Local Ethics in a Global World

by

Meir Statman
Glenn Klimek Professor of Finance
Santa Clara University
Leavey School of Business
Santa Clara, CA 95053
mstatman@scu.edu

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Abstract

Ethics, fairness, trust and freedom from corruption are all parts of social capital and social capital matters in financial markets because investors consider not only their tradeoff between risk and return based on available information but also their trust in the accuracy of information and the fairness of markets. Deficiencies in ethics and fairness mark all countries but such deficiencies are more pronounced in some countries than in others.

Levels of corruptions are higher in some countries such as India, than in others, such as Australia. Rankings by perceptions of the fairness of insider trading generally follow rankings by corruption. A survey presented in this article shows that finance professionals and university students in India, Turkey, Tunisia and Italy perceive insider trading fairer than professionals and students in Australia, the Netherlands, the United States and Israel.

Why are levels of corruption higher in some countries than in others? Why is insider trading considered fairer in some countries than in others? And what can institutions, such as the CFA Institute, do to improve levels of ethics and fairness? These are the questions I try to answer in this article. I discuss four factors that affect social capital, culture, income, education and law enforcement.

Local Ethics in a Global World

Investors eager to diversify globally are tempted to adopt Thomas Friedman's vision of a flat world where India looks very much like the United States, complete with shiny glass-and-steel buildings bearing the names of Microsoft and Goldman Sachs. But the world is not quite flat yet. India's income-per-capita in 2004 was $620, a small fraction of the $41,400 per-capita-income in the United States. Moreover, the level of corruption in India, measured by the Corruption Perception Index (CPI), is higher than that of the United States. India's score on the CPI, compiled by Transparency International in 2005, was 2.9 while that of the United States was 7.1. The United States, in turn, is not as free from corruption as Singapore which scored 9.4 or Finland which scored 9.6.

Ethics, fairness, trust and the freedom from corruption are all part of the social capital of a country and social capital matters in financial markets because investors consider not only their tradeoff between risk and return based on available information but also their trust in the accuracy of information and the fairness of markets. The experience of WorldCom, HealthSouth and Enron teaches investors that even information issued by United States companies cannot always be trusted, and their experience with the colluding behavior of NASDAQ's market makers and many reports of insider trading teaches them that they are not always assured of fair markets. Deficiencies in ethics and fairness mark all markets but such deficiencies are more pronounced in some markets than in others.

Ethics and fairness in the financial markets of a country are reflected, in part, in people's assessment of the fairness of trading practices, such as insider trading. What are the differences among countries in the assessment of the fairness of insider trading? Why

is insider trading considered more unfair in some countries than in others? And what can institutions, such as the CFA Institute, do to improve levels of ethics and fairness? These are the questions I try to answer in this article. I present assessments of fairness in financial trading by people in eight countries, from the United States to Australia, via Tunisia, the Netherlands, Italy, Turkey, Israel and India.

Social capital

Levels of social capital in countries have been assessed by surveys, experiments and examination of the law and its enforcement. For example, Treisman (2000) and Lee and Ng (2004) used the Corruption Perception Index and Knack and Keefer (1997) used the World Values Surveys of trust and civic cooperation.

Transparency International (TI) compiles the Corruption Perceptions Index from surveys of The Economist Intelligence Unit (EIU), The World Economic Forum (WEF) and similar sources. TI writes that "All sources generally apply a definition of corruption such as misuse of public power for private benefit, for example bribing public officials, kickbacks in public procedures, or embezzlement of public funds." For example, the WEF asks "In your industry, how common would you estimate that firms make undocumented extra payments or bribes…"

The World Values Surveys ask whether respondents in various countries think that people can be trusted. "Generally speaking, would you say that most people can be trusted, or that you can't be too careful in dealing with people?" Knack and Keefer recount experiments by Reader's Digest (1996) in which wallets containing approximately $50 in local currency along with photographs, names and phone numbers were 'dropped'

in various countries. They found that the proportion of wallets returned in each country was highly correlated with levels of trust.

