and political results. The relative socioeconomic power of the MS group made it possible for them to gain an audience with the Ministry in the first place, and then to persuade the government to add treatment for MS to the benefit package.

This anecdote also highlights the importance of political context in shaping ethical perceptions. In Chile, the Pinochet dictatorship only fell in 1990, and it still casts a long shadow. Given this legacy of authoritarianism, we might argue that such demonstrations of citizen power offered a sign of progress, not corruption. In the face of this history, Chile's growing responsiveness and openness to the arguments of its citizenry was an explicit source of pride to certain attendees. The MS anecdote underscored this perceived political improvement.

Seeking guidance from the general public is critical, but the challenge is to do so fairly. For example, Chilean government has held “social round tables” in the past, which sought out

public opinion. They have always conducted social surveys of societal preferences about priorities in health. From these efforts came the finding, noted by Dr. Aguilera, that Chilean society strongly values prioritizing children over the elderly. Public opinion can insure that policies reflect social preferences, and also increase trust in the Ministry and normative and political legitimacy.

Such examples of interest groups influencing policy, it should be noted, are not at all unique to Chile. (Further, as other Safra Center research has shown, it is not unique to health care either). Many countries lack systematic priority setting processes and therefore make decisions about health policies in an ad hoc manner, choosing whether to cover a treatment or not based on the arbitrary application of varying criteria.

### Priority Setting in Health as a Problem of Institutional Corruption

The Chilean conference reaffirmed the often-asserted truism that reasonable people will disagree about fair decision making processes. While some disagreement may be inevitable, common approaches to ensuring fair priority setting process are often inadequate. For example, many guidelines, or frameworks, aim to generate lists of “good” factors that will promote fair policymaking, along with “bad factors” that should be excluded from a fair process. A Ministry can then evaluate its own process against the checklist of good principles and features to avoid.

However, a process can meet all the defined criteria and still fall short. For example, public participation is a noble goal. But as the Chilean MS case shows, public participation can subvert other important priorities.

The Chilean conference highlighted just how complex public health resource allocation can be. Lists of criteria--substantive or procedural, positive or negative—alone cannot prevent rationalization of decisions unduly influenced by special-interest pressure groups. In fact, the enumeration of such lists may increase the possibility of post-hoc ethical justification of illegitimately reached decisions, i.e. ones that invoke reasonable principles without having considered the universe of relevant arguments and facts.

While there is no easy solution to this problem, I propose that viewing priority setting in health through the lens of institutional corruption (IC) may be illuminating. The definition of IC includes the concept of a force causing magnetic deviation from the “true north” of an institution. This image begins identify a different way of describing the problem of health priority setting. The IC lens frames undue influences as magnetic forces that pull a Ministry of Health away from its true mission. This is valuable because while we can see this pull exerting influence in real cases of health resource allocation, we have lacked a holistic analytic framework for diagnosing such problems.

Still unanswered, however, is the question of how the “true north” for Ministries of Health should be defined.

One goal for future research, then, is to begin to enumerate the myriad ways that a health priority setting process can go astray or deviate from what we would intuitively think is a proper allocation procedure. This enumeration can begin prior to defining a “true north”

and without a clear vision of idealized decision making, although such theoretical work would be complementary. Indeed, institutions will need to make decisions about their goals and procedural decision making processes without an overarching theoretical framework.

Eventually, the inductive process of identifying these deviations could help define what proper priority setting might look like, and aid in developing practices that expunge the sorts of undue influences that distort policy making.

Viewing priority setting for health as a problem of institutional corruption, therefore, is far from condemnatory. Rather, such a reframing provides a path towards more ethical processes by opening up possibilities for innovation and creativity.

In other words, one lesson from Chile is that we need to “build the compass” that will help define “true north” for public health policymaking institutions. Once armed with such a compass, countries like Chile can begin to align their practices in a way that will keep the ship of state on an ethical course.

<http://www.ethics.harvard.edu/lab/blog/313-dispatch-from-chile>

# Tackling Institutional Corruption in Financial Markets

[Justin O'Brien](#)

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[Justin O'Brien](#) sets out an agenda to embed warranted confidence:

The most striking aspect of [the announcement](#) by the British Banking Association of its plans to overhaul the process by which the daily London Interbank Offered Rate (Libor) is set is its piecemeal nature. From July 1 there is to be a three-month delay before publication of individual submissions.

The move is aimed at restoring trust in the validity and utility of the benchmark, used to price trillions of dollars in derivative contracts. The British Banking Association claims it will reduce the risk of the kind of manipulation that has already prompted multi-billion dollar settlements against three international banks—Barclays, UBS and RBS.

These settlements, however, are just the tip of the iceberg. As the Financial Stability Oversight Council noted in its most [recent report](#):

Recent investigations uncovered *systematic false reporting and manipulations* of reference rate submissions dating back many years. This *misconduct* was designed to either increase the potential profit of the submitting firms or to convey a misleading picture of the relative health of the submitting banks. These actions were *pervasive, occurred in multiple bank locations around the world, involved senior bank officials at several banks, and affected multiple benchmark rates and currencies*, including LIBOR, EURIBOR, and the Tokyo Interbank Offered Rate (TIBOR). Each of the banks that faced charges engaged in a *multi-year pattern of misconduct that involved collusion* with other banks [emphasis added].

A confluence of endogenous and exogenous factors makes the Libor scandal truly a perfect storm for banking industry. The global investigation is ongoing making it inevitable that New York-based institutions will become implicated. The critical question is whether adequate defenses can be put in place to provide protection against further catastrophic failure of oversight.

Fixing Libor and associated benchmarks, therefore, is the most pressing issue in the regulation of global finance. By its very nature, it necessitates transnational cooperation. It also requires the integration of technical and normative considerations.

For the rhetoric of anchoring finance to the needs of society to have sustenance necessitates substance, a criterion that has been demonstrably lacking to date.

The situation is rendered unsustainable if those responsible are not held to account and the systems put in place in the aftermath of crisis paper over the cracks rather than address the structural dynamics that inform the operation of a given regulatory regime. These include which institutional actors have voice, authority and legitimacy and how given preferences are mediated, evaluated and made manifest. Critically, these battles tend to be most obtuse at the

crucial implementation stage, which is largely but erroneously conducted on a technical basis and largely outside sustained public gaze.

The deleterious effects of such an approach have underpinned the intervention of the former Chairman of the Federal Reserve, Paul Volcker. He used [a recent speech](#) in New York to call for the establishment of a new commission. Its remit would be to ascertain and balance legitimate private and public interests.

The call reflects profound pessimism. The finance sector has failed to internalize the effects of failure of oversight or accept blameworthiness, preconditions for the building of sustainable future frameworks. For Volcker the situation is exacerbated by the institutional corruption of the regulatory process.

In a telling rationale, Mr Volcker noted the current regulatory architecture in the United States is a 'recipe for indecision, neglect and stalemate, adding up to ineffectiveness. The time has come for change.'

The need for change also animated the unexpected but exceptionally powerful [intervention](#) of Pope Francis. The pontiff noted that the 'worship of the golden calf of old (cf. *Exodus* 32:15-34) has found a new and heartless image in the cult of money and the dictatorship of an economy which is faceless and lacking any truly humane goal.'

For Pope Francis this state of affairs has practical ideational roots. It derives from corruption, fiscal tax evasion and 'ideologies which uphold the absolute autonomy of markets and financial speculation, and thus deny the right of control to States, which are themselves charged with providing for the common good. A new, invisible and at times virtual tyranny is established, one which unilaterally and irremediably imposes its own laws and rules.'

What unifies these approaches is the need to render subservient means to ends through a process of ethical and political renewal. Both Pope Francis and Paul Volcker suggest in their different ways fundamental flaws, which must be addressed if warranted confidence in capital market conduct is to be returned. This necessitates conceptual as well as practical reform. As could be expected, the Pope stressed the normative dimension.

There is a need for financial reform along ethical lines that would produce in its turn an economic reform to benefit everyone. This would nevertheless require a courageous change of attitude on the part of political leaders. I urge them to face this challenge with determination and farsightedness, taking account, naturally, of their particular situations. Money has to serve, not to rule... In this way, a new political and economic mindset would arise that would help to transform the absolute dichotomy between the economic and social spheres into a healthy symbiosis.

The Anglican community has expressed a similar combination of unease and exhortation. In an [open letter](#) to the leaders of the G8, about to be staged in a luxury resort in economically ravaged Northern Ireland, the Archbishops and Bishops of the Church of Ireland made pointed reference to the fact that 'the levels of youth unemployment in wealthy countries is not only an economic disaster, it is also a moral tragedy.'

Significantly, and equally pointedly, they note that 'it is perhaps one of the strangest and saddest aspects of the world post 2008 that governments, especially governments of wealthy

countries, have not promoted serious discussion of alternative economic models beyond those of a particular form of financial capitalism.'

Secular and religious sensibilities come together in the persona of the Archbishop of Canterbury, Rev Justin Wilby, who has emerged as a significant powerbroker in the United Kingdom, where [he serves on the British Banking Standards Commission](#).

Established in the immediate aftermath of the Barclays settlement, the parliamentary commission has been critical in forcing substantive debate on the purpose of regulatory intervention. In the process it has reclaimed the lost normative foundations of the disclosure paradigm. How to embed ethical restraint given the failure of technical measures alone has informed its deliberations and interim reports, which have been as critical of regulators as the industry itself.

With impeccable timing, its final report is to be released on Friday, just in time to inform the G8 agenda.

To be successful as an agent of change, however, requires a recognition from the financial services sector itself that the bifurcation between the economic and the political and social spheres has been disastrous to societal cohesion and indeed its own self-interest. This necessitates much more fundamental reform than that offered by the British Banking Association, which is to be stripped of its oversight under a review process overseen by the Treasury department. The question is whether the regulatory agencies have the mandate, resources or political support to effect cultural change.

One suggestion is that within the European Union the oversight function should be transferred to the Paris-based European Securities and Markets Authority, an indication that the City of London is losing legitimacy and authority. Changing location of oversight without securing commitment is however problematic. The International Organization of Securities Commissions (IOSCO) has advocated a global set of principles governing benchmark setting and administration. Unfortunately, these principles remain vague and rooted in technicalities rather than moral obligation.

Reforming Libor and by extension the financial industry necessitates a renewed social compact of the kind that underpinned the initial architecture of the disclosure paradigm. It is time for the return of political agency. It is time for a New Deal before the tsunami of litigation and warranted distrust destroy the foundations of the financial system itself. As Roosevelt pointed out in 1933, there is an urgent need to put 'an end to a conduct in banking and in business, which too often has given to a sacred trust the likeness of callous and selfish wrongdoing.' Without that kind of political will, reform will be an illusion. It is time to fashion it, tempered by the knowledge that the societal implications of failure are already apparent in the unemployment figures.

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[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2277172](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2277172)

<http://www.ethics.harvard.edu/lab/blog/314-tackling-institutional-corruption-in-financial-markets>

# The Emperor's New Clothes: A View into the Current State of Municipal Ethics

[Carla Miller](#)

My favorite fairytale when I was growing up was the famous Hans Christian Andersen story, The Emperor's New Clothes. In it, people deny the obvious fact that the Emperor was naked; they had to applaud his "new clothes" or they would be considered stupid by the group. And then a young child cries out "but the emperor is naked." I wanted to be that little child. I wanted to be brave when I saw something wasn't right, to shout out, not whisper, until others saw the truth. Years later, I got my chance, starting as a federal prosecutor.



"Here's a new file for you to chew on," said the U.S. Attorney. "Four of my attorneys have rejected it and don't see a case." Part of the evidence was a videotape of the President Pro Tem of the Florida Senate promising a restaurant owner—a felon and former member of the mafia—that he would get a state liquor license, and then the senator leaving the room with a brown grocery bag stuffed with cash. Surely, there was something wrong here. This led to a one-year grand jury investigation, several convictions and 14 additional investigations



of city officials. The tentacles of institutional corruption in the city were pervasive but only the most egregious incidents resulted in criminal convictions.

A few years later, when I was in private practice, one of the men I convicted called me from federal prison. He was crying, almost delirious with grief, and wanted to talk. I felt incredible empathy for him. A promising career spun out of control—what could have been done to prevent this? Anything?

A colleague became mayor on an anti-corruption platform and I volunteered to help draft the first ethics code for our city, Jacksonville, Florida. I wrote sections creating an Ethics Officer and requiring ethics training (maybe this would help?). In 1999, I was asked to be the city's first Ethics Officer, which I agreed to do as a volunteer. I wanted our program to be top-notch and I started a review of all U.S. municipal ethics programs. I developed a [national website](#) as a resource for other cities, was an officer of the national government ethics body ([www.cogel.org](http://www.cogel.org)) and worked to implement an [anti-corruption office](#) in my home city. After studying hundreds of examples, it became clear that local government ethics programs in the U.S. focus almost exclusively on legal compliance. (If you follow the law, all is OK.)

Current literature and research on institutional corruption typically deals with the “Big Boys”—Congress, the pharmaceutical industry, major banks. Issues focus on conflicts of interest and global connections that necessitate complex computer programs to track abuses. Most of this is over the heads of average Americans. They don't understand it. They don't get it. But they hope someone figures it out and handles it.

What they do get is what happens in their own local governments, the things that affect their lives directly, like lobbyists influencing council members so that a mega-store gets built near a residential area. Like the head of a city department using influence to “win” their spouse a million dollar no-bid contract. Like taxes going up to pay for out of control pension programs negotiated between unions and politicians. To borrow from Tip O'Neill, all politics is local. There are close to 40,000 local governments in the U.S. with varied approaches to ethics and anti-corruption programs. Let's take a look at some of them.

The first approach could be called the “Turtle approach.” That is, pull your head in and pretend no problems exist. It's enough if we comply with the law, and besides, we've always done it this way. This would seem to result from complete lack of awareness of the dependencies and influences that comprise institutional corruption or, alternatively, the recognition of the benefit of maintaining such a system.

The default approach of lawyers is what I call the “Hammer approach.” It's characterized by things like 40-slide PowerPoint presentations that go over all of the conflict of interest laws in detail. Copies of the laws are distributed and people sign acknowledgement forms so you can prove “they were told.” Unfortunately, or by design, this overlooks the actual corrupting influences in the system. Most of the tips and hotline calls I have received as Ethics Director were about situations clearly corrupt as defined by the Center but technically legal. (“You aren't saying we broke the law, are you?”) Having officials timely file their financial disclosure forms does not mean that all is well; it could be a thin veneer of compliance over a corrupted system. The legal approach is certainly a necessary component, but needs to be analyzed in light of the research of Yuval Feldman as to legal ambiguity and rule-following behavior.

Many cities attempt a “Values” approach and bring in experts to run seminars on basic ethics concepts. This is considered more advanced than just training on the law. This confuses the concept of personal integrity with the institution’s integrity, as outlined by Dennis Thompson, founding director of Harvard’s Center for Ethics and the Professions, now the Edmond J. Safra Center for Ethics. There may be elements of this approach that could be useful, as hypothesized by William English, who is researching the reliance on personal ethics where incentive architecture is not feasible.

A more complex approach is the “Decision-Making Labyrinth” which involves conversations about the law, the stakeholders, and the process used to arrive at a decision. One time I saw a lecture with an outline of how you should make a decision that filled an entire blackboard. Who makes decisions like that? The more complicated a process becomes, the more it can be manipulated by those with special interests.

And lastly, we have the approach most often used after a scandal, the “Window-Dressing Exercise.” Here, you roll out an ethics code and appoint local VIPs to a blue ribbon commission. You can spot this type of program, as it is typically connected to big press releases. Many times, the VIPs are culled from the same in-group responsible for the institutional corruption in the first place. After months of meetings, a few rules are put in place. Do they serve the public and get at the root of the corruption? Rarely.

While these frenzied “ethics” activities are taking place, the key power-brokers of the city are executing multi-million dollar contracts and channeling money to favored friends and business partners. Citizens intuitively know that their interests are not being protected, which leads to mistrust of local government. When this is combined with their mistrust of Congress, there is a cascading effect of disillusionment and disengagement. The very best players in this local government environment progress to Congress. Therefore, I would argue that in order to handle institutional corruption at the national level, it is crucial that we address solutions for municipalities.

