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# **CHEATING**

**THE ORIGIN, NATURE, IMPORTANCE  
AND IMPROVEMENT  
OF BUSINESS AND OTHER ETHICS**

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Professor Frank's solution is to tax harmful behavior not to prohibit it. Those that can afford the tax will finance the government but the harmful activity by others less wealthy will be discouraged by taxation.

## **9. DOES ETHICAL CONDUCT PAY?**

This question is difficult to answer because it is not easy to prove one way or the other since unethical conduct is usually hidden. However, in major business enterprises there are few open advocates for unethical dealing because it adversely affects the business's reputation, weakens employee morale and can create large potential risks for the business if the activity is not only unethical but illegal.

There have been many examples in the press where unethical conduct has been extremely costly to countries, companies and many individuals. Recent events in the U.S. relating to Enron and World Com are examples where the real financial condition of the business was not apparent to investors because of lack of transparency and questionable accounting practices which resulted in overstating earnings.

This situation with Enron in the U.S. arose recently after development of new trading markets with high risks. Significant speculation in a more competitive stock market with vanishing margins in some companies pushed business executives into unrealistic and dishonest accounting to maintain earnings, which, when discovered, provoked a steep downturn in the market for its stock and substantial losses for shareholders, including numerous pension funds. For workers, their jobs disappeared. In contrast, many top executives made millions of dollars selling shares based on insider knowledge before the fall. Some criminal indictments and jail sentences have been secured and law suits alleging illegal or insider trading, fraud and other legal theories have been filed and settled for large sums. Even so, unethical conduct may still have been profitable for some corporate executives as it appears to have been for

"Chainsaw" Dunlop who misled shareholders and the public when he was an executive in the Sunbeam Company and several other companies he managed. However a company which purchased Sunbeam in good faith recently recovered a judgment for 1.45 billion dollars from an investment bank which helped arrange the sale, based on its negligence in failing to inform the purchaser of its much reduced value.

Another situation occurred in 2000 in the Philippines, resulting in the attempted impeachment of President Estrada for unethical conduct and his subsequent forced resignation. This type of behavior undermined confidence and adversely affected the Philippine stock market when insider trading was suspected.

Illegal bribes win contracts which should be awarded following fair competitive principles. Such illegal conduct costs consumers more since the cost of illegal payments is passed on to them through higher prices. The U.S. Foreign Corrupt Practice Act criminalizes such activity for U.S. corporations.

Other examples of costs incurred by unethical conduct in France are recounted in a book entitled *Le coût de la non-éthique* (The cost of being unethical), Cercle Ethique des Affaires, October 1996, i.e. the hugely costly Crédit Lyonnais scandal which cost French taxpayers billions of French francs and which almost destroyed what was a leading international bank in the early 1900's. However, it should be noted that this was a government-owned bank, not a private enterprise.

Finding examples of where unethical conduct has profited immoral businessmen is much more difficult to locate or measure because, where successful, the situation is usually kept secret unless a scandal destroys secrecy.

Perhaps one exception is the business activities of the Italian mafia which has a long history and prospered in Italy and spread in the United States over a period of many years.

In these cases, bad ethics seems to have been profitable, although sometimes highly risky for its practitioners. Unfortunately such illegal businesses are widespread in many countries and sometimes move into legitimate businesses with their illegal methods, which make them even more difficult to suppress.

***Warren Buffet – Honest Business is Fun***

Warren Buffett, a leading American billionaire businessman, declined to make the judgment that crime does not pay in business dealings. He said "I won't say crime doesn't pay. But crime is not necessary and is not as much fun"<sup>186</sup>.

Unfortunately, there is, in both developed and less developed countries, corruption and unethical conduct which leads to the conclusion that our societies are still insufficiently ethically developed and law enforcement too weak, so crime and unethical conduct unfortunately often seems to reward the individual wrongdoer. Less developed countries and former communist states are often in worse shape. Ethics, development and democracy are hopefully improving and are refined over the long run although there are periods of back-sliding as well, in particular when there is a boom followed by a crash in the stock market - which is up to now a periodically recurring situation in a free enterprise economy.

One attorney active in business has estimated that in his community one-third of the businesses have activities or operating procedures that are not up to ethical standards.

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<sup>186</sup> Harvard Law Record. Apr. 10, 1998. *Buffett's Quotations*. Page 5.

***Amartya Sen<sup>187</sup>: Do Ethics Make Economic Sense?***

The following ideas were expressed by Amartya Sen, a Nobel Prize-winning economist. In contrast to Milton Friedman (another Noble Prize winner), Sen has a different view on the role of profit seeking by corporations in modern economies. The different opinions of these two notable economists are rooted, to a considerable degree, in contrasting views of ethics.