Social capital matters in financial markets. Guiso, Sapienza and Zingales (2005) found that people who do not trust the fairness of the stock market are less likely to invest in it. Levels of trust vary from country to county and so do levels of stock market participation. For example, both trust and stock market participation are lower in Italy, India and Turkey than in Australia, the United States and the Netherlands. The law is not sufficient for the creation of social capital since dissonance between the law and rules of fairness weakens the legitimacy of the law and reduces the reliability of its enforcement. As Bainbridge (1999) notes, judges enforce "those policies and moral norms that have substantial support in the community" (p. 1636). Indeed, Bhattacharya and Daouk (2002) found that while there is no relationship between the existence of insider trading laws and cost of capital, there is a relationship between the cost of capital and enforcement of insider trading laws. Specifically, the cost of capital is lower in countries that were early in the enforcement of insider trading laws. Bhattacharya and Daouk observed the insider-trading laws are less likely to be enforced where there is no political will to enforce them. In turn, there is little political will to enforce insider-trading regulations in countries where substantial proportions of residents do not perceive insider trading as unfair.

Fair trading

How do people in different countries perceive the fairness of insider trading? Research collaborators and I administered surveys to university students and finance professionals in eight countries, Australia, India, Israel, Italy, the Netherlands, Tunisia,

Turkey and the United States. Subjects read vignettes and were asked to rate the fairness of the behavior of the people described in them.

One vignette presented to subjects the stylized facts of United States v. O'Hagan. The United States Supreme Court ruled that James O'Hagen violated the law prohibiting insider trading. James O'Hagan was a partner of Dorsey & Whitney, a law firm retained by Grand Met Company in July 1988 for help with a potential tender offer for the Pillsbury Company. O'Hagan did not work on the Grand Met offer but overheard a conversation about it at the law firm. He begun purchasing call options and shares of Pillsbury in August 1988 and sold then in October 1988 for a $4.3 million profit.

Subjects were asked to rate the behavior of "Paul Bond" who plays the role of James O'Hagan.

> Paul Bond is a lawyer at the Brown & Long law firm. One day while standing outside his office at Brown & Long he overheard John Grand, another lawyer at the firm, talking with an associate about his work on a proposed purchase of the Pillow company by the Down company for $120 per share. Paul Bond had no role in the work on the proposed purchase of Pillow and Brown & Long represented only Down, not Pillow. Paul Bond bought 1,000 shares of Pillow for $70 per share. Please rate Paul's behavior as:
>
> A) Completely Fair
> B) Acceptable
> C) Unfair
> D) Very Unfair

Subjects in countries outside the United States read the vignette translated into their languages and the vignette was modified to make it local. For example, Paul Bond in the United States questionnaire was replaced by Pesi Bhabha in the Indian questionnaire and amounts of money were adjusted to be equivalent to those in the United States.

The perception that insider trading is unfair follows the notion that fair trading is trading on a 'level playing field' where all traders have equal opportunity to access information. Special access, such as that available to insiders, violates the rules of a level playing field. However, a level playing field does not imply that all traders have equal information since some traders forego the opportunity to access available information. Moreover, the notion of fairness as a level playing field can be in conflict with a libertarian notion that fairness where people are free to trade anything they own, whether a car or inside information.