There are many competent and well-intentioned people working in municipal ethics programs and they create positive effects. It is not their feathers that I wish to ruffle. My comments stem more from frustration at the shotgun approach in developing comprehensive programs. How is corruption defined? What structures are best suited to handle it? What educational tools are most effective? Who do you train, in what sequence, with what and why?

If the approach is disorganized and delivered in formats and structures that bore people or worse, inculcate hostility towards “ethics,” we are going backwards. This diminishes public trust and wastes limited resources that could be used to help people. The fact that we have sporadically trained officials and addressed random issues is not enough. We need a transformational approach based on research that has some chance of success.

When I first discovered the Center’s website and Professor Lessig’s 2009 [lecture](#) on the framework of institutional corruption, it was a turning point. The brick wall I had been running into had been named and defined. That is the foundation for being able to dismantle it.

I look forward to working with others at the Center. Their work has already shifted my viewpoint on what can be accomplished in the fight against institutional corruption. The

Center's research can be applied directly to municipal governments so that citizens and officials can be equipped with effective tools to stand up and say "the emperor is naked."

I know with 40,000 municipalities, that this is somewhat ambitious. But, as JFK stated, "Those who dare to fail miserably can achieve greatly."

I believe in the mission of the Edmond J. Safra Center for Ethics and hope to contribute to the effort—to the hope that together, we can "achieve greatly" in the fight against institutional corruption.

Attributions: Scan and text by [George P. Landow](#)

<http://www.ethics.harvard.edu/lab/blog/315-the-emperors-new-clothes>

# The Tower of Institutional Corruption: The Bank for International Settlements In The Nightmare Years

[Gregg Fields](#)

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In 1963, the political theorist Hannah Arendt produced “Eichmann in Jerusalem: A Report On The Banality of Evil,” a chronicle of the trial of Hitler’s infamous, murderous henchman. Arendt stated the controversial viewpoint, “The trouble with Eichmann was precisely that so many were like him, and that the many were neither perverted nor sadistic, that they were, and still are, terribly and terrifyingly normal.”

A riveting—if at times dispiriting—new book by British journalist Adam LeBor puts Arendt’s theory in a different context. It’s titled “The Tower of Basel: The Shadowy History of the Secret Bank that Runs the World.” (PublicAffairs, Perseus Books Group).

The book might have been subtitled, “The banality of institutional corruption.” The shadowy organization that LeBor refers to is the Bank for International Settlements. For those who haven’t heard of it, the BIS isn’t the kind of place where you go to get free checking. It is a central bank for central banks.

And it is unquestionably powerful and influential. Among other things, it hosts the Basel Committee on Banking Supervision, the international agency that has been trying—with mixed results—to bolster capital levels for financial institutions around the world. And it also hosts the Financial Stability Board, which acts as a coordinator of economic regulatory authorities around the globe. According to LeBor, BIS members regularly meet in private meetings—every other month on a Sunday at 7 p.m.—over lavish meals to hash out, in essence, how to run the world.

The BIS is secretive, no question. As one example, its website notes that its archives are open to the public—provided [the records are over 30 years old](#), “with the exception of a limited number of records.”

Despite some high hurdles, LeBor succeeds at peeling away at least some of the BIS’s facade to reveal a great deal of how it operates. Its founding statutes call for the BIS to “promote the cooperation of central banks and to provide additional facilities for international financial operations,” LeBor writes. That benign sounding mission would later become the justification for participating in some of the most horrendous crimes in human history.

## Setting The Stage

The BIS was formed in 1930, largely to process the World War I reparations required of Germany. It also performed the function of providing liquidity to European governments, which were struggling with economic instability, currency fluctuations and the Great Depression. Central banks of most large European countries joined to create the BIS. (The

U.S. Federal Reserve did not join until 1994, although its allotted shares were held by American banking interests.) Basel, in neutral Switzerland, was a natural headquarters pick.

BIS describes itself as the world's oldest international financial institution, which was a novel business model in 1930. One mechanism used to perform its duties was having countries assign their gold reserves to BIS accounts—though the gold itself might be stored elsewhere—and payments between countries were processed by officials in Basel.

By now, you've probably guessed where this is going. Adolf Hitler rose to power and Germany within a few years was unleashing its formidable war machine across Europe and setting the stage for what would become the Holocaust.

It would be reasonable to assume that the BIS then went out of business. Clearly, there weren't going to be any reparations forthcoming from the Third Reich. But the BIS became, in essence, an ATM for Berlin, LeBor argues, treating the murderous regime as if it were just another government. (The British-born LeBor, a foreign correspondent based in Budapest, clearly has the credentials for this work. His previous book, *Hitler's Secret Bankers*, examined collaboration of Swiss bankers with Nazis and was short-listed for Britain's prestigious Orwell Prize.)

He devotes a great deal of *Tower of Basel* to an episode which, though highly controversial at the time, is often overlooked by history. After Germany annexed the Sudetenland province of Czechoslovakia in 1938, Czechoslovakian leaders transferred much of the country's gold to two accounts at the Bank of England for safekeeping, LeBor writes. One account was in the name of the BIS and another was in the name of the National Bank of Czechoslovakia itself.

In early 1939, German officials demanded Prague hand over 14.5 metric tons of gold, supposedly to back Germany currency now circulating in the Sudetenland. In essence, LeBor notes, Berlin was demanding Czechoslovakia "supply the gold to pay for the loss of its territory."

A month later, Germany invaded Prague and Czechoslovakia ceased to exist. Three days later, the Reichsbank demanded the National Bank of Czechoslovakia order the gold in its BIS account transferred to Germany. They were also ordered to request the Bank of England transfer the 27 metric tons of gold in the National Bank of Czechoslovakia account there to Germany.

"The BIS transfer order went through," LeBor writes. He adds that "Nazi Germany had just looted 23.1 metric tons of gold without a shot being fired."

The Bank of England did refuse to transfer the gold in the National Bank of Czechoslovakia account there. Nevertheless, the BIS transaction gave the Third Reich a new source of funding with which to finance its war effort.

The process was repeated throughout the war years, as Germany used plundered wealth to stoke its war machine. Accompanying the looting of central bank assets were proceeds from the "Aryanization" of Jewish-owned businesses that were stolen from their owners. Meanwhile, Germany gained ever greater influence at the BIS, leading to the completely reasonable assumption that it had a firmly pro-Nazi slant.

Its multi-national staff—the president from 1940-46 was an American named Thomas McKittrick—got along well, LeBor reports. When the battles got within shooting distance—Basel borders Germany and France—the bank simply retreated to temporary quarters in the Swiss interior.

### Institutional Blindness

LeBor's recounting of the nightmare years of World War II is fittingly chilling. And perhaps unwittingly, LeBor's investigation raises a troubling question: At the BIS, where did the institutional corruption actually begin, and could it have been prevented or stopped?

One fact is undeniable: From the beginning, the BIS achieved immunity from essentially all banking regulation and international laws. Although it functioned as a central bank, it wasn't actually connected to a government. It was virtually self-governing. Located in neutral Switzerland, it gained another layer of protection by not being subject to even the notoriously secretive Swiss banking laws. For years it didn't bother to put a sign on its door. That autonomy continues.

The lack of transparency and accountability thwarted officials in Washington and Europe who wanted the BIS to be shut down. (At the Bretton Woods Conference in 1944, where plans for the post-war monetary system were developed, Norway, the U.S. and others worked to have the BIS dismantled. The effort ultimately failed.)

What is most shocking in LeBor's book is the moral blindness of BIS officials. Their goal was, apparently, to simply grease the wheels of global commerce. Their eyes were shut to the horrors in front of them.

After the war, the BIS reinvented itself as a natural team captain for the rebuilding of Europe. It didn't merely survive—it thrived. Its curved headquarters opened in 1977 and its multilingual workforce quickly earned it the nickname the Tower of Basel, a reference to the Tower of Babel story in the Bible.

Clearly, the BIS is far from the only institution shown to have been, at best, indifferent to the slaughter of Europe's Jews and the Nazis' other crimes against humanity. As a story in The New York Times recently noted: "The list of institutions and industries that have been accused of [whitewashing their links](#) to the Third Reich is long, including various governments, the Vatican, Swiss banks and American corporations like IBM, General Motors and DuPont."

Judging by other reviews, I'm also not the only reader to feel LeBor writes a bit too conspiratorially about the modern-day BIS. "Mr. LeBor's [polemical tone](#) makes his book compelling, though at times you wonder if he wrote it in a hut in the Idaho backwoods while waiting for the United Nations and the staff of Goldman Sachs to invade and carry off his firstborn," is how The Wall Street Journal put it.

But Lebor's important new book shows that the Third Reich didn't rely on bombs and bullets alone. It was also aided by the banality of institutional corruption.

<http://www.ethics.harvard.edu/lab/blog/319-tower-of-institutional-corruption>

# The Bipartisan Lobbying Center: How a Washington Think Tank Advocates for Political Unity - and its Top Donors

[Ken Silverstein](#)

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The [Bipartisan Policy Center](#) (BPC), says its website, “drives principled solutions through rigorous analysis, reasoned negotiation and respectful dialogue,” and “combines politically-balanced policy making with strong, proactive advocacy and outreach.” The BPC, which is often described in press accounts as a “centrist think tank,” is highly influential and the media and Congress treat its reports and pronouncements as consequential and weighty.

The BPC’s reputation is further enhanced due to the large number of former government officials and Members of Congress who serve on its board and as “senior fellows.” For example, on May 8, 2013, [a story in Politico](#) said that two former Senators had thrown “their energy policy weight... to make the case that the private sector—rather than federal government—should decide on whether to export natural gas.” One of the former Senators was Byron Dorgan, a Democrat from North Dakota, who was identified in the story with the reassuringly neutral title of co-chairman of the BPC’s Energy Project. The story cited Dorgan’s recent Congressional testimony, during which he had said, “We believe the market should make the decision about the exports of natural gas.”

The story didn’t mention that Dorgan is a “[senior policy advisor](#)” and co-chair of the lobbying practice at Arent Fox, one of Washington’s premiere influence peddling shops. Nor did it say that energy companies, including America’s Natural Gas Alliance, heavily fund the BPC. That’s typical of the free ride the press gives to the BPC, which routinely advocates, under the guise of independent scholarship, for policies that benefit its donors.

The BPC was founded in 2007 by former Senate Majority Leaders [Howard Baker](#), [Tom Daschle](#), [Bob Dole](#) and [George Mitchell](#), who all cashed in on their government experience by working for Beltway law and lobbying firms, and advising major corporations. The think tank’s [funders](#) include foundations, corporations and trade associations, with donors in the last two categories including FedEx, General Dynamics, Northrop Grumman, the American Bankers Association, BP, Chevron, Citigroup, ConocoPhillips, the Nuclear Energy Institute, and Shell.

A number of prominent BPC “senior fellows” work as lobbyists: These include:

- [Robert Bennett](#), the former GOP Senator from Utah, who is also a “senior policy advisor” at Arent Fox and who registered to lobby last January, [immediately after he was exempted](#) from the law that bars former elected officials from lobbying for two years after retiring from public service. Bennett, a former member of the Senate Banking Committee, also formed his own consulting firm to advocate on behalf of major financial institutions. His clients have included Americans Standing for Simplification of the Estate Tax (ASSET), a front group working to slash the

- inheritance tax.
- [Dan Glickman](#), the former Secretary of Agriculture and ex-Democratic House member from Kansas, who represented the Motion Picture Association of America and whose lobbying clients while at the firm of Akin Gump Strauss, Hauer & Feld included Dow Chemical, American Financial Group Inc., Alliance of American Insurers, Mortgage Insurance Companies of America, and the Walt Disney Company.
  - [Trent Lott](#), the former Republican Senator from Mississippi, who has lobbied for numerous companies, including energy giants ExxonMobil, Chevron and Shell, and America's Natural Gas Alliance.

The BPC has programs in health care, economic policy, infrastructure, national security and [energy](#). The latter is led by Dorgan, Lott and [William Reilly](#), who headed the EPA under George Bush Sr., and whose board affiliations have included ConocoPhillips and DuPont. Corporations are the dominant group among the energy project's [membership list](#), including CEOs and executives from Marathon Oil, ExxonMobil, Anadarko Petroleum Corporation, Exelon Corporation, and Southern Company. For window dressing there is one environmentalist, Ralph Cavanagh of the Natural Resources Defense Council.

The majority of BPC's funding comes from "philanthropies" and its energy work is supported by grants from the William and Flora Hewett Foundation and Climate Works Foundation, Rosemarie Calabro Tully, spokeswoman for the think tank's energy project, told me. "Foundation funding is generally provided to support a specific project, while corporate funding is directed to support BPC's general operations," she said.

Last February, the BPC issued a report, "[America's Energy Resurgence: Sustaining Success, Confronting Challenges](#)," which included over fifty policy recommendations. The chief outside consultant on the report was William Klinefelter, a lobbyist whose major clients include ExxonMobil.

So it's hardly a surprise that the report paid lip service to alternative energy but heavily promoted the fossil fuel industry. For example, in terms of oil and gas, it called on Congress to "expand access to oil and gas exploration and production in the Eastern Gulf of Mexico," and said the Interior Department "should accelerate the timetable for leasing areas off the coasts of the Mid-and South Atlantic states." In other words, full speed ahead for offshore drilling.

[A Wall Street Journal story](#) on the piece quoted Lott—his status as a former Senator and affiliation with the BPC were noted, but not his work as an energy lobbyist—as saying, "I would say to the leaders, Reid and McConnell, if you're looking for something that historically has been bipartisan, something where you could come together and do good for the country, energy is it." It said that Lott had recalled the "good old days of bipartisan cooperation," and that energy would be "a good place" for Congress to start that again. Other BPC personnel testified on the Hill and promoted the report's industry-friendly recommendations.

Meanwhile, the BPC's Energy Project is holding a series of events to discuss its positions on energy. The affairs are hosted by BPC Senior Fellow and former Republican Senator [Pete Domenici](#) (who in 2006 was voted "Worst in the Senate" by Republicans for Environmental Protection due to his efforts to promote oil drilling in the Arctic National Wildlife Refuge)



and [David Goldwyn](#) (who served at the Energy Department under Bill Clinton, then ran a consulting firm that provided “political and business intelligence” to oil companies, then became the State Department’s Coordinator for International Energy Affairs under Obama, and now has returned to the private sector as an energy consultant).

Speakers and panelists at the BPC's [first event on June 12, 2013](#) included a number of energy industry analysts (for example, Edward Morse, Global Head of Commodities Research at Citibank) and former Louisiana Senator Bennett Johnston. He has lobbied for energy interests ever since retiring and has also been a Chevron board member and policy advisor to The Heartland Institute, a clearinghouse for climate change denial.

The keynote speaker was Senator Lisa Murkowski from Alaska, one of the most pro-energy industry members of Congress. “We...know that this is an issue on which we must take the long view, recognizing that it will play out across decades,” she said, according to [a transcript of her remarks](#). “We will need the best and brightest working on this question, and I see many of you gathered here today. I’m glad to join you—and glad to be part of this conversation—because we really must approach it in a balanced and bipartisan manner.”

And even more importantly to the BPC, in a manner that helps out its donors and the staff’s lobbying clients.

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Note: For more on the BPC, see [this Nation piece](#) about its work on behalf of US-based retailers who, even in the aftermath of several garment factory [disasters in Bangladesh](#), have refused to sign a binding plan to improve working conditions. Also see [this story](#) by David Halperin, who discusses its work on behalf of energy companies.

Research assistant: Diego Arene-Morley

<http://www.ethics.harvard.edu/lab/blog/320-the-bipartisan-lobbying-center>

# Corrupting Practices Harm Patients

[Donald W. Light](#)

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In just a few months, [the countervailing powers](#) of academics, researchers, and the British medical profession have mounted the final campaign against the corrupting practices of hiding negative trial results that earned prominent attention recently in [The New York Times](#). Led by Peter Doshi and Ben Goldacre, the [campaign](#) includes formal endorsement by the British Medical Association, the Medical Research Council, and the editorial boards of three of the world's leading medical journals. Thirty years of distorting medical knowledge and clinical guidelines seem to be ending; but imagine the difference if the AMA, the IOM and the NEJM joined them.

While transparency is important in its own right, the real goal is to reduce unnecessary injury and sickness to patients that results from hidden or misleading information about the harm:benefit ratio—the chances of being harmed from toxic side effects compared to the chances of being helped by taking a new drug. Harm to patients is mentioned in passing, but it deserves greater attention as reflecting the root of this and related practices that distort medical knowledge—substantially more sales and profits from selected positive spin than full disclosure would generate. The BMJ has just published my [letter](#) making this case.