Sen begins by questioning the source of the idea that business has no need for ethics. Sen points out that in both eastern and western thought ethics has been seen as integral to business transactions. Sen traces the idea that there is no connection between ethics and business to a misinterpretation of a famous passage by Adam Smith which reads as follows:

“It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love”. See Smith, Adam, *An Inquiry into the Nature and Causes of the Wealth of Nations*.

This widely quoted passage has been interpreted as showing that markets can function solely on the basis of self-interest. Concern about others is unnecessary. Hence, ethics is simply not needed in business.

Sen argues that this reading of the passage misinterprets what Smith thought about ethics and business. He makes three important points to show the limits of pure self-interest in the market.

1. While self-interest provides effective motivation for the butcher, brewer, and baker to produce goods, a

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<sup>187</sup> “Does Business Ethics Make Economic Sense ?” by Amartya Sen, *Business Ethics Quarterly* 3, no. 1 (1993): 45-54. Also see Bunting, Madeleine, *Global Development* [www.theguardian.com/world/2013/jan/16/Amartya-Sen-india-dirty-fighter](http://www.theguardian.com/world/2013/jan/16/Amartya-Sen-india-dirty-fighter).

market also needs trust and confidence to function efficiently. For example, how much bread would a consumer buy if there was a suspicion that the baker substituted rat poison for flour because it was cheaper? [...]

2. Well –functioning economies need public as well as private goods. Public goods are essentially goods that are shared as opposed to private goods which are not shared. To a considerable extent, it is other-centered considerations that drive the production of public goods, rather than personal gain.

Sen offers some examples: one example of a public good is an epidemic-free environment. Since public goods are essentially shared, there is a significant free-rider problem. Air pollution is an example of a public bad.

3. In the distribution of goods, there are important non-self-interested motivators. People care very much if they don't receive their fair share of credit; they may well be outraged if they are unfairly blamed. Furthermore, many people are motivated by a desire to do good for others, say by contributing time or money to help flood or earthquake victims.

Finally, Sen says that there are two ways one can connect business and ethics. One is in a purely instrumental sense; the free market system needs a significant amount of ethics to function [...]. The other is out of intrinsic concern for such ethical values as fairness, the well-being of others, and a personal sense of integrity.

Sen has also written that economic growth without investment on human development is unsustainable and unethical. His work has contributed to the UN Human Development Index.

### ***Armand Hammer - A Successful Unethical and Criminal Businessman***

In John Richardson's book, *Sacred Monsters Sacred Masters*, published by Random House in 2001, he has rewritten a series of essays he previously wrote mostly about painters and collectors of art he has known personally "either because their genius, quirkiness or villainy intrigued me [...]". In pages 268-288 he describes Armand Hammer, a businessman villain who was extremely successful in business, often on TV as a business leader, flew around in a luxurious jet and had a reputation as a genius philanthropist.

Richardson worked for Hammer's company, M. Knoedler & Co, an illustrious firm of international art dealers.

In his essay he writes "at first I was fascinated by Hammer, watching him fabricate something out of nothing. The boasts, the lies, the corners he cut!

I was also fascinated by Hammer's ability to persuade a great many people who should have known better. Deng Xiao Ping, [...] Edward Heath, Menahem Begin, [...] Leonid Brezhnev, John D. Rockefeller and Henry Kissinger [...] Hammer would have you believe he was one of the most farsighted entrepreneurs of his day who had built Occidental Petroleum [...] from nothing into a \$21 billion company, that he had brought off the deals of the century [...] with the Soviet Union and China [...] and he was the last great collector. This was virtually all a sham contrived out of smoke and mirrors and bullshit".

According to Richardson it was not until twenty years later after a brilliant investigative book by Edward J. Epstein who taught at MIT and other top schools: *Dossier: The Secret History of Armand Hammer*<sup>188</sup>, did he appreciate

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<sup>188</sup> For a summary of *Dossier: The Secret History of Armand Hammer* by Edward Joy Epstein see <http://www.freerepublic.com/forums/2661957.htm>  
*Gore Family Ties* by John Ervin. Find articles/News/Insight on the news, May 22, 2000.

the extent of Mr. Hammer's dishonesty. Epstein was an accomplished political scientist who explained how Hammer bought politicians like Al Gore Sr. and Jr. and how they were in his pocket – sort of business associates who received stock in Hammer's company Occidental Petroleum, the 4<sup>th</sup> largest in the United States. Hammer's father Julius (probably a spy for Russia) taught his son how to be a communist and a capitalist expert in all the dirty tricks. President Bush pardoned him for his conviction for making illegal contributions to Richard Nixon's election campaign. So he "bought" both Democratic and Republican politicians.<sup>189</sup>

So if one considers the case of Arnaud Hammer, one could conclude dishonest, criminal, unethical businessmen sometimes are extremely successful in business and still maintain good public reputations probably due to their charitable activities. What percentage of successful businessmen are dishonest? Half?