Only 5 percent of finance professionals in the United States and the Netherlands rated Bond's behavior as completely fair or acceptable, followed by Australia and Israel where 16 percent rated Bond's behavior so. The proportions of professionals who rated Bond's behavior completely fair or acceptable in Tunisia, Italy, India and Turkey were much higher, 41, 43, 49 and 56 percent respectively. (See Figure 1)

The order of the eight countries by perceptions of the fairness of Bond's insider trading generally parallels their order by freedom of corruption, trust, first year of enforcement of insider trading laws, and levels of participation in the stock market. For example, the correlation between the perception of Bond's behavior by finance professionals and freedom from corruption is 0.88 and the correlation with trust is 0.69. However, the order of countries by the various scoring methods does not match perfectly. For example, the United States is ranked third by freedom from corruption and by trust but it is ranked first by the perception of insider trading as unfair. Australia is tied with Italy

and Turkey by the first year of enforcement of insider trading laws but differs in the perception of the fairness of insider trading. (See Table 1)

What tools do we have to move markets closer to level playing fields? I discuss four tools, none quick or easy. They are changes in culture, higher income, better education, and more effective enforcement of the law, especially through the application of technology.

Self-interest and fairness

Leveling the playing field is difficult because it often conflicts with people's self interest. Leda Cosmides, an evolutionary psychologist, noted that self-interest and its reflection in cheating is universal and identified mental modules in our brains she called "cheater detectors". Allman (1994) quotes Cosmides saying "Many of the most important problems our ancestors had to face were social. They needed to know how to cooperate, how to respond to threats, how to participate in coalitions, how to respond to sexual infidelity, and so on the results is that the human mind contains a number of specific mechanisms that were especially designed by evolution for processing information about the social world. One of these mechanisms is a 'cheater detector.'" (p.40)

Self interest is so prevalent that it underlies the behavior of the 'economic man' of standard economic theory. As economist George Stigler (1981) wrote: "[When] self-interest and ethical values with wide verbal allegiance are in conflict, much of the time, most of the time in fact, self-interest-theory… will win." (p. 176). According to standard economic theory manifestations of self-interest are limited only by the 'cheater detectors' of others. Self-interest tempts borrowers to renege on their loans, but self-interest prompts

lenders to pursue them. And even lenders who eventually collect their loans brand defaulting borrowers as cheaters and refuse to extend further loans to them.

There is much truth in the portrait of people as self interested economic people. People everywhere look for low prices at grocery stores and everywhere some people trade on inside information or cheat on their taxes. But self-interest theory does not explain all economic behavior. Self-interest fails to explain why some people return lost wallets. Moreover, self-interest theory fails to explain why on average people in some countries, such as Norway or Denmark, are more likely to returns lost wallets than people in other countries, such as Italy or Switzerland.

Self-interest theory is especially challenged by the results of the Ultimatum and Dictator games. These games show that human behavior combines self-interest and fairness. The games also show that the balance between self interest and fairness varies not only from person to person but also, on average, from one country to another.

The experimenter in an Ultimatum game has a pot of money, say $1,000, to be divided between a Proposer and a Respondent who are anonymous to each other and will remain anonymous after the game is completed. The Proposer proposes a division of the $1,000 between him and the Respondent; say $500 for him and $500 for the Respondent or $800 for him and $200 for the Respondent. But the rules of the game specify that the proposal is an ultimatum. The Respondent can accept it, in which case the money is divided as proposed, or refuse it, in which case neither Proposer nor Respondent receive anything.

Self-interest-theory predicts that a Proposer would propose a highly unequal division of the $1,000, say $999 for him and $1 for the Respondent. The theory also predicts that a Respondent would accept the $1 proposal since $1 is better than nothing. But results of the Ultimatum game are inconsistent with pure self-interest. For example, Roth et al (1991) found that Proposers in Pittsburgh offered an average of 46 percent of the pot and most of them offered 50 percent.

Self-interest theory can possibly explain generous offers by Proposers as strategic. Proposers fear that less generous offers would be rejected by Respondents, leaving them with nothing. But self-interest theory cannot explain why many Respondents reject offers of 20 percent of the pot or even more. Concern for fairness explains such rejections. Respondents who reject 20 percent of the pot deprive Proposers of 80 percent of it and what Respondents lose in money they gain in fairness.