As rational economic actors, pharmaceutical companies suppress or selectively publish results from clinical trials to make their drugs look less harmful or more effective than they really are so that more doctors will prescribe them and increase profits. That means more patients are exposed to a worse harm:benefit ratio than they are led to believe.

This applies to other Edmond J. Safra research projects on pharmaceutical policy as well. For example, the bottom line for ghost managing and ghost writing articles is more sales but more adverse events and less benefit for patients who are misled to believe drugs are safer and better than they are.

The bottom line for paying experts and clinicians is more sales but more adverse events and less benefit for patients who are misled to believe drugs are safer and better than they are.

The bottom line of off-label marketing that skirts FDA prohibitions is more sales but more adverse events and less benefit for patients who are misled to believe drugs are safer and better than they are.

Evidence of an epidemic of harmful side effects from drugs that usually have few or no advantages to offset their risks is made in an [article](#) for the Edmond J. Safra special issue of the *Journal of Law, Medicine and Ethics* on pharmaceutical policy. Emphasizing that epidemic magnifies the importance of policy research on data transparency, ghost management, payment disclosure, and prescribing for unapproved uses.

<http://www.ethics.harvard.edu/lab/blog/321-corrupting-practices-harm-patients>

# Risky Drugs: Why The FDA Cannot Be Trusted

[Donald W. Light](#)

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A [forthcoming article](#) for the special issue of the *Journal of Law, Medicine and Ethics* (JLME), edited by Marc Rodwin and supported by the Edmond J. Safra Center for Ethics, presents evidence that about 90 percent of all new drugs approved by the FDA over the past 30 years are little or no more effective *for patients* than existing drugs.

All of them may be better than indirect measures or placebos, but most are no better for patients than previous drugs approved as better against these measures. The few superior drugs make important contributions to the growing medicine chest of effective drugs.

The bar for “safe” is equally low, and over the past 30 years, approved drugs have caused an epidemic of harmful side effects, even when properly prescribed. Every week, about 53,000 excess hospitalizations and about 2400 excess deaths occur in the United States among people taking properly prescribed drugs to be healthier. One in every five drugs approved ends up causing serious harm,<sup>1</sup> while one in ten provide substantial benefit compared to existing, established drugs. This is the opposite of what people want or expect from the FDA.

Prescription drugs are the 4<sup>th</sup> leading cause of death. Deaths and hospitalizations from overdosing, errors, or recreational drug use would increase this total. American patients also suffer from about 80 million mild side effects a year, such as aches and pains, digestive discomforts, sleepiness or mild dizziness.

The forthcoming article in JLME also presents systematic, quantitative evidence that since the industry started making large contributions to the FDA for reviewing its drugs, as it makes large contributions to Congressmen who have promoted this substitution for publicly funded regulation, the FDA has sped up the review process with the result that drugs approved are significantly more likely to cause serious harm, hospitalizations, and deaths. New FDA policies are likely to increase the epidemic of harms. This will increase costs for insurers but increase revenues for providers.

This evidence indicates why we can no longer trust the FDA to carry out its historic mission to protect the public from harmful and ineffective drugs. Strong public demand that government “do something” about periodic drug disasters has played a central role in developing the FDA.<sup>2</sup> Yet close, constant contact by companies with FDA staff and officials has contributed to vague, minimal criteria of what “safe” and “effective” mean. The FDA routinely approves scores of new minor variations each year, with minimal evidence about risks of harm. Then very effective mass marketing takes over, and the FDA devotes only a small percent of its budget to protect physicians or patients from receiving biased or untruthful information.<sup>3,4</sup> The further corruption of medical knowledge through company-funded teams that craft the published literature to overstate benefits and understate harms,

unmonitored by the FDA, leaves good physicians with corrupted knowledge.<sup>5 6</sup> Patients are the innocent victims.

Although it now embraces the industry rhetoric about “breakthrough” and “life-saving” innovation, the FDA in effect serves as the re-generator of patent-protected high prices for minor drugs in each disease group, as their therapeutic equivalents lose patent protection. The billions spent on promoting them results in the [Inverse Benefit Law](#): the more widely most drugs are marketed, the more diluted become their benefits but more widespread become their risks of harm.

The FDA also legitimates industry efforts to lower and widen criteria prescribing drugs, known by critics as “[the selling of sickness](#).” Regulations conveniently prohibit the FDA from comparing the effectiveness of new drugs or from assessing their cost-effectiveness. Only the United States allows companies to charge what they like and raise prices annually on last year’s drugs, without regard to their added value.<sup>7</sup>

### A New Era?

Now the FDA is going even further. The New England Journal of Medicine has published, without comment, proposals by two senior figures from the FDA to loosen criteria drugs that allege to prevent Alzheimer’s disease by treating it at an early stage.<sup>8</sup> The authors seem unaware of how their views about Alzheimer’s and the role of the FDA incorporate the language and rationale of marketing executives for the industry. First, they use the word “disease” to refer to a hypothetical “early-stage Alzheimer’s disease” that supposedly exists “before the earliest symptoms of Alzheimer’s disease are apparent.” Notice that phrasing assumes that the earliest symptoms will become apparent, when in fact it’s only a hypothetical model for claiming that cognitive lapses like not remembering where you put something or what you were going to say are signs of incipient Alzheimer’s disease. The proposed looser criteria would legitimate drugs as “safe and effective” that have little or no evidence of being effective and expose millions to risks of harmful side effects.

No proven biomarkers or clinical symptoms exist, the FDA officials note, but nevertheless they advocate accelerated approval to allow “drugs that address an unmet medical need.” What “unmet need”? None exists. This market-making language by officials who are charged with protecting the public from unsafe drugs moves us towards the 19-century hucksterism of peddling cures of questionable benefits and hidden risks of harm, only now fully certified by the modern FDA.<sup>9</sup>

The main reason for advocating approvals of drugs for an unproven need with unproven benefits, these FDA officials explain, is that companies cannot find effective drugs for overt Alzheimer’s. Their drug-candidates have failed again and again in trials. The core rationale of the proposed loosening of criteria is that “the focus of drug development has sifted to earlier stages of Alzheimer’s disease... and the regulatory framework under which such therapies are evaluated should evolve accordingly.” Yet they admit there are no “therapies” in this much larger market where (with the help of the industry-funded FDA) companies will not have to prove their drugs are effective. In fact, these FDA officers propose to approve the drugs without ever knowing if they are therapeutic or not. Their commercialized language presumes the outcome before starting. The job of the FDA, it seems, is to help drug companies open up new markets to increase profits for the FDA’s corporate paymasters.

These two FDA officials maintain that “the range of focus must extend to healthy people who are merely at risk for the disease but could benefit from preventive therapies.” Yet they admit we do not know who is “at risk,” nor whether there is a “disease,” nor whether anyone “could benefit,” nor whether the drugs constitute “preventive therapies.” Similar FDA-encouraged shifts have been made for drugs treating pre-diabetes, pre-psychosis, and pre-bone density loss, with few or no benefits to offset risks of harm. This week, based on policy research at the Edmond J. Safra Center for Ethics, [a letter of concern](#) was published in the New England Journal of Medicine. The authors write that approval for drugs to treat “early stage Alzheimer’s disease” must meet “a much higher bar—evidence of slowed disease progression.” But without clinical manifestations or biomarkers for an alleged disease, how will such progression be measured?

Advice to readers: Experienced, independent physicians recommend not to take a new drug approved by the FDA until it is out for 7 years, unless you have to, so that evidence can accumulate about its real harms and benefits.<sup>10</sup>

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Disclaimer: The assessment and views expressed here are solely the author’s and do not necessarily reflect those of persons or institutions to which he is associated. The comments and suggestions of Gordon Schiff, an expert in prescribing at Brigham and Women’s Hospital, and Robert Whitaker are gratefully acknowledged.

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<http://www.ethics.harvard.edu/lab/blog/312-risky-drugs>

# A Few Predictions on the Sunshine Act

[Genevieve Pham-Kanter](#)

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As the implementation of the Physician Payment Sunshine Act draws near, a reasonable question to ask is, just how sunny is this Act really going to be?

The Sunshine Act—for those of you who did not meticulously read all 11,000 sections of Bill HR 3590—is that part of last year's health care reform law that requires pharmaceutical and medical device manufacturers to report payments that they make to doctors for consulting services, speaking, meals, research grants, and other gifts of monetary value.

These payments have long been cause for concern because of their potential to influence the prescribing and research practices of payment recipients (for background, see this [Institute of Medicine report](#)). Surely requiring the disclosure of these potentially distorting payments would be a good thing; what more needs to be said?

It turns out that more than a few Edmond J. Safra Center Lab Fellows have something to say about these payments and about the public disclosure of these payments. And what they have to say warrants a rather less sunny disposition towards the federal disclosure law. In particular:

- Lab Fellow Michelle Mello (Faculty, Harvard School of Public Health) and her co-author examined the Sunshine Act in relation to reporting regulations in other contexts like finance and health care quality. Past experience in these environments shows that consumers have difficulty with specialized and complex information so that disclosure without expert assistance in interpreting these disclosures will have little effect on consumer behavior. ([New England Journal of Medicine 2013](#))
- Lab Fellow Genevieve Pham-Kanter (Faculty, University of Colorado Anschutz Medical Campus) and co-authors looked at the effect of state-level sunshine laws, precursors to the federal Sunshine Act. Their analysis of prescription claims showed that these sunshine laws had no effect on the prescribing practices of doctors or on prescription drug expenditures even though, in one of the states, payments information could be requested by and made available to the public. ([Archives of Internal Medicine/JAMA Internal Medicine 2012](#))
- Lab Fellow Sunita Sah (Faculty, Georgetown University McDonough School of Business) and her co-authors found in their lab experiments that when individuals were presented with financial conflicts of interest that induced bias in the individuals' advice-giving, the knowledge that this conflict would be disclosed increased the bias of the advice individuals gave. Advice recipients who were informed of the conflict of interest adjusted somewhat for the bias of the advice giver but did not fully account for the degree of bias in the advice. ([Journal of the American Medical Association 2012](#))
- On the other hand, Lab Fellow Aaron Kesselheim (Faculty, Harvard Medical School) and his co-authors found, in experiments in which internists were presented with research abstracts of hypothetical studies that varied in quality and funding source,

that doctors judged abstracts more harshly and were less willing to prescribe the hypothetical drugs under study when there was disclosure that the research had been funded by industry (vs. no disclosure or disclosure of NIH funding). This harsher judgment was rendered regardless of the quality of the study, suggesting a negative bias associated with industry-related research payments. ([New England Journal of Medicine 2013](#))

In short, analyses of sunshine regulations as they operate in the field predict little effect of the Sunshine Act on consumers or doctors. Lab experiments suggest perverse effects of disclosure but in somewhat conflicting directions: subjects who were informed of payments received by a party authorized to convey (ideally unbiased) information could either under-compensate or over-compensate in response to the disclosure of the payment. (The exact conditions for under- vs. over-compensation remain to be elucidated and are an intriguing direction for research.)

The evidence accumulated by Edmond J. Safra Center Lab Fellows so far suggests the Act is not quite sunshine; it's more like a dim flickering lamp post that occasionally lights up a street corner. We can intently scrutinize the part of the street that the lamp sometimes illuminates, but will that give us an accurate reading of our environment or just shift sketchy activity from one place to another?

Let's be clear that these results do not entail that obfuscation is preferred to transparency. A better lesson is that critical thinking and careful research, even if the findings are politically inconvenient and militate against our prior beliefs, are paramount because they can help legislators and agency rule makers make better policy. Disclosure is not the enemy; simple-minded slogans are.

And let's also distinguish simple-mindedness from cynicism or fatalism. The Lab and its Fellows (and other scholars elsewhere) are continuing to study the Physician Payment Sunshine Act and disclosure in medicine, and looking for ways to make disclosure work—for patients, doctors, researchers, the government, and firms.

A non-cynical and more productive view of this strand of literature from the Lab is that it tells us we may need a higher wattage light bulb, more or different kinds of lamp posts, more foot patrols, as well as the testing of these different initiatives. Systematic experiments, in the field and in the lab—rather than wishful thinking—are required to test and observe, infer and learn, about what works with payments data collection and what does not. In concrete terms, this may mean that an important part of refining the Sunshine Act, in addition to research like the Lab studies discussed above, is the incorporation of on-going evaluation and feedback processes into the payments reporting system itself. (And as part of this refinement and review, we can find out whether there had been in fact not very much dubious activity going on or that there was much, much more than we initially thought.)

summary, the Lab predicts somewhat dim illumination from the Sunshine Act. But this simply means that our next task will be to find ways to improve the Act and prove our predictions wrong. I suspect many of us would, in this case, be pleased to ultimately be proven wrong.

Not all of the Lab's work on the Physician Payment Sunshine Act and disclosure in medicine could be highlighted in this post. For further reading, see:

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<http://www.ethics.harvard.edu/lab/blog/322-a-few-predictions-on-the-sunshine-act>



# Simply Fab: Institutional Corruption and the Trial of Fabrice Tourre

[Gregg Fields](#)

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The Beatles may have been the Fab Four, but at Goldman Sachs a few years back, Fabrice Tourre was the Fab One. The trader had a clear gift for enticing sophisticated investors into less than fabulous vehicles like subprime mortgage securities.

The question that remains: can he prove as persuasive to the New York jurors who hold his fate in its hands? Tourre is facing civil charges brought by the Securities and Exchange Commission for his actions at Goldman Sachs.<sup>1</sup> Pundits have portrayed this trial as the beleaguered SEC's last chance to prove it can win big cases against Wall Streeters involved in the 2008 financial collapse. However, no matter what the jury decides, the clear verdict of this trial is that institutional corruption is a common characteristic along the Wall Street-Washington axis.

It's understandable if you've never heard of Fabrice Tourre. Goldman Sachs may be a titan on Wall Street, but Tourre was more of a rank-and-file foot soldier. When it filed [its suit](#) against him in 2010, the SEC's first reference to Tourre calls him an "employee." Officially, he was "a vice president on the structured correlation trading desk." He wasn't yet 30.

Despite his youth, Tourre was the central player in what would become a legendary episode in the mortgage meltdown. In 2006, a hedge fund named Paulson & Co., run by a man named John Paulson, began to suspect the subprime mortgage market was set to collapse.

Paulson saw a once-in-a-lifetime opportunity: make huge and complicated bets against securities backed by home loans likely to go bad. (This process of making money off an investment that goes south is known as selling short.) For help, he turned to Goldman Sachs and was led to Tourre.

Tourre, in turn, agreed to put together a security named ABACUS 2007-AC1. The reference to the ancient Chinese counting machine is ironic, because the mortgage-backed securities that went into it were picked largely because they didn't add up. Tourre, with heavy influence from Paulson, assembled a portfolio whose weakness was its greatest appeal, according to the SEC.

But Goldman's marketing materials to investors represented the portfolio as having been selected by a third company name ACA Management. Paulson's role wasn't mentioned at all. And "Tourre also misled ACA into believing that Paulson invested approximately \$200 million in the equity of ABACUS 2007-AC1," when in fact Paulson was betting big that large losses loomed, according to the SEC complaint.

Paulson paid Goldman Sachs \$15 million for putting the deal together. It closed on April 26, 2007. By October, a whopping 83 percent of the securities in ABACUS had been downgraded and the other 17 percent were on negative watch. Three months later, 99

percent of the portfolio had been downgraded. Investors were out \$1 billion, which was the approximate profit for Paulson.

### The Influence of Influences

In a [recent paper](#), Lawrence Lessig, who heads the Edmond J. Safra Center for Ethics, offered this working definition of institutional corruption: “Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution’s effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public’s trust in that institution or the institution’s inherent trustworthiness.”

In that context, the Tourre case is a veritable textbook example of such influences, and of lost trust. Furthermore, the case has another trait common in cases of institutional corruption: no one has been accused of a crime. Goldman was a co-defendant in the SEC’s case against Tourre, but all the charges are civil.

Paulson and his company have never been implicated by the SEC at all. Indeed, the SEC complaint includes a Paulson & Co. memo that suggests the company was simply taking advantage of an opportunity created by the mutual benefits Wall Street’s major players reaped from churning out zombie securities despite the dangers.

