Introduction

The following is a summary of my recently published book entitled “Trust and Honesty, America’s Business Culture at a Crossroad” (Oxford University Press 2006). It is hard for any author to believe that his book can be summarized in a short paper. I am no exception. Therefore, what I offer in this short paper are three questions with which the book is engaged, and focus on issues concerning the regulation of fiduciaries. I look forward to our discussions.

First: Where are we now?
Has America changed? Are we moving towards a culture that more readily accepts and justifies abuse of trust and dishonesty? Are we getting used to, and expect dishonesty as a “fact of life”? Is this movement which we are experiencing important?

Second: How did we get here?
How did we move towards this culture? What changes in the environment could have contributed to this change?

Third: What do we do about it?
Is there a quick and easy formula, or any formula for that matter, to put a stop to the movement towards abuse of trust and dishonesty? If not, what can each and every one of us do about it?

1. Where are we Now? Has America changed? Are we moving to a culture that is more ready to accept, and justify abuse of trust and dishonesty? Is this movement which we are experiencing important?

Open the newspaper and you will find items concerning fraud. It seems that fraud has spread over the population: in insurance and healthcare; by reporters and scientists; by students who cheat on exams and job applicants that offer untruthful resumes; by lawyers who pad their billable hours and accountants who invent ways to mislead through financial statements; by analysts that are truly salespersons and rating agencies that suffer from conflicts of interest; by athletes and international organization that deals with athletic events, and the latest is a writer of a best selling memoir “A Million Little Pieces” who admitted that he made up details of his life, as the New York Times of January 12, 2006 reported.

The list is long. Does it mean that America is more beset by fraud than in the past? Does it mean that America today is more transparent? Does it mean that America has adopted a higher standard of honesty?

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What seems to be unique to today’s environment is that there is more acceptance, justification and even re-definition of dishonesty. Some people admire those who “made it” by whatever means “got away with it.” Some say: “What can we do? Everyone does it.” Some say: “It is bad, but not so bad.” Some blame others: the government, the law, the investors that “made me do it.” Some attribute dishonesty to others with whom they deal, as a defense of their dishonest behavior towards them. It is simply a protection one must take.

Acceptance of this sort leads to a culture of dishonesty. When people get used to, and expect others to behave in a dishonest way, a culture (a social habit) of dishonesty develops. No longer do people argue on what is right or wrong. They assume automatically that this is the way things are, and then adopt defensive mechanisms. They are dishonest towards others, and mistrustful of others with few exceptions.

Dishonesty and abuse of trust are costly to the economy, regardless of their effect on other social and personal relationships. When it reaches the cultural stage we may call it corruption. Wealthy countries can become third-world countries. Are we heading this way?

2. How did we get here? Has our Environment Changed? And if so, how?

During the past three decades we saw rising opportunities and temptations to defraud and falling barriers to these temptations. We saw a rising drive for “more,” no matter how much one has, we had the bubble years, we had the creeping greed in corporate leadership as well as the “golden age” of the legal profession. The bubble years created opportunities to earn enormous amounts of money from insubstantial (air-filled) assets, and very little contribution on the merits. Similarly, corporate management earned millions in the bubble stock market.

During the past thirty years we have reduced the barriers to dishonesty. We have reduced the weight and importance of morality, as well as the weight and respect for the law, and raised the weight and importance of market regulation.

The three major building blocks of the barriers to dishonesty are morality, law and the markets. Morality denotes self-limitation by trusted persons, even if there are no police around. Clearly, this is the most efficient and least costly mechanism. The law offers government’s power to control dishonesty. The markets offer the control of dishonesty by the other parties to the relationship. To be sure, in some cases such control is effective. But when the nature of the transaction exposes one party to the mercy of the other markets are not effective and in fact are very costly mechanisms for inducing honesty and protecting the dependent parties. Let me be quite clear. I am not speaking of people who are unsophisticated. I am speaking of transactions that by their very nature put one party, sophisticated or not, at the mercy of the other because the cost of verification and monitoring the other party are too high.
Buying a newspaper does not require trust. Vesting a life’s savings in a money manager requires trust, whether or not the investor is sophisticated. Our country is based on specialization. The more costly it is to acquire specialized skills (e.g., teaching law; open-heart surgery) the more reliance one must have on the person exercising the skills. No market protection can help here unless we wait long enough and word of mouth will create enough evidence to frighten users away. The cost of such waiting may be very high. Besides, the users are not going to mistrust only the person or organization that was proven dishonest. Users are likely to mistrust all those who offer the same kind of skills—e.g., all physicians. It is costly to distinguish between those who are competent and honest and those who are not.