### ***Clement's Unethical Blue Chips***

Ronald W. Clement in his article *Just How Unethical is American Business?*<sup>190</sup> concludes that as of 1999, forty corporations in the Fortune 100 had reports in the press relating to accounting, securities or consumer fraud, discriminatory practices, undisclosed executive pay, questionable practices or patent infringement. The author lists the names of companies having the most unacceptable behavior as follows: Philip Morris (Altria), Lorillard (Loews), Merck, Ford Motors, MCI, WorldCom, Enron,

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<sup>189</sup> The author is grateful to Gail Messiqua for referring him to John Richardson's book which initiated his research on Armand Hammer. Hammer has been the subject of five more favorable biographies: in 1975 (Considine, authorized biography), 1985 (Bryson, coffee table book), Weinberg, 1989, Blumay 1992, and Epstein, 1996 – and two autobiographies (1932 and a best seller in 1987).

<sup>190</sup> Clement, Ronald W. 2006. *Just How Unethical is American Business*. In "Business Horizons", No. 49, pp. 313-327. HBS Publishing.



Citigroup, J.P. Morgan Chase, Bank of America, Time Warner, Boeing, Exxon Mobil, Prudential, Microsoft.

### ***Game Theory***

Experiments in game theory on computers indicate that the tit-for-tat program wins when it uses cooperation for the first move and then plays whatever the other player chooses on the previous move. Its success was due to its being nice (not the first to defect), "provocable" (responding to the other player's decision with a defection), forgiving (punishing and then cooperating after a defection) and clear (easy for the other player to understand). Increasing the number of players tends to make cooperation more difficult<sup>191</sup>. Does this mean cooperation and ethical conduct in larger groups is more difficult and less likely? That is the conclusion of economist Mancur Olson who notes that in small groups one who contributes to the common good at his own expense shares more than he would if his contribution were made to a very large community, perhaps a more "ethical" act because his share of the common good is negligible (Mancur Olson, p. 71).

In conclusion, unethical conduct may pay for some individuals, companies and governments in some circumstances and especially in the short term, where the gain is very high compared to the risk and "cost" of being punished by the business community or the government, or when the unethical conduct remains a secret. But generalized ethical conduct in society makes the society work better, which directly or indirectly benefits the individual.

### ***Sometimes Ethics Pays. Sometimes Crime Pays***

The answer to the question "does crime pay" asked above depends upon the context. The examples given in the

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<sup>191</sup> Axelrod, Robert and Dion, Douglas. December 1988. *Further Evolution of Cooperation*. Science, Vol. 242, pp. 1385-1390.  
<http://poverty2.forumone.com/library/view/7043> (viewed 26 March 2007).

paragraphs above show how varied and nuanced the answer can be.

#### **10. CAN ETHICS BE ENFORCED? RELATION BETWEEN ETHICS (MORALITY), LAW AND JUSTICE**

Minimum ethics tend to be enforced by law where the law is effectively enforced. Some individuals are selfish, envious, greedy, avaricious, violent and not always intelligent, so civilized societies need minimum rules of conduct enforced in practice by some authority. This authority is usually the State, the usual provider of justice through application of legal procedures. Some state power is practically non-existent like in Somali where powerful leaders enforce their rules more effectively.

Justice can be harsh and severe like in the Old Testament. Or it can be more merciful and human. In either case it is closely related to ethics. This is obvious after one reads the leading books on Justice: “Justice in Robes” by Ronald Dworkin (2006), Justice What’s the Right Thing to Do? Mitchel J. Sandel (2009) and “The Idea of Justice by Amartya Sen (2009). Ethics and Justice are adjacent concepts. Justice perhaps has a more public side than ethics and often implies enforcement in court. Aristotle wrote about justice and ethics. His justice is closely tied to citizenship and the good life<sup>192</sup>. A company's reputation depends in part upon how it applies social justice in dealing with employees and other third parties.

A leading scholar has written that the concept of justice arose in ancient Greece<sup>193</sup> when there were conflicts and disputes between the noblemen and the common people when the latter's economic position improved.

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<sup>192</sup> Sandel, Mitchel J. 2006, Justice.

<sup>193</sup> Jaeger, Werner. 1979. *Paideia: The Ideal of Greek Culture*. Oxford University Press, pp. 102-104.