“In my opinion this situation is due to the fact that rating agencies, (collateralized debt obligation) managers and underwriters have all the incentives to keep the game going, while ‘real money’ investors have neither the analytical tools nor the institutional framework to take action before the losses . . . are actually realized,” the unnamed Paulson employee wrote. It is a situation that sounds a great deal like the phenomenon known as dependence corruption—where mutual interests skew institutional behavior in ways that don’t serve the public interest.

According to an email obtained by the SEC, Tourre himself wrote an acquaintance: “The whole building is about to collapse anytime now. . . Only potential survivor, the fabulous Fab.” Keep in mind that this was several months before the ABACUS deal closed.

### The ABC’s of the SEC

Another institutional actor in this case is, of course, the SEC. The agency managed to quickly get a [\\$550 million settlement](#) with Goldman just months after filing its complaint. It was the largest penalty ever assessed by the enforcement agency.

“This settlement is a stark lesson to Wall Street firms that no product is too complex, and no investor too sophisticated, to avoid a heavy price if a firm violates the fundamental principles of honest treatment and fair dealing,” Robert Khuzami, the agency’s director of enforcement at the time, said. While \$550 million is unquestionably a lot of money, it’s worth noting that in its most recent fiscal quarter Goldman’s net earnings were [\\$1.93 billion](#).

Furthermore, Goldman settled the case without admitting or denying the allegations against it. Settling cases without requiring the defendants to acknowledge guilt is a common SEC practice, but has drawn criticism that it reflects an abdication of institutional responsibilities,

particularly in regard to investigating and determining what happened. In 2011, U.S. District Judge Jed Rakoff rejected a \$285 million SEC settlement with Citigroup in a mortgage-related case. The SEC “has a duty, inherent in its statutory missions, to see that the truth emerges; and if it fails to do so, this court must not, in the name of deference or convenience, grant judicial enforcement to the agency’s contrivances,” [Rakoff wrote](#). In something of a rare convergence, both the plaintiff SEC and defendant Citigroup have appealed his decision.

Finally, it’s worth pondering why Tourre, who now is working on a doctorate at the University of Chicago, is the only Goldman employee who was pursued by the SEC. The SEC complaint makes clear that Tourre was in regular contact with other Goldman officials. The transaction was approved by Goldman’s mortgage capital committee, “which included senior-level management.”

In going after a virtual unknown, the SEC pattern is similar to one it followed in the Citigroup case referenced above. That, too, involved the marketing of risky mortgage-backed investments, but the only person brought to trial was a midlevel executive named Brian Stoker. A jury would later clear Stoker, and one juror later told The New York Times he was a bit baffled why the SEC cast such a small legal net. “I wanted to know why the bank’s CEO wasn’t on trial,” [Beau Brendler](#), jury foreman, told the Times.

1. Much of the details and quotes in this article are drawn from the [2010 SEC complaint filed against Tourre and Goldman Sachs](#).

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P.S. Aug. 2, 2013. Fabrice Tourre’s trial lasted 11 days. On Thursday, Aug. 1, 2013, a Manhattan federal jury found Tourre liable for six of the seven civil fraud counts he faced. His punishment will be determined at future proceedings and may include fines and a possible ban from working in the financial industry.

<http://www.ethics.harvard.edu/lab/blog/323-simply-fab>

# Systematic Evidence of Less-Than-Truthful Commercial Free Speech That Harms Citizens

by [Donald W. Light](#)

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In *U.S. vs. Alfred Caronia*, the U.S. Court of Appeals for the Second Circuit concluded that criminalizing the promotion of off-label uses of pharmaceuticals—that is, for purposes not approved by the Food and Drug Administration—amounted to an unconstitutional restriction on free speech. The court did not comment on evidence that Caronia had been untruthful in promoting a narcolepsy drug for the treatment of fibromyalgia and for patients under the age of 16.

The pharmaceutical trade association, which shapes much of the “news” on drugs through its huge news network, also overlooked the less-than-truthful use of free speech when it [commented](#), “PhRMA believes that truthful and nonmisleading communication between biopharmaceutical companies and health care professionals is good for patients, because it facilitates the exchange of up-to-date and scientifically accurate information about new treatments.”

But what about untruthful or non-truthful communication that fails to mention risks of harm and facilitates exchanges with missing or inaccurate information? One documented case can be found in [Congressman Henry Waxman's report](#) of the repeated distortions and omissions Merck used to promote Vioxx, the drug that killed or seriously harmed more patients than any other in history.

The Vioxx disaster led to extensive changes in law and practice to emphasize safety. Are drug companies behaving differently now? We now have the first systematic, prospective, comparative, randomized survey in which primary care physicians in three countries (and cultures) report on the truthfulness of the drug reps who talk with them. [A leading group of researchers](#) used precise definitions of truthful speech, and found that drug reps provided “minimally adequate safety information” about the risks of harm described in the label only 1.7% of the times they spoke to doctors. (“Safety” is the modern euphemism for risks of harm.) Pharmaceutical companies claim their mission is to help people get and stay healthier. Why, then, do they allow their sales reps to understate risks of harm and overstate benefits so that physicians are misled and mislead their patients in turn?

Despite reporting the frequency with which drug reps make untruthful omissions of harmful side effects, 54 percent of these same board-certified physicians rated the quality of scientific information provided by the reps to be good or excellent! And 64 percent said they were ready to prescribe the drug being promoted. A friendly, lucid sales pitch that falls well short of the trade association's standard of truthful communication wins the day. As a [classic article](#) on selling drugs described, reps don't sell drugs—they sell friendship, and by the way, here is new drug your patients will like and a whole carton-full of free samples you can give to your patients.

This is how misleading commercial free speech is used 98 percent of the time in the pharmaceutical industry across all companies represented in this three-nation randomized study. Patients, trusting their personal physicians to serve their best interests alone, become defenseless victims.

Here we have the key elements of institutional corruption: the corruptors, the nature of the corruption, and the corrupted, all protected by law and built into the economy of interests as well as into institutional practices. The study also provides evidence supporting the experiments in social psychology sponsored by the Edmond J. Safra Center for Ethics, which document how people take in and interpret partial and misleading information as suits their interests and emotional relationships.

Implicitly, the study emphasizes the importance of the current huge campaigns for greater transparency, by companies, with regard to trial data and payments to doctors, because they can counter other less-than-truthful commercial free speech. Such campaigns may even reduce the [epidemic of serious harmful side effects](#) from drugs that patients take but which have few or no offsetting advantages for them. [In a letter](#) responding to the study, published this week, I emphasize the risks of harm that result from corrupted free speech. In their reply, the authors add two examples, of a statin and antidepressant, which have greater risks of serious harm than alternatives and yet are widely promoted and prescribed.

Although the FDA prosecuted Caronia, it is failing in its mission to protect patients from harmful drugs. After an exhaustive review for approval, it allocates only a small percent of its budget to ensuring that physicians and patients are fully informed of the risks in the label, leaving it to companies to craft journal articles and have their sales reps overstate benefits and understate harms. The FDA regards clarifying the truth beyond the label as interfering with the practice of medicine. Or rather, as interfering with the less-than-truthful promotion of drugs that fails to warn about risks of harm.

Restricting or prohibiting contact with sales reps and the provision of free samples gets at the root of these widespread practices that distort both medical knowledge and medical practice. Quite a few places are already doing just that.

Acknowledgements: Much appreciation to Gregg Fields for his critical read and suggestions.

<http://www.ethics.harvard.edu/lab/blog/326-less-than-truthful>

# On The Edge: The SAC Capital Indictment Draws a New Line on Institutional Corruption

[Gregg Fields](#)

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It's relatively easy to spot common characteristics of institutional corruption. Things like conflicts of interest, way-too-cozy relationships between industry and government, and a general lack of transparency are often indicators that institutional actions are being driven by influences that don't serve the public interest.

Typically, institutional corruption has another common feature: It isn't a crime. Election financing may be dominated by mega-donors, and regulations often seem to ultimately favor those who spend the most on lobbying. But campaign contributions and aggressive lobbying are hardly criminal conduct.

A recent indictment in New York suggests that the legal sands of institutional corruption may be shifting, however. The case is [United States of America v. S.A.C. Capital Advisors](#) and several related corporate entities. SAC is a hedge fund run by financier Steven A. Cohen, who hasn't been charged himself, although he does face civil procedures from the Securities and Exchange Commission for how he ran his firm.

"As described below, this indictment charges the corporate entities responsible for the management of a major hedge fund with criminal responsibility for insider trading offenses committed by numerous employees and made possible by institutional practices that encouraged the the widespread solicitation and use of illegal inside information," the indictment, unsealed on July 25 by Preet Bharara, U.S. Attorney in Manhattan, begins.

The indictment then takes aim at an alleged corporate culture brimming with institutional corruption. "Unlawful conduct by individual employees and an institutional indifference to that unlawful conduct resulted in insider trading that was substantial, pervasive and on a scale without known precedent in the hedge fund industry," the indictment charges. The alleged actions took place between 1999 and 2010.

The allegations are similar to those the SEC has made in a number of civil complaints against the SAC organization and associated individuals. (The SEC doesn't have authority to bring [criminal actions](#).)

The criminal indictment's language is striking for a couple of reasons. One, it makes clear this is not some mere civil inconvenience to be settled with a wrist-slap fine and a consent decree where the company neither admits nor denies guilt.

Secondly, it places the blame for the actions on an institution. Although some SAC employees have been charged separately—and some have already pleaded guilty—this indictment is notable in that it, in effect, criminalizes corrupt corporate cultures. In the fight against institutional corruption on Wall Street, it would seem, the stakes have been raised.

And no doubt many would argue that it's about time, considering the [dearth of prosecutions related to the financial collapse of 2008](#).

### Trimming Hedges

A useful place to start the SAC story would be the definition of "hedge fund." What, exactly, is that? Despite being shrouded in secrecy, hedge funds are essentially private mutual funds for very rich people. They are largely unregulated. The word "hedge" refers to their historical role in using various trading strategies to hedge risks—particularly with an eye toward trimming potential losses—for well-heeled investors. However, modern hedge funds are most noted for aggressively seeking sky-high returns through the use of sophisticated financial instruments like derivatives contracts and highly leveraged transactions.

It's incredibly lucrative for some. SAC, for instance, typically charged its investors three percent of their assets annually, plus it got to pocket up to 50 percent of all investment returns, according to the indictment. Cohen's personal fortune has been estimated at north of \$9 billion, although clearly it could be set for a large fall if SAC's investors flee. (He also stepped up to the plate and became a [minority owner](#) of the New York Mets. The Mets owners were in a financial pinch at the time over investments made with Bernie Madoff.)

SAC, according to the indictment, flourished by encouraging its portfolio managers and analysts to gain an "edge" on the competition. And this edge, says the indictment, primarily consisted of ferreting out inside information on companies, then making or selling investments based on this knowledge before it was publicly disclosed. SAC theoretically had internal compliance systems, but the indictment portrays them as so limited as to be no match for traders who stood to earn millions of dollars by shirking the rules.

"The predictable and foreseeable result, as charged herein, was systematic insider trading by the SAC entity defendants resulting in hundreds of millions of dollars of illegal profits and avoided losses at the expense of members of the investing public," the indictment says. They gained the inside information simply by currying favor from employees in the know at the companies whose shares they owned.

### Drug Deal

Here's an example. In 2008, the SAC hedge fund's largest investment was \$700 million in two drug companies, Elan and Wyeth. On July 18 of 2008, Mathew Martoma, a portfolio manager specializing in health care, obtained negative inside information on a drug trial Elan and Wyeth were conducting. The information came from a doctor involved in the trial, and Martoma went to Michigan to meet with the man in person. According to SEC documents, the man is Dr. Sidney Gilman, a former professor at the University of Michigan Medical School, who was overseeing the trial's safety monitoring committee. According to the SEC, [Dr. Gilman settled](#) and agreed to cooperate with the SEC. He also received a non-prosecution agreement with prosecutors.

On Monday, July 21, 2008, after receiving the negative information, SAC began selling its entire \$700 million position in the companies, then shorted \$260 million of the stock. (Shorting is a form of investing where you profit if a stock falls in price.)

The drug at issue was bapineuzumab, an experimental Alzheimer's experiment. According to [a Wall Street Journal article](#) on July 30, 2008, the trial results had been issued at the International Conference on Alzheimer's Disease and "remain inconclusive and may underwhelm many scientific experts and investors."

Noted Marketwatch.com: "Shares of Elan Corp and Wyeth were battered Wednesday, the day after the companies released [more clinical data](#) on their hotly anticipated Alzheimer's therapy bapineuzumab."

By selling early, "The SAC Hedge Fund's profits and avoided losses from this illegal insider trading amounted to approximately \$276 million," the indictment alleges. Martoma, who [reportedly fainted](#) the first time FBI agents approached him at his South Florida home last year, has been indicted for insider trading but has maintained he is innocent. He earned a \$9.8 million bonus in 2008, according to SEC documents, but never was able to duplicate his performance that year and was fired by SAC in 2010.

Earlier this year, CR Intrinsic Investors, the SAC affiliate that handled the trading in the drug companies, [agreed to pay the SEC](#) more than \$600 million to settle charges that it participated in insider trading.

A similar situation occurred the month after the Elan-Wyeth episode. An analyst named Jon Horvath learned on Aug. 18 from a contact that Dell, the computer maker, would soon be reporting disappointing earnings. On Aug. 26, SAC unloaded its \$12.5 million in Dell holdings. Two days later, on Aug. 28, Dell indeed reported disappointing earnings. According to a CNNMoney.com clip at the time, net income fell 17 percent compared to the same quarter a year earlier. "Shares of Dell plunged after-hours on the news," [CNNMoney.com](#) reported. By selling early, SAC avoided losses of \$1.7 million, the indictment says. (Horvath pleaded guilty to insider trading last year.)

### What's Wrong

Although the institutional corruption concerns regarding the SAC allegations are pretty self-evident, they nevertheless bear a proper analysis.

Consider the simple issue of transparency. If one buys the premise that robust financial markets are good for society, then it only follows that the public must have trust in the integrity of those markets. Transparency can go a long way toward establishing such trust. But SAC, according to the civil and criminal cases, chose to invest based on secret information it gained illegally.

Another common indicator of institutional corruption is what is known as dependence corruption—where two parties are united by motivations that don't serve the public interest. A common example is the dependence of Congress on mega-donors, who depend on Congress for legislation that may not necessarily serve the public but, rather, the economic interests of the donors.

The SAC case provides a new facet to the dangers posed by dependence corruption. To wit, companies depend on large investors to support their stock price. Large investors depend on corporate performance to help their portfolios grow. If insider trading is allowed to flourish, a corporation would only naturally be motivated to tell large investors ahead of time if, say, a news event was going to impact the stock. It's only logical to presume that smaller investors



would get material news later—they're simply less important in the scheme of things. As an example of what dependence corruption can do the public trust, think of the reputations of credit rating agencies and their banking clients following the implosion of highly-rated mortgage securities that preceded the housing collapse.

Another issue often linked to institutional corruption is the revolving door syndrome. It typically refers to public servants leaving for lucrative private sector jobs. But in the SAC case, the government alleges employees were hired primarily because they could provide the "edge" of inside information. In such a context, it's certainly plausible that insiders at a company could share information with the hope of joining the hedge fund later. (A world where, as we have seen, Martoma's annual bonus was \$9.8 million.)

To be sure, there are unanswered questions in the SAC case. Among the most noteworthy: Why wasn't Cohen indicted? In July, the SEC instituted administrative proceedings against him, based primarily on transactions that are detailed in the indictment against his companies. Yet, the current indictment refers repeatedly to "the SAC owner," and never mentions Cohen by name.

### Game On?

The answer may be that, simply, the case isn't over. On July 30, for instance, Bharara, the U.S. Attorney in New York, [brought charges against a research analyst](#) formerly based in San Francisco. It's alleged the analyst fed information to Richard Lee, an SAC portfolio manager, about Microsoft and Yahoo. Lee pleaded guilty on July 23 to one count of conspiracy and one count of securities fraud.

Charles Gasparino, author of the newly published *Circle of Friends*, a book about the government's more recent investigations of insider trading, wrote in [Time magazine](#) last week that pundits who think Cohen has beat the rap are probably wrong. "In other words, don't be surprised if you see an indictment of Cohen in the coming weeks as well," he wrote.

