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La confiance est cruciale pour le bien être du système financier et de l'économie. Toutefois, aujourd'hui, on accepte et on justifie plus facilement les comportements malhonnêtes.

La culture de la malhonnêteté et de l'abus de confiance est dangereuse. Si la malhonnêteté est acceptée parce que « tout le monde le fait », celle-ci peut devenir une habitude sociale très difficile à modifier.

L'alternative à la confiance est la vérification. Toutefois, la vérification et les précautions peuvent avoir un coût très élevé.

Trust is crucial to the health of the financial system and the economy. In the past, when most trade and finance were conducted by people who knew each other, trust or mistrust developed naturally. In small communities, sanctions, like exclusion, could be a powerful means of preventing abuse of trust. But today, in a global financial system, people are forced to interact with strangers, and trust cannot be established as it was in the past.

What is the state of trust in the financial system today? When I was writing the book on *Trust and Honesty, America's Business Culture at a Crossroad* (published in 2006), I found a significant change in people's attitudes towards honesty and trustworthiness. There is no proof that there are more incidents of fraud today than there were in the past. America has always had its fair share of scandals and fraud. It has had its Robber Barons and medicine men who defrauded gullible people in small towns. It has had many corporate and financial frauds throughout the ages. I cannot prove that there is a change in the number of frauds today compared with the past.

What has changed, however, is the attitude towards dishonesty and breach of trust. Today, there is great

er acceptance and more justification of dishonesty. In some cases, we have legitimized what in the past would have been considered an abuse of trust. And, moreover, the potential victims are required to protect themselves from abuse. This new and very dangerous trend leads to a culture of dishonesty and, in some respects, this cultural change is far more serious than an increasing number of cases of dishonesty.

Culture considered as social habits

I define culture as social habits: it is how people expect themselves and others to behave. We don't give much thought to this expectation; it is not questioned or examined. In fact, people can rarely imagine any other way of doing things than the habits of the society in which they live. Culture often includes social enforcement of these expectations. If people expect others to tell the truth, then liars will be ostracized. If people are used to hiring assassins to kill their competitors, self-protection, deep mistrust and killings are part of the culture. Like all habits, social habits are efficient. People need not think about how to behave, or how not to behave. They need not

La confiance est soutenue par plusieurs mécanismes, parmi lesquels il y a la moralité, les lois et le marché.

Le comportement moral est valorisé parce que sa mise en application est la moins coûteuse pour la société.

De plus, des tendances psychologiques telles que la honte, l'empathie et la culpabilité, retiennent la plupart des gens de faire du mal aux autres. Toutefois, une culture qui dénigre et ridiculise ces tendances peut affaiblir leur effet dissuasif.

Alors que la loi peut faire obstacle à la malhonnêteté, son influence s'est affaiblie ces trente dernières années.

weigh the pros and cons. They can act quickly and automatically. Yet habits are far from perfect. They are hard to develop. It takes many repetitions before peoples' actions and attitudes are established and become habits. Moreover, habits can be bad, or can become bad with a changing environment. Because culture is ingrained, it takes time and effort to change. Tendencies to bad habits must therefore be strongly discouraged before they can become habits.

That is why a culture of dishonesty and abuse of trust is so dangerous. If dishonesty is accepted because 'everyone does it', the acceptance might freeze into a social habit and would then prove very hard to eliminate.

Trust and alternative verification

Trust can be defined in many ways. I define it as the 'reasonable belief that trusted persons: (1) tell the truth and (2) keep their promises'. An alternative to trust is verification. If people did not show trust, they would seek to verify the other persons' statements, and demand guarantees to back the others' promises. However, verification and guarantees can be very costly. If we measure trust and verification by cost, we can determine when trust is necessary and when it is less important.

For example, buying a newspaper does not require trusting the seller. The buyer can easily verify that the newspaper is the one the buyer wants. And because the exchange of price

for newspaper is simultaneous, there is no need for guarantees. Besides, the amount involved is not very large. In this case the buyer can protect his interests. But if I hand over my life's savings to a money-manager, I have no choice but to trust the manager. It is nearly impossible for me to verify what the manager will do with my money without negating the very usefulness of his service. In addition, entrusting the money and receiving the service are not simultaneous. I entrust my money to the manager first; only then can the manager perform his service for me.

Therefore, I am at risk that the manager might be tempted to avoid telling the truth or abiding by his promises. In addition, the amount of money involved here could be large and the risk of losing it may affect my future. In this case I must trust the manager and I may demand guarantees or regulation to reduce my risk of loss. If I cannot trust him, I had better not entrust my savings to him. Trust in this case must be supported by other mechanisms that protect from dishonesty.