What have we done to the law and that regulates trusted persons, that is, the fiduciaries? We have begun to shift the rules that apply to fiduciaries. Fiduciaries usually offer services to others. Some of these services require expertise. Often fiduciaries are entrusted with other people’s money and power such as power to bind other people to legal obligations, power to operate on other people’s bodies, including teachers who are entrusted with the power to grade their students’ performance. None of the entrusted assets or power belongs to the fiduciaries. Yet, the nature of the relationship makes it impossible to monitor and control the fiduciaries in the performance of their services. Such controls would undermine the very utility of the relationship.

Thus, fiduciaries must exercise self-limitation not to take what does not belong to them, even if there are no police around. In fact, the law that governs fiduciaries is designed to create incentives for fiduciaries to behave in that trustworthy way.

In contrast, contract law assumes a very different posture among the parties. Each is presumed and required to fend for himself. In contract the law does not require each party to take care of the other party’s needs and interests but rather to take care of its own. Each party is required only to tell the truth (when asked) and to fulfill its promises. No more; no less.

Even though most contracts and fiduciary relationships are consensual, the law treats them differently. Fiduciary rules constrain the fiduciaries from putting themselves in tempting situations and impose greater remedies and punishments on breach of trust, including a stigma of “abuse of trust” denoting stealing, as compared to the stigma from the “breach of promise.” This is being changed. Fiduciaries are less constrained today, the rules are interpreted in a more restrictive way, allowing fiduciaries more freedom and increasing the costs of enforcing the rules.

What have we done to the professions? Professionals, such as physicians and lawyers are fiduciaries. They have duties to their patients and clients but their main client in times past was society. To be sure, they had to make a living as well. But the focus on society has reduced their competition among each other, because they all shared the one client. We have changed the law to allow them, encourage them and perhaps require them to compete. The assumption that this change will bring more information and lower costs of services has not panned out. It may well be that the reverse has happened. We now see
the spectacle of plaintiff lawyers fighting over leadership in mass litigation, partners protecting themselves against other partners in enticing clients away from others, and similar unseemly and trust-destroying behavior.

3. What Do We Do About It? What can be done about creating a more honest and trustworthy society?

I have no easy quick recipe. I do have some observations.

First, it took years to move America in this direction. We cannot expect a drastic change immediately. Second, law alone cannot do it. Law can deal with a minimal number of violators. If the number and magnitude of violations grows, the prohibitions will be re-defined out of existence. Law can, however, influence behavior not only by threats but also by providing incentives. We can do a better job creating such incentives. Third, like changing a bad habit America must first become far more aware of the habits it has been developing. It must then recognize that they are harmful to its well being and then encourage everyone, from the public to the leadership to the various segments of society to get involved. My fourth point answer is better expressed at the end of my book.

Here it is:

A PARADOX OF A DETAILED SOCIAL DESIGN

A detailed social design or blueprint presents a paradox. It must be sufficiently simple and clear. Or else people cannot easily follow it. Yet, if it is simple and clear, it becomes unreal and false. It will subvert the way we live. If we seek a short concise book of “how to” rules to lead to a more honest society, we face the paradox of the social design.

It is useful to think of the world as a market; people as self-interested; all relationships as exchanges; all transactions as contracts; all behavior of investors as uniformly rational. These views offer insights on the examination table. But as a blueprint to be implemented in real life, the views are pernicious. They can pave the road to deception and abuse of trust on a grand scale, even if their prophets do not preach these results. Markets without rules, fairness and morality, are destined to fail. If they benefit the few at the expense of the many, they will not last long in a democratic society. At some point the prey wakes up and flees the predators, or replaces them by the weight of sheer numbers, or joins them to overwhelm and crush the system under the weight of deception.

Self-interest, without compassion and self-control, is bound to raise a culture devoid of empathy for others and destructive of trust. Exchange that applies to everyone and everything robs people of the joy of giving and other forms of more subtle reciprocity. It breeds meanness and dries up humanity. Rationality without reasonableness can bring most bizarre results. It can open the gates to treacherous, disloyal, and fraudulent behavior, seeping like sewage throughout society and
contaminating everything in its way. Banishing morality, ethics, and emotions from consideration by exclusion or absorption is wrong. It is unclear whether even the sciences can excuse moral considerations. Social sciences and law that ignore human traits and commitment to community are unreal.