For his part, Bharara hasn't publicly tipped his hand as to plans for Cohen. However, when he unsealed the indictments on July 25, he described the SAC organization in terms that made clear that the antidote to institutional corruption is institutional integrity—which sometimes requires the heavy weight of criminal prosecution. "Companies, like individuals, need to be held to account and need to be deterred from becoming dens of corruption," Bharara said in [a prepared statement](#). "To all those who run companies and value their enterprises, but pay attention only to the money their employees make and not how they make it, today's indictment hopefully gets your attention."

<http://www.ethics.harvard.edu/lab/blog/327-on-the-edge>

# If You Could Ask 100,000 People Around the World One Thing to Better Understand or Tackle Institutional Corruption, What Would it Be?

by [Dieter Zinnbauer](#)

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A couple of weeks ago the NGO I am working for, Transparency International, published its bi-annual [Global Corruption Barometer](#)—this time covering a record 107 countries with representative household surveys. This is the largest public survey exercise that seeks to elicit a detailed account of the perception of, and experience with, corruption around the world. Covering 114,000 households and more than 8 million data-points, this is a treasure trove for research and policy analysis on corruption.

Our own analysis can only tease out some of the many interesting findings that the data may hold, and we warmly invite everyone to get the data from us and run their own analysis. But the picture that emerges is clear.

Here is the three-message speed-read:

1. the scale and scope of corruption that people in many countries around the world are faced with in their daily lives is pretty astounding. More than 1 in 4 people reported to have paid a bribe in the last 12 months when dealing with key public institutions and services
2. the public view of the degree of integrity of all kinds of really important public institutions is pretty damning, but still:
3. the reported readiness to take action and do something about it is surprisingly high.

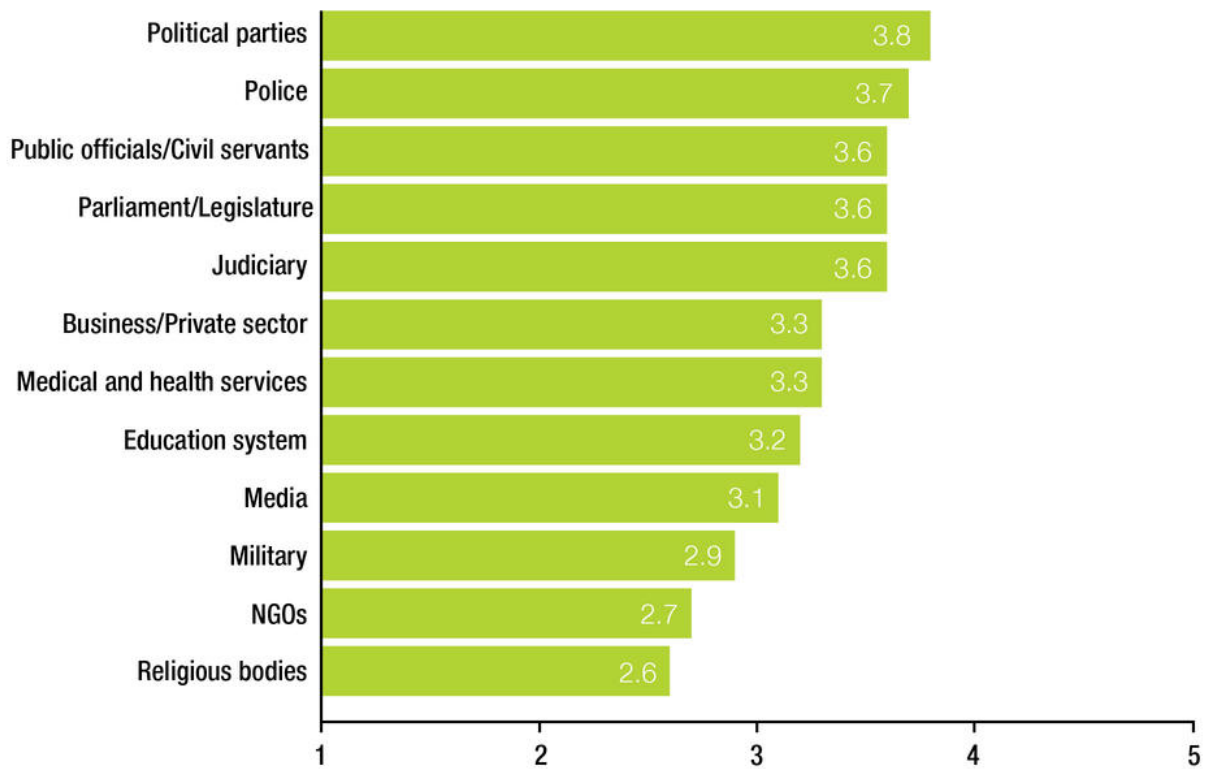
The Barometer gives us a good empirical picture of all kinds of street-level types of corruption, from bribes to the importance of personal connections for getting things done.

Yet it is much more difficult to come up with questions that would allow us to *capture policy capture* - measure, trace, compare and ultimately focus public pressure and advocacy on the more subtle types of upstream corruption. And it is at least equally tricky to include questions that would help us get a better handle on what the community of experts gathered around the Edmond J. Safra Center might call the scale and scope of institutional corruption.

One might argue that a general household survey is the wrong approach for this in the first place. Still, there are several questions included in the Barometer that already yield some interesting leads in relation to policy capture and/or institutional corruption:

- We ask people about their overall perception of corruption in a number of institutions (political parties, media) and services (health, education, police) that are often considered particularly vulnerable to institutional corruption. Here is the global picture:

On a scale of 1 to 5, where 1 means 'not at all corrupt' and 5 means 'extremely corrupt', to what extent do you see the following categories in this country to be affected by corruption?



- We also want to know the extent to which people think that their country is run by special interests. Here are the relevant results for some OECD countries:

To what extent is this country's government run by a few big interests looking out for themselves? Percentage of respondents that answered 'large extent' or 'entirely'.

<b>% respondents that think the government is run by a few big interests</b>			
Norway	5	Canada	54
Switzerland	19	Germany	55
Denmark	24	France	57
Finland	28	Slovakia	60
Korea (South)	28	United Kingdom	60
Luxembourg	39	Mexico	62
Japan	44	Chile	63
New Zealand	44	Slovenia	63
Estonia	46	United States	64
Czech Republic	49	Spain	66
Turkey	49	Belgium	70
Australia	52	Italy	70
Hungary	52	Israel	73
Portugal	53	Greece	83

- And we invite them to assess whether overall corruption has gotten better or worse in the last couple of years.



*All three figures from Transparency International (2013): Global Corruption Barometer 2013 Report, <http://www.transparency.org/gcb2013/report>*

So how is this linked to institutional corruption? At the very least, these responses in themselves indicate that it is critical to explore institutional corruption as one possible factor behind what are truly alarming numbers. In addition, by gauging and tracking the public trust in certain services and institutions, the Global Corruption Barometer provides an important contextual backdrop for identifying and designing remedies for institutional corruption in these areas. And quite likely, the collective sentiments expressed in answers to these questions could at least partially also reflect institutional corruption:

- either directly, when high-profile corruption scandals that people have learnt about through the media influence their perception of a specific institution or sector
- or indirectly, since other factors that may drive these views, such as a sense of being left behind, or unfair treatment, could themselves be the negative consequences of, and thus a red flag for, institutional corruption at work and its adverse impact on social mobility, income inequality, etc.

So the Barometer 2013 results may provide some interesting empirical leads and context for the study of institutional corruption. But could more be done?

After the survey is before the survey.

And it is never too early to start thinking about the questions that could be brought on board in the next iteration, in order to help us better understand, trace, and tackle issues of policy capture or institutional corruption. This is a great opportunity to compare notes on how to approach the measurement of institutional corruption. What empirical tools do you find most suitable to measure and track policy capture and institutional corruption? What could help us tease out some relevant information, specifically in those tricky situations where institutional corruption may not even be perceived by the public as such, and leave no clear traces in the public (dis)trust of affected institutions? What kind of questions could we ask more than 100,000 people around the world in 2015 to help make progress on understanding, tracking and fixing institutional corruption?

I would love to hear from you: [dzinnbauer@transparency.org](mailto:dzinnbauer@transparency.org)

<http://www.ethics.harvard.edu/lab/blog/328-if-you-could-ask-100000-people>

# The AIG Bailout Revisited: Calculated Corruption or Miscalculated Risk Management?

[Malcolm S. Salter](#)

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How we tell stories matters. If we tell the AIG bailout story as an example of calculated corruption, we wring our hands about how best to reverse the declining legitimacy of 21<sup>st</sup>-century capitalism. And we write more rules and regulations, offer stiffer punishments for violations, and beg for more ethical leadership.

If, however, we tell the AIG bailout story as an example of miscalculated risk management, then our attention shifts to the sources of these miscalculations, such as existential fear of a total credit market collapse, and the ways in which we can better cope with such fears and uncertainties when trying to de-risk and restructure an entire industry.

The implications of the first telling are largely legal. The implications of the second telling are largely technical, managerial, and psychological.

Five years after considerable financial assistance was provided to the American International Group by the New York Fed and the U.S. Treasury, the AIG bailout story remains highly controversial. But what is the “true” story? And why is this story still so controversial?

Controversy over the bailout was present from its earliest days, starting in September 2008 when many members of Congress and allied non-interventionists raised their voices against the plan being put in place by the U.S. Treasury and the Federal Reserve Bank. These critics saw the bailout as an inexcusable breach of market discipline. Early complaints about the appropriateness of an AIG bailout were subsequently reinforced by the relentless public criticisms of Fed and Treasury officials by Neil Barofsky, who served as Inspector General of the \$700 billion TARP program from December 2008 through March 2011 (*Bailout: An Inside Account of How Washington Abandoned Main Street While Rescuing Wall Street*). Following Barofsky's public criticisms was Simon Johnson, a former Chief Economist of the International Monetary Fund, who voiced his criticisms in a 2010 book (with James Kwak) documenting the power of Wall Street in the economic governance of nations (*13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*). More recently, David Stockman, well known as the Director of the Office of Management and Budget under President Ronald Reagan, has attacked the bailout in his 2013 book bemoaning the corruption of American capitalism (*The Great Deformation: The Corruption of American Capitalism*).

Simon Johnson's and David Stockman's criticisms of the AIG bailout mark a turning point in the conversation.. Both argue that American capitalism—and financial institutions in particular—hold the global economy hostage to private interests, as in the prelude and aftermath of the 2008 financial crisis, and that this control is in large part perpetuated through so-called “cronyism.” They also agree that the AIG bailout is a prime example of “crony capitalism” at work in America today—a calculated corruption of the political

process whereby the success or survival of a business is dependent on the favoritism it is shown by the ruling government instead of being determined by a free market.

Today, bailout critics typically point to two problems: first, that warding off an AIG bankruptcy was totally unnecessary in the first instance as a bulwark against serial collapses of other financial institutions (so-called “contagion”), which could lead to a total shut-down of credit markets in the U.S. and abroad; and, second, that the bailout as eventually structured was a not-so-subtle cover for public subsidies to banks holding large amounts of depreciating securities (such as collateralized debt obligations) linked to the collapsing housing market, which were effectively insured through the purchase of billions of dollars of credit default swaps (CDS) from AIG. For these critics, the AIG bailout story is just about as pure an example as there is of how cronyism and lack of transparency have corrupted American capitalism.

While the tumultuous context of the AIG bailout makes a definitive assessment of these claims difficult, contemporary critics do spotlight two pivotal questions that have not as yet been answered to many parties’ satisfaction:

- *Was federal assistance to AIG truly essential for financial system security?*
- *Was the ultimate form of this assistance—most particularly, the government-sponsored repurchase of credit default swap contracts held by AIG’s customers at their par value—a misuse of public monies that served private interests at the expense of the public interest?*

If the answers to these two questions are positive, then AIG should indeed be branded as a paradigmatic case of crony capitalism and the dishonor that goes with this label.

This may well be the case, but it is worth testing whether or not such a telling of the AIG bailout story is accurate. There is a big difference between (a) calculated corruption in the form of generous financial transactions put in place by the U.S. Treasury and the New York Fed for the benefit of large domestic and foreign banks deemed vulnerable to an AIG collapse and (b) unintended miscalculations by Treasury and Fed officials working in a state of existential fear to manage the risks of a global financial meltdown.

I am currently exploring the latter possibility—that both the initial bailout decision and the subsequent structure of the bailout was a much more complicated phenomenon than characterizations of corruption, collusion, and crony capitalism suggest. I am attempting to argue that the lingering controversies over the bailout are not a result of the corrupt behavior of public officials but rather the result of impromptu and highly improvised risk management by officials who had never before experienced or tried to manage such a risk to the global financial system and who were conditioned by their professional training, deeply embedded world view, and current responsibilities to focus on the worst-case scenarios following a fast-approaching AIG collapse. Public officials no doubt made miscalculations and missteps; but where miscalculations were made, they should not be confused with corruption.

My initial reading of the unfolding crisis in 2007-2008 suggests that federal assistance to AIG was indeed essential to preserve financial system security, as argued at the time by Fed and Treasury officials. I also see that there is little reason to believe the bailout was purposively designed as a cover for the subsidization of AIG’s counterparties (mainly large banks) with which principal decision makers for the government had long-standing personal



relationships and, in the case of Treasury Secretary Henry Paulson, a prior financial relationship that created significant personal wealth.

However, the eventual form of the federal assistance, which unfolded in four separate transactions from September 2008 to March 2009 in response to changing conditions at the company and in the capital markets, appears more problematic because AIG's counterparties in the credit insurance business—mainly large domestic and foreign banks—received what now looks to be very generous treatment from the government during the bailout. This treatment has been seized upon by bailout critics who passionately argue that government officials with long histories and deep connections in the finance industry promoted this generous treatment, and that such treatment is a perfect example of corrupt “crony capitalism” at work. Critics also point to a lack of transparency in SEC filings about the identity of AIG's counterparties, payments made to them by AIG, and the compensation of AIG officials. (N.B., Davis Polk, the New York Fed 's lawyers, reviewed and approved all draft SEC filings.)

Fair enough, but the crony capitalism claim deserves careful examination. A plausible counter-argument is that claims of blatant cronyism in the AIG transaction are overblown and, indeed, inaccurate. Rather than a planned campaign by Treasury and Federal Reserve officials to use public monies and credit facilities to protect and obfuscate the private interests of banks with which these officials had nurtured long-standing relationships, the form of the bailout strategy can more accurately be seen as reflecting a set of assumptions about the nature of systemic risk to the global financial system and the menu of possible remedies, both of which had become deeply ingrained in the world view of Fed and Treasury officials during decades of work with the finance industry. These assumptions (and related fears) were reinforced by many months of mounting evidence and accompanying anxiety over the vulnerability of the financial system to a major “readjustment.” They inevitably shaped officials' understanding of what was “the right thing to do” while trying to manage rapidly emergent and shifting risks. In hindsight, mistakes may have been made. But rather than a classic case of cronyism, collusion, and corruption, I see the AIG bailout as a case of impromptu and highly improvised risk management under conditions of extreme anxiety over possible outcomes.

I say this fully realizing how tempting it is to assume the worst about crony capitalism in the AIG bailout when Timothy Geithner, president of the New York Federal Reserve Bank, and Henry Paulson, Treasury Secretary under President Bush, were in the saddle. After all, Paulson was the former chairman and CEO of Goldman Sachs, a major recipient of significant government aid in the course of the AIG bailout, from 1999 to 2006; his staff at the Treasury included many former Goldman Sachs veterans—for example, Robert Steel, Steve Shafran, Neel Kashkari, Dan Jester, and Ken Wilson; Geithner's chief of staff was an ex-Goldman partner; and Geithner's board of directors include many of Wall Street's most influential players. In addition, the cronyism charge is bolstered by the fact that in the heat of AIG' worst troubles, the New York Fed hired Morgan Stanley, later itself a recipient of public monies, to advise on the AIG bailout. Finally, certain details of the bailout program related, most specifically, to the government-financed buyback of credit default swaps from AIG's counterparties at par value (when the counterparties' insured mortgage-backed securities were falling in value) have raised a firestorm of complaints. But these outwardly incriminating facts do not seem to fit with the career paths, public service aspirations,

conflict of interest controls, and risks of public humiliation for high-ranking Treasury and Federal Reserve Bank officials.