Morality as a barrier to abuse of trust

As I have already mentioned, there is a greater acceptance of dishonesty today. The danger is that this attitude could become part of the American or even universal culture. Abuse of trust, and the mistrust that follows, can undermine commercial and financial interaction, and drastically change our way of life. Trust can

Selon une conviction répandue parmi les membres du Congrès américain, moins il y a de lois, plus est grande la liberté du secteur privé et du management financier, et donc mieux l'Amérique se porte.

Dans les trente dernières années, la moralité et les lois ont reculé devant à la régulation du marché par lui-même.

L'idée de régulation du marché part du principe que l'information et l'éducation sur les questions financières et sur le système financier permettent aux investisseurs de prendre librement les bonnes décisions.

be supported by many mechanisms. Here I shall focus on just three: morality, law and the market.

The first of them, morality, is voluntary. Moral behaviour is self-regulating rather than enforced -when good behaviour is imposed by the threat of punishment, the behaviour is no longer moral. We value moral behaviour because its enforcement is the least costly to society. Moral people will do the right thing even if there are no police around. Police are an expense to society; they can also cause problems of abuse of power. So self-enforcement of social rules is a better option.

Morality can be taught. Usually, it must be taught at an early age, at home and in school. Some studies show that morality is part of our genetic make-up, together with our drive to survive. There are psychological tendencies, such as shame, empathy and guilt that induce most people to avoid harming others. However, while most people have those feelings, culture can strengthen or weaken them. A culture that denigrates and ridicules shame, empathy and guilt, can weaken them. So can a culture that emphasizes opposite drives, such as rational self-interest as the best guide to human behaviour, benefiting both individuals and society.

Adam Smith recognized morality, caring for others, and love. But this part of his teachings has been distilled and his name is forever associated with a different approach to economics and understanding of markets. Thus, morality and the feel

ings that restrict antisocial behaviour – the most effective and least expensive form of trust enforcement -have been weakened.

The law can serve as a barrier to dishonesty but, in the past thirty years, respect for the law has eroded. Some courts have interpreted law narrowly and literally, avoiding any consideration of policy, which is what they used to do in the past. That left room for self-interest without a balance of societal interest. In addition, Congress has been populated by members who believe that the less legislation, the greater the freedom of private sector corporate and financial management, the better off America would be.

The law supports trust

A few years ago, Congress imposed constraints on corporate power and gatekeepers, by enacting the Sarbanes-Oxley Act. This Act was passed in reaction to massive frauds in large corporations. However, when the shocked reaction to these frauds subsided, business leaders, lawyers, and academics sharply criticized the Act as imposing unnecessary costs on business. That may to some extent be true, but this ferocious and concentrated attack suggests that the pressures to curtail the field of application of law that began in the mid-1970s are still at work.

In the past thirty years, morality and law have lost ground to market regulation. The idea of market regulation was that people should be offered information and should be edu-

Tout le monde devrait pouvoir emprunter autant qu'il le souhaite, s'il trouve quelqu'un qui veuille bien lui prêter l'argent.

Les régulateurs ont suivi la tendance. Ils ont adopté une attitude permissive envers les innovations financières, en les dégageant des contraintes légales sans toutefois contrôler comment cette liberté était utilisée.

Dans la pratique, la théorie n'a pas marché précisément comme espéré. Il peut ne pas être suffisant d'offrir des informations aux investisseurs, notamment quand l'information est complexe et les erreurs potentiellement désastreuses.

La régulation financière est soutenue par des mécanismes destinés à maintenir la confiance. Mais, pendant les trente dernières années, ces régulateurs n'ont pas réussi à assurer la confiance et l'honnêteté sur les marchés.

cated about financial matters and the financial system. As a consequence, they should be free to choose advisers. They should be free to decide what investments are good for them. Government should not determine that an investment is too risky for anyone. No court should decide that an offer of risky securities is fraudulent, so long as true information was provided publicly. No one, including individuals and corporations, should be restrained from borrowing as much as they wished, provided they find someone prepared to lend to them.

The third mechanism: the market

The regulators followed the same trend. They took a permissive attitude to financial innovation, freeing it from legal constraints but not following up to discover how the freedom was used. Regulators believed that market signals were better than government planning for the economy. The aggregate judgment of millions of investors, even if many of them were not experts, was more accurate than the judgment of a few experts.

However, in practice, the theory did not work precisely as was hoped. Providing information to investors may not prove enough, especially when the information is complex, and mistakes can be disastrous. Investors' self-education is not optimal when it is time-consuming, and when financial intermediaries send out signals of trustworthiness. Moreover, the requirement of self-pro

tection signals the opposite of trust: 'Don't rely on others'.