A recent proposal by DARPA, a renowned government-supported research organization to create a "terror futures market" demonstrates the results of faith in a world that consists only of markets and of rational actors. The proposal is based on the assumption that “talk is cheap, but money speaks the truth,” as cited in the Economist. Or perhaps “money speaks louder.” People will seek to gain by predicting terrorist activities, based on their information and beliefs. The proposal is based on the theory that the input of all the information represented in the betting will provide more accurate predictions than the predictions of experts. The Economists describes emerging research projects about “information markets.” “The aggregate hunches of many people with money at stake are likely to be more accurate than the opinion of disinterested experts or of whoever happens to be at home when a pollster calls.” Indeed the results of some of the research suggest that the predictions of numerous anonymous people are more accurate than the analysis of identified experts. The DARPA proposal was rejected when it dawned on some people that terrorists could benefit greatly from this market. The market information may help terrorists guess the public policy that might react to the information. The terrorists may play the market and profit. After all, the terrorists can predict the future better than anyone else, and are more likely to win.

Besides, the market in terror futures is partially based on the assumption that people would bet on the basis of the information they have, not on the basis of the information that others have. The market prices will reflect no touting and no manipulation and less bias. Yet in today’s markets, solid information is competing with betting, touting, and manipulation. It is unclear which motivates people to buy and sell stock or derivatives. The public market mechanism is therefore inappropriate for pooling the information people might have about possible terrorist attacks. The Economist noted that “information markets are also prone to imperfections. One is that they can exaggerate traders’ misperception of risks…” can be too optimistic, and affected by personal tastes. As much as we seek the objective prediction, human nature stands in the way.

If we reject a blue print of society as markets, exchanges, and individual selfishness, what other options do we have? Any detailed social design would share the same characteristics. It would have the same faults, even as it negates the substance and message of economics. To be popular and understood, it must offer a clear alternative world, with few nuances, approaches, categories or contradictions. Yet, humans and their societies cannot be packaged neatly. They are complex, messy, and continuously changing by actions and interactions among themselves and with their environments.

Society is populated by honest and dishonest persons; by selfless compassionate idealists and self-centered ruthless narcissists; by true victims and foolish or fake victims; by productive entrepreneurs and mimics of entrepreneurs who produce nothing. People behave inconsistently, change and evolve. Moreover, truth, trust, and honesty are
indeterminate. The differences between trust, gullibility, and faith, are relative. They depend on the sources and cost of verifying the trusted persons' statements and of monitoring the trusted persons' activities to meet their promises. They depend on the abilities of the people who rely on trusted persons to protect themselves against fraud. Protection against dishonesty is tricky. The very protection may undermine trust that we wish to foster in society. And the law, although helpful, is not the whole answer.

Therefore a competing clear and specific blue print will be as unreal and misleading as the legal economics view of the world. An ideal world of truth, trust and commitment to others as well as to one’s own self is just as unrealistic. The closer the competing view will come to reflect the real complex world, the less understood it would become. We are too complex to be put into a square box, or any box for that matter.

Alternatively, we can continue to search for the simple and specific world that does not exist. A society with a strong sense of survival, like the American society, will swing from one such simple world to another. When a view supports an environment that has become too despotic and corrupt, as the one towards which we are heading, the pendulum could swing drastically in the opposite direction. Historically, America has been switching from one simplistic blue print to another. As one blue print became intolerable Americans adopted another, which became intolerable in turn. America experienced Puritanism with its despotic intrusion into private actions and thoughts, as well as the Wild West, the “roaring” twenties, and the rebellious sixties, with their attitude of "anything goes.” Thus, after extreme authoritarian strictness, came extreme permissiveness. After confining rules of behavior, dress, and moral rules, came a revolt against any rule. Perhaps when the compulsive and corrupt 1990s finally end, the pendulum will swing again and the country will recede into intrusive regulation and controls of deception and abuse of trust.

To avoid sharp swings of the pendulum from one simple book of rules to another, we could abandon the search, accept an unstructured world, and suffer the enormous anxiety and confusion that it produces. But such a solution may disintegrate and disorient communities and even individuals. It may also result in uncontrolled power, both governmental and private, a mix of benevolence and despotism, but with no principles and no guidelines.