Telling the AIG bailout story fully and clearly requires a detailed description of the multi-step transaction that unfolded over many months in a largely incremental fashion. Strangely enough, not all the facts of this highly technical transaction are clear or understood five years later. Similarly, few folks realize that by the end of 2012, four years after the bailout was initiated, the Treasury reported an overall positive return of \$22.6 billion on the \$182.3 billion committed by the government to stabilize AIG during the financial crisis.

Once the basic facts of the bailout transaction and subsequent implementation are laid out, the two questions noted above need to be carefully addressed. Was the bailout truly necessary in the first instance? Would an AIG bankruptcy actually lead to “deadly contagion” in the form of cataclysmic financial failures of large, systemically important banks? For this first set of questions to be answered satisfactorily, we need to look into the specific situations of one or two leading banks: What would have been the likely impact on a bank like Goldman Sachs or Merrill Lynch of the loss of protection (via CDS contracts) on bonds, mortgage backed securities, and other assets insured by AIG and held on its balance sheet? What would be the financial impact of losses of 20 or 30 percent on any AIG paper or other loans held on a bank’s balance sheet? What proportion of a bank’s existing capital base would such potential losses represent? How much impairment of the capital base of a large bank like Goldman Sachs does it take to cause an immediate shutdown of access to overnight repurchase agreements for all trading banks, which is one definition of a total financial collapse?

Next, the claim of cronyism surrounding the government-sponsored repurchase of credit default swap contracts held by AIG’s customers at their par value needs to be investigated. Of particular interest was why Treasury Secretary Timothy Geithner, who was still head of FBNYC in September 2008, allowed AIG to pay clients the full value (par) of AIG-issued CDS contracts when (a) the bonds and other insured securities like CDOs had fallen so significantly in value, (b) other mortgage-bond insurers had been able to strike deals on similar contracts at reduced prices, and (c) when, prior to the bailout, AIG had been negotiating in an attempt to get its counterparties (bank customers) to accept as little as 60 cents on the dollar. To some observers, AIG’s payments—funded by government-extended credit—were no less than a bailout of Wall Street, and Goldman Sachs in particular. Indeed, a report prepared by the House Committee on Oversight and Government Reform refers to these payments as a “backdoor bailout of AIG counterparties.” (Paulson was still Treasury Secretary.) In this sense, the committee report echoed the finding of Neil Barofsky, the special inspector general for TARP, that the Fed “refused to use its considerable leverage” to negotiate better terms. Barofsky’s finding was later roundly criticized by the New York Fed.

At hearings held by the aforementioned House Committee in January 2010, an important report commissioned by the New York Fed and prepared by the BlackRock asset management firm in 2008 came to light. The BlackRock report fueled House Committee interest by demonstrating on the basis of its modeling of AIG counterparty derivative positions and related investment strategies that without harried pressure from the New York Fed, AIG would probably have been able to strike a better settlement with its most important counterparties and save a lot of public money. In particular, the BlackRock study suggested that Goldman Sachs was, prior to the bailout, willing to take a haircut on its AIG

CDS payouts (i.e., taking something less than the par value of the relevant credit default swaps).

Apparently, this was a possibility for Goldman (but not for the other top counterparties) because Goldman had sold off its entire CDS-insured CDO book of business—thereby leaving very little CDO risk on its balance sheet. In this way, Goldman was essentially “an AIG conduit.”

Whatever leverage Goldman had in bargaining with the Fed over the repurchase of AIG-issued CDS, it was successfully mobilized. Like Goldman, neither Merrill Lynch nor Société Générale budged on price. (Deutsche Bank’s position remains unclear.) The open question, of course, is how each of these counterparty banks were able to gain such remarkable leverage over the New York Fed in structuring the terms of the AIG stabilization program.

Secretary Geithner responded to the BlackRock report and similar analyses that revealed counterparties’ capacity to accept less than par value on their AIG-issued insurance contracts by testifying to the Congressional Committee, “If we had tried to force counterparties to take less than they were entitled, AIG would have collapsed. There were no better alternatives.” But is this correct? We can only know by discovering and analyzing other alternatives that the Fed considered and rejected.

Much work remains, if only to “set the record straight.” But more than this, if we as a nation, influenced by inaccurate story telling, end up mistaking abundant of caution and existential fear for corruption and crony capitalism (and all the venality that this label connotes), then the chances of attracting and retaining truly knowledgeable and honest men and women from the private sector and academia to high-stakes and inevitably controversial positions in the public sector will diminish considerably—to our collective disadvantage. Henry Paulson, who refused multiple invitations from President Bush to become his Treasury Secretary, along with his bailout partners at the Washington and New York Fed, may not have been the best possible person from business and academia to contain the unfolding financial crisis. But it is difficult to imagine many more than a dozen or so other qualified, deeply committed individuals for that job at that time.

<http://www.ethics.harvard.edu/lab/blog/333-the-aig-bailout-revisited>

# The Tail Wagging the Dog: Institutional Corruption and the Federal Sentencing Guidelines for Organizations (FSGO)

[Carla Miller](#)

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In his article "[On the Edge](#),"<sup>1</sup> Gregg Fields wrote about the recent criminal case filed against [SAC Capitol Advisors](#) and noted a shift in that the indictment "criminalizes corrupt corporate cultures." Interestingly, after the indictment, SAC bragged about its "strong culture of compliance" in a [New York Times article](#). SAC even went so far as to say their compliance program was "cutting edge," and cost tens of millions of dollars with 38 staff, including top-notch lawyers and consultants. Reporter James Stewart asked "Which sets up the question: What were they doing?"<sup>2</sup> Indeed, what were they doing?

As a former federal prosecutor, I have closely followed the history of a unique aspect of prosecuting corporations—the Federal Sentencing Guidelines for Organizations ([FSGO](#)). The FSGO are used to set the penalty for a corporation's criminal acts. Credits have been created for corporations that have established an effective ethics program; these credits can generate very valuable reductions in fines and penalties. How will SAC's "cutting edge" compliance program, as stated above, impact the end result in this prosecution? What is the value of having spent tens of millions of dollars? Could it get any worse without the program? The ethics community will be closely watching the outcome of the case to see if the FSGO is used, and how, in setting any criminal penalties.

There is a broader question as it relates to the concepts of institutional corruption and the work of the [Lab at the Edmond J. Safra Center for Ethics](#). Over the last decade, the FSGO has begun to have a life of its own outside of the criminal justice system and it drives the creation of thousands of ethics programs, including some in my area of interest, municipal governments.

Can something that has its genesis in the criminal justice system effectively outline the components of a comprehensive structure that not only prevents crime, but addresses the non-criminal aspects of institutional corruption? Do we define the structure and content of ethics programs from the bottom up (fear of punishment) or from the top down (prevention of institutional corruption)?

## The Basics (FSGO in a Nutshell)

- In 1987, [Guidelines](#) were formulated by the U.S. Sentencing Commission to promote fairness in sentencing individuals convicted of a crime.

- Organizations can also be held liable for the criminal acts of their employees (vicarious liability) and can be charged with crimes. If convicted, the entity can pay large fines, be placed on probation and be monitored by outside parties.
- In November, 1991, the standards were released for sentencing organizations; these are the Federal Sentencing Guidelines for Organizations ([FSGO](#))
- These guidelines apply to all corporations, labor unions, pension funds, non-profits and governmental entities.<sup>3</sup> They come into play after the entity is charged with a crime, gets convicted, and is at the sentencing stage.
- The most significant section is [Part B2.1](#)—“Effective Compliance and Ethics Program” which is the section that lays out the criteria that is used to evaluate whether an ethics program is effective or just a facade. If it is effective, credits are applied and money is saved.
- The FSGO guidelines focus on the prevention of crimes, and define an effective ethics program as one that “prevents and detects criminal conduct.”
- Within a few years after these standards were created, most major corporations had ethics programs in place. Either the threat of more severe punishment or the incentive of perhaps even avoiding a prosecution altogether served as a “nudge” (maybe a kick) to create these ethics programs.
- Since 1991, there has been a huge growth in corporate ethics programs, which includes outside consultants, certifications and organizations (e.g. the [ECO](#)). Conferences dissect the guidelines and share best practices on creating programs that fit the FSGO criteria. It has been estimated that business ethics consulting and related spin-offs have created a billion dollar industry.
- The FSGO was the catalyst for hundreds of thousands of hours of work and hundreds of millions of dollars in investment to create strong structures and materials for ethics programs. Many of these programs are exemplary, and the ethics professionals working in them are dedicated and diligent within the parameters of their company's policies.
- Government ethics consulting at the local level is sporadic and not well funded, but FSGO standards have spilled over into municipal governments as the framework for creating local ethics programs (e.g. [Austin ethics audit](#); [Denver ethics audit](#)).
- The FSGO standards, even though created in the context of sentencing in criminal cases, have become the de facto blueprint on how to implement ethics programs in the U.S.

#### The Report of the Ethics Resource Center

In 2012, the [Ethics Resource Center](#) (ERC) released an excellent [study](#) summarizing 20 years of FSGO practices. The report acknowledged many positive results, but also listed several challenges to the program.

Statistically, over the last 20 years, only five corporations out of 3,433 sentenced have received the “credit” for having a good ethics program. The challenge is that the large companies seem to be able to get their cases dropped or settled prior to a trial, and the statistics are murkier at this stage. Larger corporations have more money and more lawyers to fight the prosecution in the early stages. The real goal is not to get credit for an ethics program at sentencing, but for the criminal indictment to never see the light of day in the first place.

The ERC also noted confusion, and inconsistencies across numerous federal agencies, in applying ethics standards and in making them transparent. This increase in complexity only invites “experts” to offer costly solutions. In fact, there is an ethics revolving-door phenomena. Those government employees intimately familiar with the complex ethics regulations are highly sought after in the private sector, the “ethics industry.”

In 2010, there were active lobbying efforts to lighten the requirements of the FSGO; these efforts were successful. As the guidelines become more technical, the complexity of the subject matter provides the opportunity for a monopoly or capture by the few attorneys who understand how to adroitly utilize them to fend off prosecutions for their clients.

Another challenge noted in the ERC report was that it is difficult for some people to comply because of the general nature of the guidelines; people like to check the box as to compliance and they need clear directions in plain English. If some people have difficulty in applying the 7 steps of the FSGO, they would have even more of a problem with an analysis for institutional corruption.

### The Seven Guidelines

The FSGO guidelines for an effective ethics program focus on the prevention and detection of crimes. There are [seven components](#) that need to be in place. Here is my simplified version.

1. Have standards and procedures in place to prevent crimes.

What about standards and procedures that will prevent the legal and systemic corrupt influences and dependencies in the organization? Are there such standards that could be applied in concise guidelines? Do they exist? If not, why not? It is not likely that people will work with the concepts of institutional corruption unless they are condensed into practical nuggets for practitioners.

2. The Governing Board shall have oversight over the ethics program; there will be a high level “point person” for the program with direct access to the Board.

It is easier to do risk assessments and reports to a Board on what is being done to prevent actual crimes. It conceivably would be much harder for an employee to report to the Board on issues that involve the more abstract concepts of legally corrupt activities in the culture of the group, of which the Board itself could be an inextricable part; this has been a recipe for disaster in the past. Ultimately, the reporting ethics personnel have their economic future tied to what the Board thinks of them; they can be “blinded” to significant issues regarding legally corrupt activities. This is especially true if they are not lawyers and bow to the more “sophisticated” analysis of their attorneys.

3. Don't give discretionary authority to people in the organization who have a criminal history.

How about identifying the positive characteristics for those in authority: courage in reporting offenses; going against the group culture; and identifying more than just the crimes of the organization? How do we identify, encourage, train and cultivate those few people in the group who can take on institutional corruption?

4. You need to train people on your standards.

This usually involves classroom settings or online courses that people certify they have completed. Sometimes values training is added to the legal rules. The vision for training would be to introduce the group to ideas of institutional corruption and how it relates to the fragility of our democratic institutions. See William English's [paper](#)<sup>4</sup> on "Institutional Corruption and the Crisis of Liberal Democracy." If they have an emotional connection to the bigger picture, one that conceivably could threaten their future, the more specific rules and values might stick.

5. There must be monitoring and auditing to detect crimes and to evaluate the program. There may be anonymous ways to report crimes without fear of retaliation.

May be anonymous reporting? Should be. Most people will prefer to keep quiet rather than risk losing their jobs; and that's for reporting crimes. What about people coming forward with early warning signs of corruption? The focus on actual crimes is essential, but it is only the first step in correcting corrupt cultures that push the envelope on technical compliance with the law.

6. Create incentives and disciplinary measures for your ethics program.

(See number 1, above. The focus is too narrow if only on criminal violations and not broader organizational corruption.)

7. After a crime occurs, don't let it happen again.

It's always good to learn from mistakes; hopefully this isn't used in a more devious fashion in which the activity is continued, but done in a "technically legal" manner.

### Gaming the System

Enron had an [ethics code](#) and a sophisticated ethics program, most likely in conformance with the FSGO standards which had been in effect for almost a decade when Enron's code was released in July, 2000. In December 2001, Enron was bankrupt, and the breakdown will be the source of lessons on fraud and institutional corruption for decades.

Malcolm Salter of the Safra Center stated in his [paper](#)<sup>5</sup> ("Short-Termism at Its Worst") that Enron pursued one of the "greatest gaming strategies of all times" and that "much of this behavior was not clearly unlawful." "Many of Enron's complex transactions . . . lived instead in the penumbra between the clear light of wrongdoing and the clear light of rightdoing." Gaming can be spotted when there are ambiguities in laws, unclear language and confusion; the ERC has already noted these challenges with the Federal Sentencing Guidelines. The programs that were put in place for "ethics" can themselves be subject to capture by the forces of institutional corruption.

Gaming the system is at the heart of institutional corruption. If the FSGO program maintains its focus on criminal conduct alone, then it can be used as a joystick for a very large game. If a company or a government heralds its "ethics program" it should mean something to the public; it should be something they can trust is not a charade.

Institutional corruption should be seen as the overarching construct that can be utilized to repair institutions, including local governments. By narrowing the scope of “ethics” programs to the prevention of crimes and legalistic regulations, we have the “tail wagging the dog.”

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3. <§ 8A1.1. “ ‘Organization’ means ‘a person other than an individual.’ 18 U.S.C. § 18. The term includes corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations.”
4. William English, “Institutional Corruption and the Crisis of Liberal Democracy,” Edmond J. Safra Research Lab Working Papers, No. 15 (2013), SSRN: <http://ssrn.com/abstract=2281305> or <http://dx.doi.org/10.2139/ssrn.2281305>.
5. Malcolm S. Salter, “Short-Termism at Its Worst: How Short-Termism Invites Corruption . . . and What to Do About It,” Edmond J. Safra Research Lab Working Papers, No. 5 (2013), SSRN: <http://ssrn.com/abstract=2247545> or <http://dx.doi.org/10.2139/ssrn.2247545>.

<http://www.ethics.harvard.edu/lab/blog/334-the-tail-wagging-the-dog>



# Is Financial Reform Being Gamed? What Implementation of the Volcker Rule will Reveal about the Gaming of Financial Reform

[Malcolm S. Salter](#)

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With both the President and members of Congress now calling for a swifter implementation of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, it seems to be a good moment to reflect upon some of the large issues involved in the implementation of financial reform. One such issue involves the extent to which large banks may be gaming financial reform in ways that subvert the public purpose of the Act rather than working in a more straightforward mode with regulatory agencies to define and comply with rules in ways that reflect legislative intent.

Three features of the Dodd-Frank Act—a massively long statute running over 2,200 pages long—would seem to invite various forms of gaming. First, the financial stakes and competitive implications for the domestic banking industry are undeniably huge. Second, some important features of this act are considered ill-advised and unwarranted by many bankers and members of Congress. (Only 3 Republican senators voted for the House Version of the bill.) Third, Congress chose to subcontract to federal regulatory agencies the actual writing of hundreds of new rules pertaining to key provisions of the Act. This legislative strategy predictably opened the pathway to full-throated lobbying by the banking industry as the regulatory rule-making process geared up.