Market regulation is supported by mechanisms designed to maintain trust. Most important are the lawyers, accountants, advisers, financial planners, analysts, rating agencies, and appraisers. During the past thirty years, these gatekeepers have failed to ensure trustworthiness and honesty in the markets. One reason for their failure is that these gatekeepers turned their main focus from gate-keeping to profit-making - they have become businessmen.

This conversion of gate-keeping professionals to businesses in pursuit of monetary profits as their main mission undermined a crucial element required in maintaining market regulation in support of trust. Gatekeepers should view their main mission as preventing illegal actions. Instead they focused on profit-making.

In 1979, the Supreme Court of the United States overruled the long-term practice of the legal profession that prohibited lawyers from advertising and required them to charge fixed fees for various services. After 1979, lawyers could compete for business and charge different fees. The presumption was that in a free market, lawyers would compete to provide potential clients with more information and charge reduced fees.

The results were disappointing. Legal fees went up, not down. Lawyers became far more like businessmen, and competition did not result in higher quality services. In fact, it

En effet, ils ont délaissé la surveillance des marchés pour se tourner vers le profit.

La tendance a été de réduire la pression exercée sur les opérateurs pour les laisser s'autoréguler, et en même temps de demander de se protéger elles-mêmes aux victimes potentielles d'abus.

La conviction que le marché peut contrôler la malhonnêteté et que l'autorégulation doit se substituer à l'action des gouvernements est basée sur le postulat de l'aptitude du marché à « remédier » à ses propres problèmes.

La question n'est pas de savoir si le marché est en mesure de « remédier » aux abus, mais si ces remèdes ne sont pas trop coûteux et s'il ne vaut pas mieux poser certaines limites dès le départ.

lowered the quality. Gate-keeping was subverted. Some lawyers provided clients with innovative loopholes in the law, all at a price. Market focus on 'let the other party protect itself from me' took hold.

Thus, the trend of the last thirty years has been to strengthen the markets, and consequently, require trusting people to protect themselves against abusers of trust. The trend has been to reduce the pressure on trusted persons to self-regulation or to obey the laws that restrict and prohibit the abuse of trust. These conditions led to the flight of trusting people from the financial markets and had a devastating effect on the economy.

Can a market regulate dishonesty?

The belief that any market can regulate dishonesty and that market regulation should trump government regulation is based on an assumption that the market can 'correct' problems of dishonesty as they arise. After all, it took a few months for the shares of Enron Corporation to fall from approximately \$78 to about 19 cents. There are always some trendsetters, who lead the correction. It may well be that regulators react faster than the market, and prevent some of the losses that market corrections might cause.

However, even if this is the case, government regulation has flaws. Regulators do not know the unintended consequences of their actions; regulation may inhibit innovation;

and, therefore, in the long-run regulation may create greater problems.

Yet the cost of market solutions and resolution of problems can be very high. In the case of the Enron Corporation, the losses to Enron's shareholders -individuals and institutional investors, such as pension plans -were enormous. Today, there is indeed 'market correction' of excessive borrowing and risk taking. There is market correction of innovations that were not well tested and those that led to deceit and abuse of trust. However, the price of such corrections to the country is proving to be devastating.

The issue, here, is not whether markets can regulate behaviour. The issue is the price that the financial system and the economy pay for market regulation. In fact, today the markets are correcting the excesses of the past twenty-five or thirty years. Lending and borrowing have stopped altogether. Excess leverage has reached melting down point. Speculation has been replaced by a frantic search for security, liquidity, and lower risks. Yet, before these 'corrections' took place, the market allowed financial intermediaries to provide enormous leverage, and take incredibly high risks, only to result in similarly drastic 'corrective measures'.

Therefore, the issue is not whether markets 'correct' behaviour that undermines trust, but whether market corrections are at times too costly and whether less initial freedom might lead to lower correction costs. Of course market regulation has a place. But its place has been expanded and the right

La régulation du marché par lui-même présuppose que les personnes qui confient leur argent à des professionnels se prémunissent contre des fraudes possibles de la part de ces derniers. Cela conduit à une inévitable baisse de confiance.

Ceux qui font appel à la confiance sont délaissés par leurs clients et les marchés financiers eux-mêmes, fondés sur la confiance, en sont ébranlés.

Les marchés qui font appel à la confiance disparaissent parce que l'autoprotection y est trop chère et la connaissance personnelle des autres parties pratiquement impossible.

La question cruciale aujourd'hui est donc le déclin de la confiance dans le système financier.

balance between market, morality and law has been lost. What is the best balance of morality, law and market regulation? The balance is not clear. There are disagreements on whether markets and competition enhance or undermine morality.