Let us muddle through in search of a balance. Let America look for a balance. Let self-interest balance with altruism, let taking balance with giving, and commitment to the self with a commitment to society. Moral and self-limiting behavior is not stupid behavior. It offers rewards. Law is not the enemy of business. It is the enemy of crooked business. Law does not undermine free markets. It protects free markets.

Society and its leaders reflect each other. In this American strong democratic society, followers can lead. That is, if they get involved. If Americans had enough of what they have seen lately. If they want a society in which relationships are more honest and less cynical, more trusting and less doubting, Americans can reject a culture dominated exclusively by the self and the market’s self-protection. They can tell their leaders and
themselves to move towards an honesty society. The Economist has said it: “Making capitalism work well will never be easy. To make it work, shareholders must be seen to play a wise and active role in governance. That would certainly be the best way to restore faith in top business bosses. To excel, good corporate leaders need good owners.”

JUST PICK AND FOLLOW THE GOAL OF HONESTY AND TRUST

Just aim at honesty and trust. We will disagree on the details, but no matter; so long as we care about trust and honesty and as long as most people factor-into their decisions the component of honesty and include in their considerations the society at large. The problem, as this book shows, is not the definition of honesty and trust. The problem is that too many people and too many leaders have abandoned trust and honesty as a goal.

Aiming at honesty and trust, among other goals, could serve to control and mitigate the inhumanity, cruelty, despotism, and rational unreasonableness that any view of the world in vogue is likely to produce. Following this goal, we can maintain the insights of economics, yet restrict manipulation, deception and abuse of trust. The vision can pull us back from a culture of con artists towards which we have been sliding, and lift us towards a truthful and more efficient culture. Like a toddler, we might even take a few steps towards this vision, muddle through and oscillate on the road to the world we will never reach.

The cynics may say: "Wake up! Be realistic! You are talking of people, not angels." That is true. But neither are most Americans cruel predators, self-centered beings lacking in empathy, and greedy to embezzle other people’s savings by deception. Many Americans would like to see their corporate and financial world in the better light of trustworthiness. They may even be willing to receive less but true returns on their money. The danger and damage of white-collar criminals to society can be abated if a sufficient number of people believe in an honest society, expect everyone to follow, and apply social sanctions on those that do not follow. Then, abusers of trust are likely to remain in the minority, always in the shadows; never emerging to lead in the light.

The critics would say: "This approach eliminates competition. It endangers America's prosperity and way of life." Yet Americans need not cease to compete. The goal of honesty is not to reduce competitive ardor but to channel it to less destructive ways. Honesty encourages competition on the merits and prohibits competition by cheating. Honesty brings better quality of products and services and less shoddy products fake services. If businesses do not compete on fraud, they can be more successful in gaining customers. More likely, the ambition towards an honest society will lead America to a better mix of preventive mechanisms, and to the middle of the road, rather than to the extremes.

Aim at an unreachable goal. Accepting and trying to reach an unreachable ideal is not new to America. American people have relentlessly aspired to unachievable goals. And they have produced a free society and an economy that is the envy of the world. The
real test for an honest and efficient society is not what the society has achieved, but what
it aims to achieve. A society can put honest people on the pedestal, even if they do not
maximize their own personal benefits and preferences. It can discard and shun as models
of failure dishonest people who achieve their highest ambitions by fraud and abuse of
trust.

If we substitute the word “honesty” for the statement of Senator Moynihan about
crime in America, his words say it all: Honesty is not “revealed truth nor yet a
scientifically derived formula…It is simply a pattern that we observe in ourselves. Nor is
it rigid.” As we have been redefining honesty downward, we are “getting used to a lot of
behavior that is not good for us.” If the analysis in this book wins acceptance, and if the
readers feel a sense of “genuine alarm” at what has been happening to our measure of
trust and honesty, “we might surprise ourselves how well we respond to the manifest
decline” of the American business morality.

The one thing on which we need not compromise is the ambition to become an
honest society and have our society reap the rich rewards of honesty. This ambition is an
idea, yet it can shape the building block of our culture and our reality. Being an idea, it is
fully within our control -- powerful and empowering. We can mold it any way we want.
It is Utopia, which we cannot reach. But it can guide life every day. "A man's reach
should exceed his grasp," wrote Robert Browning. A society's reach towards honesty
should exceed its grasp as well. It is not reaching that ideal, but striving towards it, that
makes an honest society.¹