The current rule-making process has already extended way beyond the two years originally envisioned for conforming to the Dodd-Frank Act—a result of the complexity of the issues involved, extensive comment periods of proposed regulations, aggressive industry lobbying, and the inability of regulatory agencies to agree on final regulatory language. According to Davis Polk & Wardwell, which closely follows the implementation of the Act, just 158 of the 398 required rule makings (or 40 percent) have been finalized nearly three years after Dodd-Frank was passed. During this delay the banking industry has naturally sought to win arguments at the regulatory level that were never addressed or resolved during the legislative phase. Bank officials and their representatives have not only tried to gain as much clarity and as many exclusions as possible in the new rules, but also to preserve maximum flexibility in regulatory compliance going forward. Congressional sponsors of the Act have also been working hard to ensure that the language of the new rules does not water down or otherwise subvert the intent of the legislation. Suspicions of gaming naturally led to snail-like negotiations and word-crafting.

On many of the Act's provisions, bankers, financial economists, Congressional sponsors, and federal regulators have widely diverging views of what rules are called for and can be effectively implemented. One of the most highly contested rules is known as the "Volcker Rule", championed by former Federal Reserve Chairman Paul Volcker.

### The Volcker Rule: Key Provisions and Regulatory Context

Known formally as Section 619 of the Dodd-Frank Act, the Volcker Rule is one of the law's iconic provisions. It is also one of the act's most complex provisions. Although Dodd-Frank devotes only 5,000 words to the Volcker Rule, Congress left plenty of leeway for regulators to design (bend?) how the final rule will look —as with so much within the bill.

The intent of the Volcker Rule is to prohibit banks from engaging in both commercial banking and investment banking, as the 1933 Glass-Steagall Act once did. Since a large part of investment banks' business is now proprietary trading, which involves the purchase and near term sale of high-risk investments for banks' own account, the intent of the Volcker Rule is to prohibit large, integrated banks from putting their federally insured deposits at risk by making risky investments for their own trading account. The rule also seeks to eliminate potential conflicts of interest between large banks and their customers.

In addition to prohibiting federally insured, deposit-taking banks from engaging in proprietary trading, the Volcker Rule also limits the amount of money (no more than 3 percent of a bank's capital) that banks can invest in or use to sponsor hedge funds and private equity funds. The idea behind these investment restrictions is to eliminate the temptation of banking entities to bail out investors in troubled hedge funds and private equity funds, which are typically highly leveraged and can significantly expand a banking entity's losses during a financial crisis.

In contrast to these *prohibited* activities, the Volcker Rule also expressly includes exemptions from these prohibitions for certain *permitted* trading activities, including "making a market" for the benefit of customers, risk-mitigating hedging activities, underwriting, and trading in U.S. treasuries, U.S. municipals, U.S. government agencies, and the paper of Fannie Mae and Freddie Mac.

These exemptions may seem simple enough, but the Volcker Rule as crafted by Congress does not precisely define important permissible activities. For example, market-making is permitted by section 619 to the extent that it is "designed to not exceed the reasonably expected near term demands of customers, or counterparties," but this provision neither defines "market-making" as a banking activity nor offers a clear meaning of the phrases "reasonably expected" or "near term." The lack of clarity between prohibited proprietary trading and permitted market-making has alarmed the banking industry. Many bankers argue that under normal trading conditions, there is often overlap between customer-oriented market-making and proprietary trading, especially in relatively illiquid credit markets where a simple matching of buyers and sellers is not possible. In such situations, maintaining a functioning market for bank customers in credit instruments and derivatives, along with equities, for bank customers frequently requires market makers to obtain positions in these securities *in anticipation of* customer flow. But under these circumstances, the market maker is necessarily exposed to changes in the value of the securities, and market-making begins to look very much like proprietary trading. Is this permissible under the Volcker Rule?

Authority for developing final definitions necessary to implement the intent of the Volcker Rule (and other rules under the Dodd-Frank Act) is shared by several regulatory agencies under the overall authority of the newly formed Financial Stability Oversight Council (FSOC), chaired by the Treasury Secretary. These agencies include the Office of the Comptroller of the Currency (Department of the Treasury), the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Federal Reserve Board, and the Securities and Exchange Commission. Dodd-Frank required FSOC to study the implementation of Section 619 and make recommendations to the five agencies responsible for Volcker Rule implementation within six months of the statute's enactment. FSOC's first action was a request, on October 1, 2010, for public input on the Volcker Rule. Approximately 8,000 comment letters were received, with roughly 6550 being identical letters arguing for strong implementation of the Volcker Rule. The remaining 1450 comments set forth individual perspectives from financial market participants, Congress, economists, and the public at large.

On October 11, 2011 FSOC released a highly complex, 298-page report, which proposed a variety of definitions and preliminary regulations and then posed more than 1,300 questions for comment by industry participants. FSOC asked that comment letters addressing the proposed rules and outstanding questions be submitted by January 13, 2012.

By the January 13 comment deadline, hundreds of banks, asset managers, business groups, American corporations, members of Congress, U.S. regulators, foreign regulators, and others submitted detailed letters addressing FSOC's proposed definitions, regulations, and questions. A review of comment letters submitted by leading Wall Street banks, the Securities Industry and Financial Markets Association, members of Congress, and former industry executives reveals many persistent disagreements and concerns about the Volcker Rule. While the banks tended to accept the risk-reduction premise of the rule (namely, that proprietary trading on Wall Street should be placed outside the taxpayer safety net), they argued that the rule, in its current form, is too complex, too burdensome, and inconsistent with preserving the functioning of global trading markets. In the words of JPMorgan Chase, the "extraordinary complexity and large number of laws" in the Volcker Rule makes implementation impossible without imposing "unacceptable costs on our economy and financial system."

### Initial Debate over Regulatory Rule-Making

Underlying these broad criticisms are a broad array of more specific concerns. For example, in its 65-page comment letter JPMorgan Chase questioned, among many other matters, (1) the proposed definition of a "trading account," —a seemingly minor matter but one which is absolutely critical to one's understanding of what constitutes prohibited proprietary trading; (2) proposed criteria for defining and differentiating between proprietary trading and market-making; and (3) various proposed rules that inhibit effective asset-liability management, risk-mitigating hedges, and liquidity management —all argued by JPMorgan Chase to be central to safe and sound bank management. The bank also argued that FSOC's assumption that banking entities will camouflage prohibited trading and work to evade and subvert the intent of the Volcker Rule has contributed to unnecessary complexity.

The basic thrust of Goldman Sachs' 63-page comment letter was that FSOC's definitions of permitted and prohibited trading activities are so narrowly defined that they significantly

limits banks' capacity to help clients raise capital, manage their risks, invest their wealth, and generate liquidity for their holdings. More fundamentally, Goldman criticized regulators and rule-makers for their "totally out-of-date" conception of how financial markets work, one based on an antiquated agency-based, exchange-traded equities paradigm. In the current world of finance, Goldman argued, new illiquid assets abound, thereby invalidating the applicability of the regulators' implicit, exchange-traded market model. In other words, being a market-maker in today's world requires warehousing an inventory of securities in order to actually make a market—since for many securities there is simply no counterparty currently available, and therefore no price. Goldman claimed that if FSOC stays with the old conception of how financial markets work, the inevitably narrow and restrictive definitions of market-making would destroy market liquidity. (The Securities Industry and Financial Markets Association reiterated Goldman's dire warning about the devastating effects on corporate liquidity in its 175-page comment letter.) According to Goldman, the inevitable result will be massive mark-to-market losses on bank and corporate balance sheets and an escalation of cumulative financial transaction costs into the hundreds of billions of dollars. The most promising way forward, Goldman argued, is to invest in developing quantitative "metrics" that could be helpful for indicating the true character of a trading activity—be it proprietary trading or market-making—and to avoid inappropriately restrictive definitions. The design and implementation of such metrics, Goldman argued, will require "robust and on-going dialogue between banking entities and their regulators. It will also require expanding the conformance period beyond the July 2012 start date." Whether this suggestion will be perceived as foot-dragging or gaming the implementation of financial reform remains to be seen.

Chairman Volcker's comment letter argued that the market liquidity argument, put forth by Goldman and others, was way overdrawn: "There should not...be a presumption that evermore market liquidity brings a public benefit. At some point, great liquidity, or the perception of it, may itself encourage more speculative trading..." Volcker also rebutted claims that proprietary trading by commercial banks is not a serious risk factor, that the competitive position of U.S. based banking institutions will be adversely affected (as claimed by JPMorgan and Goldman), and that the proposed regulation is simply too complicated and costly. But Volcker did agree with Goldman's call for meaningful metrics to help discriminate between permitted market-making and prohibited (and "deliberately concealed and recurring") proprietary trading. Volcker also recognized in his letter "the thorny issue of guidance" with respect to situations where market-making for customers takes on characteristics of prohibited proprietary trading. Since only a very few, large banks engage in continuous market-making on any significant scale, Volcker was nevertheless sanguine about the possibility of effective regulatory oversight.

Chairman Volcker's concise letter, while seemingly balanced and non-confrontational, was not seen as such by Jamie Dimon, the chairman and chief executive of JPMorgan Chase. Dimon told Fox Business in a February 13, 2012 interview, "Paul Volcker by his own admission has said he doesn't understand capital markets. He has proven that to me." Dimon added, "I understand the goal to make sure these companies don't take huge bets with their balance sheets. But market-making? Just like these stores down the street, when they buy a lot of polka dot dresses, they hope they're going to sell, they're making a judgment call. They may be wrong! So protecting the system I agree with, but starting to talk about the 'intent'...I tell you... for every trader, we're going to have to have a lawyer,

compliance officer, a doctor to see what their testosterone levels are, and a shrink [asking them], “what’s your intent?” No, we’re going to make markets for our clients to give them the best products, the best services, the best research and the best prices. That’s a good thing in spite of what Paul Volcker says.”

One of the most remarkable comment letters came from John Reed, who held CEO titles at Citigroup and its predecessor from 1984 to 2000. Reed had helped engineer the merger between Citibank and Sanford Weill’s Travelers Group (owner of the investment firm Salomon Smith Barney) after the repeal of the Glass-Steagall Act, which had separated traditional banks from those involved in capital markets. He has since said that the repeal of Glass-Steagall was a mistake. In his comment letter, Reed recommended that the proposed Volcker Rule be made stronger by requiring regulators to change how traders are paid to prevent future abuse of the activities that the rule still permits, requiring quarterly CEO and top management signoffs on complying with the rule, and the imposition of “severe penalties” for non-compliance.

Eighteen months after all the requested comment letters were received by FSOC, it is still unclear how such disparate, strongly held views about the final rendering of the Volcker Rule will be reconciled. Hence the mounting impatience of the President and some members of Congress. Not only have various bank regulators been at loggerheads over such issues as distinguishing between permitted market-making activities and prohibited proprietary trading, but regulators have also been swamped with industry lobbyists seeking to water down the rule’s various provisions. The delay in implementing the Volcker Rule is palpable. In the words of Paul Volcker, “We passed a law, like it or not, and three years later, we’ve got no rule.”

### Are New Rules Related to Proprietary Trading Being Gamed?

Gaming in the present context refers to deceptive (and often lawful) behavior that subverts the intent of socially mandated rules for private gain. Gaming contrasts with good faith negotiation of rules or good faith compliance with the spirit of established rules. When it comes to rule-making in the world of economic regulation, the distinction between deception and good faith negotiation lies in the motives of affected firms and their lobbyists. If companies and their lobbyists try to negotiate language and rules with regulators that leave open unintended possibilities for side-stepping the rule’s intent in the future, then such behavior can be said to be a deception and a form of gaming. If, however, the motive were to clarify the meaning or scope proposed rules without pushing for loopholes that permit unintended evasion of regulatory or legislative intent in the future, then that would be a case of good faith negotiation rather than a case of gaming.

Game players typically try to rig society’s rules in their favor through largely invisible lobbying efforts. They also tend to follow the letter of the law but not necessarily its intent or spirit. They exploit —for personal or institutional gain —purposely grey areas of the law that are not easily understood or recognized as violations.

Gaming typically comes in two, trust-destroying forms: a rule-making game and a rule-following game.

The rule-making game is an *influence* game. It involves influencing the writing of society’s rules by legislative or regulatory bodies, so that loopholes, exclusions, and ambiguous

language provide future opportunities to “work around” or circumvent the rules’ intent for personal or institutional gain. The rule-following game is a *compliance* game. It involves the exploitation of gaming opportunities created during rule-writing.

Since only 38 percent of the required rules under section 619 of Dodd-Frank have been written and agreed upon, it is difficult as of August 2013 to report any authoritative conclusions about the behavior of large banks with respect to gaming the implementation of Dodd-Frank in general and the Volcker Rule more specifically. For sure, during the legislative phase there was massive lobbying in Congress by financial institutions and their various associations in opposition to reform. While this lobbying did not prevent passage of the Dodd-Frank Act, it did succeed in significantly watering down the Volcker Rule as originally proposed. And during the continuing regulatory rule-making phase, the gray area between proprietary trading and market-making would seem to invite heavy influence peddling and lobbying—particularly with respect to definitions of permitted and prohibited activities creating exclusions and loopholes that could be exploited for private benefit in the future.

That said, during *preliminary rule-making*, which includes draft rules and related questions issued by FSOC on October 11, 2011 and the subsequent comment period for industry participants (ending on January 13, 2012), I have not been able to detect—sitting outside the lobbying process—any truly defining cases of gaming behavior that fundamentally subverts the intent of the statute, as opposed to good faith (and persistent) efforts to achieve clarity and ease-of-implementation in the final regulations.

For example, all of dozens of comment letters that I reviewed from the largest banking institutions and industry associations to the FSOC in January 2012 addressed specific regulatory questions regarding prohibitions or exclusions related to trading, market-making, and hedge fund investing in a substantive, largely technical manner. While most of these respondents were not supporters of the Dodd-Frank Act (although not totally adverse to some sort of financial reform), opinions and recommendations were typically substantiated by systematic analysis of financial function and supporting processes. In my review of invited comment letters, I detected no gross misrepresentations of fact or mischaracterizations of banking processes, although there was certainly room for substantial differences of opinion over the costs, benefits, and challenges of prohibiting certain trading functions under the proprietary trading restriction.

Of course, in preparing public letters of this sort there are no conceivable gains to be had from overtly self-interested, unsubstantiated arguments on the part of banks targeted for re-regulation. For this reason, we should not rush to any judgments about this laudable straightforwardness. Beneath this surface of comity and technical debate, and outside my field of vision, it is possible—and even likely—that a battle royal is being fought over the crafting of regulations in ways that would enable banks to lawfully sidestep some of the prohibitions or even subvert the intent of the Volcker Rule in the future. Indeed, the large amount of money being spent on lobbying by banking interests has hardly declined as the Dodd-Frank Act has moved from the legislative phase to the current regulatory rule-making phase. And given the significant financial stakes involved for large banks, we know that there are many incentives for banks to figure out ways of side-stepping prohibitions against proprietary trading by claiming such trading to be part and parcel of such permitted trading activities as market-making, hedging, or other customer-initiated transactions.

This gaming potential was clearly acknowledged in the January 2011 report by FSOC on proprietary trading. This report minced few words in acknowledging and describing the various ways in which banks could mask prohibited proprietary trading as market-making or risk-mitigating activities, thereby gaming the essential purposes of the Volcker Rule. In the same vein, U.S. Senator Jeff Merkley, the Oregon Democrat who with Senator Carl Levin, a Michigan Democrat, put the Volcker Rule into Dodd-Frank complained to Bloomberg in response to industry claims that the new proprietary trading rule would choke off liquidity in the markets, "The banks are using every strategy they possibly can to 'confuse the issue'."

### What the Record Reveals

As far as predicting future gaming and circumvention is concerned, many opportunities exist. First, many regulations (and prohibitions) have yet to be written, inviting the normal sparring over substantive restrictions and language. Second, great uncertainty exists about whether or not the intent of financial reform can actually be adequately protected by the regulatory regime put in place by the legislative authors of the Dodd-Frank bill. This regime puts the onus of compliance on the banking entities themselves (a costly and complicated function requiring breakthrough methodologies). It also requires relevant government agencies to conduct robust oversight and enforcement (also costly and involving dispersed regulatory authority). The effectiveness of this regime will only be revealed in the coming months and years.

These disclaimers aside, what else can we say now about past and current industry efforts to shape and perhaps side-step the intent of the Volcker Rule?

As a start, we can say that lobbying and influence peddling remains robust as of the summer of 2013. All indications are that the energy and resources invested by industry associations and financial institutions in lobbying for favorable regulatory language have remained large and sustained. The industry has been heavily engaged in all aspects of the financial rule-writing through a wide variety of channels like the U.S. Chamber of Commerce, the Securities Industry and Financial Markets Association, the American Bankers Association, the Financial Management Association International (for hedge funds), and the Financial Services Roundtable.