An inevitable reduction in trust

Morality - self-restraint - conflicts with market competition - the drive to get ahead of others. Yet, while markets and morality can weaken each other, they need not undermine each other. With cutthroat competition markets would not survive. Total self-restraint may also be destructive to markets. Long-term competition involves self-restraint. A similar balance can be sought in the law.

What is clear is that the degree of expanding market regulation has not been justified. Market regulation shifts the burden of maintaining trust from 'trusted persons' to 'trusting persons'. Market regulation requires trusting persons to protect themselves against fraud of the people to whom they entrust their money.

The result is an inevitable reduction in trust by these vulnerable persons. And when their self-protection is weak, and morality of trusted people weakens as well, the shift to market regulation is likely to be accompanied by an abuse of trust. Freedom from supervision of trusted people poses great temptations. When this freedom and rejection of legal constraints are accompanied by theo-

retical justifications, abuse of trust is likely. This abuse may become cultural. It is then no longer called abuse. The behaviour is accepted and justified because 'everyone does it'. What used to be considered as abuse can be legitimized by denigrating the law, and even explicitly amending it.

Consequences of mistrust

Trusting people do not cease to trust on the first doubt or signal of abuse. But at some point abuse and unexpected large losses will cause a breakdown in trust. People who were unable to protect themselves from abuse learn their lesson. Those who could protect themselves, but did not, also learned their lesson. And people who have learned self-protection will tend to mistrust. In the end, all flee the market. It is then that those who rely on being trusted are left without clients, and the financial markets that are founded on trust crash and are decimated.

To be sure, markets continue to exist. However, they exist among parties who can protect themselves from the abuse of others or who have good reasons to trust. Deals are made by people who have known each other, usually depend on each other, and therefore can enforce the trust in each other. The markets that disappear are the markets in which trust is necessary because self-protection is too costly and personal knowledge of the other parties is almost impossible. These markets no longer function. The trusting people flee from them. This is the situation we have reached today.

La confiance est une conviction. Si elle est perdue, la personne ou l'institution qui veut la rétablir doit donner un accès immédiat aux données concernant les opérateurs. La personne qui se risque à nouveau sur le marché ne doit pas avoir à chercher des garanties. On doit les lui offrir.

La seule chose pour laquelle il ne faut accepter aucun compromis est l'ambition de devenir une société honnête. Cette ambition peut guider notre vie de tous les jours.

Il faut qu'une pression sociale s'exerce pour faire honte à ceux qui se vantent de leurs gains réalisés sur le dos des autres. Il faut bannir les gens qui ont abusé de la confiance des autres. Ne les laissons pas être nos leaders !

Although financial problems are closely related to correcting market imbalance, the crucial issue today is the failing trust and confidence in the financial system. No matter how much money the government might pour into the banks; no matter how strongly it will support market institutions and large corporations that borrowed more than they can repay, these actions are insufficient to restore trust in the system and its intermediaries. Ironically, the government has taken over much of the financial system and said: 'trust me'. Yet, even those who have the cash to offer liquidity to the starving markets are loath to invest in the market because they do not trust the intermediaries or the market prices. The U.S. government's decision to support tottering banks did not bring the stock market prices up. In fact, stock prices fell!

An essential ambition

There are, of course, many advisers and much advice on the subject of restoring trust. One source for research is the definition of 'trust'. After all, trust is a belief. If trust is lost, the person or institution that wishes to restore it must offer free verification. The trusting person need not seek proof. The trusted person must offer it. In general, moving towards more stable trust and honesty requires changes in the culture; and changes in the culture require altering aspirations and assumptions on acceptable behaviour. We need to change a number of fundamental beliefs. First, benefits to individuals

or to a few corporations do not necessarily constitute benefits to larger groups of individuals and the country. What is good for General Motors is not necessarily good for America. There is a balance between individual and societal benefits. The balance cannot always be achieved by self-interest and conflict but most often, by a commitment to the other party's benefits. This commitment is expressed by honesty and trustworthiness. This is where the culture must lead if we are to restore trust in the financial system and the economy.

So here I make a leap to aspirations. We may have to compromise on the details. But the one thing on which we may not compromise is the ambition to become an honest society. This ambition is an idea, yet it can shape and become a building block of our culture. Being an idea, it is fully within our control -powerful and empowering. It may be a Utopia, which we cannot reach. But it can guide our daily life. Let the social pressures shame and prevent people from bragging about their gains at the expense of others. Let people who have abused trust be shunned. Do not let them be our leaders. Follow those who are not afraid to say: 'I try my best to be honest. I want to live in a society of honest persons. I will not take advantage of others even when I can, and even when it is perhaps permissible under the law, and even if I give more than I can take'. This would enable our society and economy to become far more prosperous and secure than they are today. •