To complicate the problem, members of Congress have long received significant campaign contribution from the finance industry. According to the Center for Responsive Politics, a nonprofit organization that monitors political donations, the financial sector is one of the largest source of campaign contributions to federal candidates and parties. And according to Robert G. Kaiser's detailed legislative history of the Dodd-Frank Act (*Act of Congress: How America's Essential Institution Works, and How It Doesn't*. Knopf, 2013), the watchdog Public Campaign Action Fund has calculated that members of the House Financial Services Committee (chaired by Rep. Barney Frank during the writing of the Dodd-Frank Act) received a total of \$62.9 million from the financial sector from the start of their Congressional careers through the spring of 2009—an average of \$885,000 per member. Kaiser also reveals that Chairman Frank received considerably more finance sector donations, totaling \$1,041,298 in 2007-08 alone. Frank's co-author and collaborator, Chairman Chris Dodd of the Senate Banking, Housing, and Urban Affairs Committee, received \$6,081,836 over the same period. We can safely assume that members of the Senate committee received comparable attention and care. Both Barney Frank and Chris Dodd have

claimed that this campaign money did not influence their approach to regulatory reform, and that they have consistently supported reforms that large banks opposed. Still, as Kaiser observes, neither Dodd nor Frank ever proposed breaking apart the large banks or otherwise changing the fundamental structure of the banking sector.

With respect to lobbying, Marcus Stanley —legislative director of Americans for Financial Reform (a coalition of 250 national, state and local consumer, labor, investor, civil rights, community, and small business organizations) —claims that the financial industry spent \$1.4 billion on lobbying to influence the legislative process in 2008-2010. In addition, according to *The Economist*, the financial services community deployed more than 3,000 lobbyists to influence the scope and content of the Dodd-Frank reform bill. That's about 30 lobbyists per U.S. Senator. During the legislative phase of Dodd-Frank and the Volcker Rule, the influence game was rigorously played and, if the act's mind-numbing complexity is any guide, responsive to many private interests.

After the passage of the Dodd-Frank bill, the financial sector maintained its level of spending on campaign contributions and lobbying. Lobbying-only numbers released by the Center for Responsive Politics, show that finance firms and trade associations spent collectively \$96.8 million during 2012, only a little less than the amount that was spent in 2010 and 2011 when Dodd-Frank activity on Capitol Hill was most intense.

Immediately after the bill was voted, the "ground war" conducted by industry lobbyists shifted from Congress to on federal agencies like the Federal Reserve and the Securities and Exchange Commission, to which the act left the tough work of writing the actual regulations. According to Gary Rivlin of [OpenSecrets.com](http://OpenSecrets.com), the infantry on the ground in 2012 included 183 lobbyists working for the U.S. Chamber of Commerce, 91 for the American Bankers Association, 60 for JPMorgan Chase, 51 for Goldman Sachs, 49 for the Securities Industry and Financial Markets Association, 28 for the Financial Services Roundtable, just to mention a few. To give a sense of relative "fire power," the top five industry groups working to influence and bend Dodd-Frank to their interests fielded 406 lobbyists on Capitol Hill in 2012, versus 20 for the top five consumer protection groups defending Dodd-Frank —a 20 to 1 ratio. This ratio does not reflect the combined forces of regulatory lawyers, research staffs, PR people, friendly think tanks supporting the finance industry, and, of course, bankers themselves meeting face to face with federal agencies on dozens of occasions.

It should be no surprise that these motivated lobbyists are extremely well organized. According to detailed research of industry lobbying by Kim Krawiek, within hours of the bill's passage in July 2010, big banks and industry trade groups systematically divided their teams of lobbyists into 18 work groups, each focused on different elements of the new law. One of these work groups focused on the Volcker Rule. In the words of Krawiek, "battalions of lawyers burrowed deep in the federal government to foil reform." Whether that characterization is appropriate remains to be seen. But there is little doubt about the massive effort to influence regulatory language. Says Michael Barr, who was an assistant secretary at the Treasury Department during the writing of the Dodd-Frank bill, "You pick a page at random, and I'll tell you about all the issues on that page where the fighting was intense."

### The "Big" Questions



How do we understand the full picture of how the Volcker Rule is being implemented and perhaps gamed? As the regulatory rule-making process grinds to its inevitable end, will the Act's essential purposes be protected or successfully subverted? How will the public interest and legislative intent be interpreted in matters of highly technical securities trading? What exclusions, loopholes, and gaming opportunities will survive final rule-making? How will Wall Street's largest banks choose to comply with the final provisions of Volcker Rule? How much trading with proprietary-type characteristics will actually be shut down?

With respect to proprietary trading by large banks, what we know so far is that Goldman Sachs —just to stay with this example —reported in its annual 10-K filing with the U.S. Securities and Exchange Commission that it liquidated during 2010 “substantially all the positions” in the principal-strategies unit that operated within the firm's equity division. That was certainly a quick response to a first reading of the bill. In addition, the bank reported that in the first quarter of 2011 it “commenced the liquidation of the positions that had been held by the global macro proprietary-trading desk” within the fixed-income, currencies, and commodities (“FICC”) division.

We also know that Morgan Stanley was planning to break off its largest pure-proprietary trading group, Process Driven Trading, as an independent advisory firm by the end of 2012. Similarly, we know that executives from JP Morgan Chase, Citigroup, General Electric's GE Capital unit, and Credit Suisse have met with Federal Reserve or U.S. Treasury Department officials on multiple occasions to discuss implementation of the Volcker Rule.

All of these examples are indicators of trust-building adaptation to changed circumstance. Still, important questions remain. Goldman, for example, which has publicly supported financial reform, has not entirely eliminated some businesses that make bets with its own capital. While Goldman states in its SEC filing that it “will continue to assess our business, risk management, and compliance practices to conform with developments in the regulatory environment,” we do not yet know whether or not it will lawfully transfer some of its remaining proprietary trading off-shore to its Global Macro Proprietary Trading Desk in London. Similarly, we do not know whether or not large banks will shift some of their traders to market-making or client-service desks—thereby enabling the bank to continue operating as before, albeit at diminished scale and visibility. Similarly, we do not yet know how large banks will respond to prohibitions on investments in hedge funds and private equity funds? Will they follow JP Morgan Chase in shedding its private equity operation? How will banks deal with new hedge fund restrictions? As noted in the first FSOC report, while a number of banking entities have shut down or plan to shut down dedicated (“bright line”) proprietary trading operations and hedge fund businesses that were a source of losses during the financial crisis, impermissible proprietary trading may continue to occur within permitted activities that are not organized solely to conduct proprietary trading.

We can only imagine the full range of questions pertaining to the implementation of Volcker Rule that remain for bankers and their regulators to clear up. And we can only imagine how much energy and resources the banking community will invest during the final rule-making phase in trying to preserve opportunities for lawfully practicing various forms of trading that contribute so much to banks profits. For this reason, continuing to follow the implementation of the Volcker Rule will help us better understand where and to what extent the Volcker Rule has been gamed, where it has been responsibly adopted and complied with, and how the remnants of gaming can be best contained in the future. There is no better test

case by which to assess regulatory and industry behavior in the implementation of financial reform.

<http://www.ethics.harvard.edu/lab/blog/335-is-financial-reform-being-gamed>

# One Holy Mess: Pope Francis Fights Institutional Corruption at the Vatican Bank

[Gregg Fields](#)

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They are scenes reminiscent of a Dan Brown novel: whispers of money laundering and connections to the mafia; a banker found hanging from the Blackfriars Bridge in London; and a powerful American consulting firm delving into the secrecy-shrouded financial arm of the Vatican.

But the drama surrounding the Institute for Religious Works, commonly known as the Vatican Bank, is not a sequel to the controversial bestseller *The Da Vinci Code*. The Vatican's banking unit is in the middle of a firestorm of controversies and acknowledged lapses in oversight. The cleanup started under Pope Benedict XVI but has been thrown into high gear by Pope Francis. There are signs already that greater transparency and increased regulatory oversight are in the pipeline.

In a broader context, the saga of the Vatican's bank is a telling example of how, given the right conditions, institutional corruption can infest organizations blessed by moral authority and endowed with a mission of public service. It shows how institutional corruption can insidiously erode the public's trust in respected organizations, reducing the effectiveness of their leadership. It classically illustrates the moral hazards that arise when relations between the regulator and the regulated grow too cozy—in this case, they were virtually the same entity.

"To the consternation of the public and to the continued embarrassment of Catholics worldwide, the Vatican bank remains a rich source of material for Italian journalists, conspiracy theorists and anyone else who wants to build a case for Vatican intrigue," wrote [Francis J. Butler](#), former president of the Foundations and Donors Interested in Catholic Activities, in a recent commentary for the independent U.S. newspaper National Catholic Reporter. "The question before Pope Francis is whether the elimination of the Vatican bank entirely—which would mean giving up about \$86 million euro in yearly profits—would be the only sure way to be free of further financial scandal."

## An Eternal Issue

The Vatican, of course, is one of the highest profile organizations in the world. In that sense, the pontiff's banking reform efforts will naturally be widely watched around the globe, particularly the 1.2 billion Roman Catholics. Its bank, which most commonly goes by IOR, the Italian acronym for Istituto per le Opere di Religione (in English, the Institute for Religious Works) has been a lightning rod for controversy almost since its founding by Pope Pius XII in 1942, in the depths of the horrors of World War II.

If Pope Francis succeeds in saving the IOR and restoring its credibility, the results may prove to be a persuasive template for those addressing institutional corruption in other powerful entities such as Congress or Wall Street. Yet, as with financial reform following the financial crisis, the effort to rehabilitate the IOR is now several years old, illustrating the intractable nature of institutional corruption.

“Since 2010 the IOR and its management have been working hard to bring structures and processes in line with international standards for anti-money laundering,” [Ernst von Freyberg](#), the IOR’s president, said this summer in announcing a management restructuring that saw the IOR’s director and deputy director resign. Von Freyberg, a German industrialist, was hired to clean up the bank earlier this year. “While we are grateful for what has been achieved, it is clear today that we need new leadership to increase the pace of this transformation process,” he said.

Scandals linked to the IOR are hardly new. It has been accused, though never found liable, for colluding with Croatia’s collaborationist government to steal assets from Hitler’s victims during World War II. A suit filed in the U.S. by Holocaust survivors, *Alperin v. Vatican Bank*, was [ultimately dismissed](#) on grounds that IOR is protected by the Foreign Sovereign Immunity Act. (Collaboration controversies have also long dogged the Bank for International Settlements, based in Basel, most recently in the book *Tower of Basel* by Adam LeBor.)

In the 1960s, controversy flared when the IOR hired Italian financier Michele Sindona as a financial advisor. The problem: Sindona was a central player in a seemingly endless number of banking collapses and financial swindles in Italy. His major American holding, Franklin National Bank, collapsed in 1974—reportedly costing the Vatican tens of millions of dollars—and he eventually was given a 25-year sentence for fraud related to the debacle. He was later extradited to Italy to face other charges, and died in prison in 1986 [of cyanide poisoning](#). Whether it was suicide or murder was never determined.

Perhaps the most notorious blemish on IOR’s past, however, is the 1982 collapse of Italy’s largest bank, Banco Ambrosiano, with which the Vatican, as a shareholder, had a strong working relationship. Banco Ambrosiano’s chairman, Roberto Calvi, whose Vatican ties had earned him the nickname “God’s banker” despite a conviction for illegal foreign exchange transactions, was later [found hanging](#) from London’s Blackfriars Bridge. An initial finding of suicide was later discredited and it is now generally accepted that he was murdered. (A highly fictionalized character based on Calvi was a subplot in *Godfather III*.)

“Our biggest issue is our reputation,” von Freyberg conceded [in an interview](#) with Vatican radio earlier this year.

### Self-regulating

How could a city-state with a population of 800 become so enmeshed in international financial intrigue? In essence, the IOR operated much like an “offshore” banking haven like Grand Cayman or Bermuda. Like those small islands, the Vatican City-based IOR had sovereign status. Its regulator is the Financial Information Authority, an internal watchdog of the Vatican. In recent weeks, the Vatican has essentially conceded that this led to what students of institutional corruption might call regulatory capture. In early August, the pope

issued a [Motu Proprio](#)—a decree at his own initiative—that increased the FIA’s powers of supervision over the IOR.

Those who study institutional corruption often conclude that a lack of transparency is a contributing factor. It’s a relevant point in this case, because the IOR was perhaps the least transparent financial institution in the world. No branches, no shareholders and essentially no central banking authorities to whom it must answer.

It also has a structure that significantly limits the constituencies to whom it must answer. It doesn’t make loans, for instance, or perform other traditional bank functions. Only people like Vatican employees, clerics, and entities like charities and dioceses affiliated with the Holy See (the authority and government functions of the papacy) are allowed to have accounts. In one example of how inscrutable its operations were, the bank only developed [a website](#) in summer 2013.

Certainly, religious organizations are often granted a great deal of leeway in terms of privacy regarding their operations. However not many institutions own their own bank—one that, according to its new website, [www.ior.va](http://www.ior.va), has more than \$9.4 billion in assets.

### Outside Influences

Despite the publicly announced cleanup efforts, scandals have continued. One example concerns the case of Monsignor Nunzio Scarano. He [was arrested](#) earlier this year over an alleged plot to bring 20 million euros in cash into Italy. According to press reports, he is also being investigated for money laundering in southern Italy. The Vatican’s criminal court has frozen Scarano’s accounts.

It is worth noting, meanwhile, that the Vatican financial reforms, which gained traction under Pope Benedict XVI and are clearly gaining momentum now, came only after years of bruising international pressures. In 1989, the G-7 countries including the United States, Italy and the United Kingdom banded together to form the Financial Action Task Force, to coordinate international money laundering efforts. One of the biggest concerns then, at least for the U.S., was drug smuggling proceeds.

In the 1990s, Moneyval, an organization comprising smaller states belonging to the Council of Europe, was formed to combat money laundering. Global anti-money laundering initiatives gained new urgency after the terrorist attacks in 2001, with a number of international agreements forcefully lifting the shrouds of secrecy that had been one of the leading competitive advantages that banking havens historically enjoyed.

The Vatican only joined Moneyval in 2011, which led to a Vatican-requested review of IOR released last year. The [report found](#) the Vatican had “come a long way in a very short time” but that “further important issues still need addressing in order to demonstrate that a fully effective regime has been instituted.”

Besides bringing in von Freyberg, [Promontory Financial Group](#), the prominent Washington consulting firm, has been hired to conduct a forensic review of the bank’s finances. In May, it signed an [information sharing agreement](#) with the U.S. Financial Crimes Enforcement Network (FinCEN).

“The IOR is engaged in a process of comprehensive reform, to foster the most rigorous professional and compliance standards. These efforts are based on the legal framework set forth by the Vatican, in cooperation with international bodies,” von Freyberg, the president, says in a letter posted on the [IOR website](#). “This includes implementing strict anti-money laundering processes and improving our internal structures. We are conducting an extensive evaluation of all our clients’ accounts, with the aim of closing down those relationships that do not conform to our strict standards.”

### Restoring Faith

In that regard, von Freyberg has hit upon what many observers have missed about the scandals surrounding the IOR. True, there appear to have been a number of unsavory characters with whom it associated. But what likely attracted them was a system that was easily subject to influence. A mutually dependent relationship—one might call it dependence corruption—seems to have developed between IOR and people that ultimately sullied the reputation of the institution. Long term, that undermined its moral authority.

As Lawrence Lessig, director of the Edmond J. Safra Center for Ethics, [wrote recently](#): “Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution’s effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public’s trust in that institution or the institution’s inherent trustworthiness.”

That would suggest the IOR faces two challenges. One, it must create new systems that eliminate its vulnerability to the influences that lead to institutional corruption. Secondly, and perhaps more importantly, it must re-strengthen the credibility that lies at the heart of the public’s trust.

The question in this case is whether it’s too late. Pope Francis raised that possibility himself in [a press conference](#) earlier this summer. “Some say perhaps it would be better as a bank, others say it should be an aid fund, others say it should be shut down,” he said, during the return flight from his papal visit to Brazil. “But the hallmarks of the IOR—whether it be a bank, an aid fund, or whatever else—have to be transparency and honesty, they have to be.”

<http://www.ethics.harvard.edu/lab/blog/336-one-holy-mess>