Moreover, results of the Dictator game show that fairness considerations, not only strategic considerations, play a role in generous offers by Proposers. Proposers in the Dictator game can dictate the division of money between them and Respondents and can keep all of the money if they wish. Frohlich and Oppenheimer (2001) found that Proposers in the Dictator game played in the United States offered 16 percent of the pot on average and Proposers in Canada offered 27 percent. These are less than the average offers in the Ultimatum game, but much higher than the zero offers predicted by self-interest theory.

Everywhere people combine self-interest with fairness, but there is substantial variation among people in the tilt toward self-interest or fairness. Frohlich and

Oppenheimer found that 47 percent of Dictators in the United States offered zero of the pot, consistent with pure self-interest. However, 26 percent offered 50 percent of the pot, consistent with pure fairness. Moreover, average offers in the games vary from country to country. For example, Roth et al (1991) found that offers in the Ultimatum game were lower in Japan than in the United States and those in Israel even lower. Difference between average offers in developed economies, such as the United States, Japan and Israel, and average offers in less developed economies are even greater. For example, while the mean offer in the Ultimatum game played in Pittsburgh was 46 percent and the mode 50 was percent, the mean offer in the game played among the Amazonian Machiguenga was only 25 percent and the mode was 20 percent. Why are people different from one another in their tilt toward self-interest or fairness and why are people of one country different, on average, from people of another? I begin with culture, religion and politics.

Culture, religion and politics

Culture, religion and politics explain some differences in levels of corruption among countries. La Porta et al (1991) and Treisman (2000) proposed that egalitarian or individualistic religions, such as Protestantism, encourage challenges to power while hierarchical religions such as Catholicism, Eastern Orthodoxy and Islam discourage them. They found that Protestantism is associated with lower levels of corruption. Mantinola and Jackman (2002) found that the effect of political structure on corruption is non linear. Partial democratization may increase corruption but established democracies inhibit

corruption. Treisman (2000) concluded that countries are less corrupt only after 40 years of democracy.

Trust in people outside the family is one aspect of culture and levels of corruption are generally high in countries where levels of trust are low. Fukayama (1995) emphasized the two way street between culture and economics. Current levels of trust reflect past economic structures while current culture affects future economic structures. He related the prevalence of family business in Italy's Tarza region, where levels of trust are low, to its economic history of sharecropping, based on long-term contracts between landowners and heads of the families who contracted on behalf of the other family members.

Fukuyama's insights are consistent with results of the Ultimatum games. Henrich et al (2003) wrote that fair-mindedness is more prevalent in societies where people regularly engage in market transactions and the payoffs to cooperation with non-relatives are high, such as the Pittsburgh society, than in societies where market transactions are rare and no one's economic well-being depends on cooperation with non-relatives, such as the Amazonian Machiguenga society.

Changes in religion take centuries and changed in politics or culture take decades, but they all change. Past economic forces promoted family business in Italy but current economic forces promote global corporate business, and the process is likely to increase trust and reduce corruption. Landler and Fisher (2006) wrote about Aldo Bonomi's Italian valve factory founded by his grandfather that is now facing global competition.

> "Look at these valves," Mr. Bonomi said, plunking down a matched set. "This one is mine; this one was made in China. It doesn't work as well as mine, but it's close enough." The Chinese one costs half as much.

Some Italian businesses are responding to global economic forces by joining the global economy. Landler and Fisher wrote that:

> Emanuele Bertoli, the owner of a company that makes mother-of-pearl buttons for clothing designers like Giorgio Armani and Stefano Ricci, has thrived by putting most of his production in Vietnam and China, near the hatcheries for his pearls.

Similarly, Indian-born steel tycoon Lakshmi Mittal shocked the Indian business community when Mittal, his family business, took over Arcelor and ceased being a family business. Glader and Bellman (2006) wrote that Mr. Mittal "belongs to an ethnic group called Marwari that traditionally believes it's critical for companies to maintain family ownership." They added that

> Mr. Mittal's move has already forced India's Marwaris' to question whether their traditional way of operating is outdated. India's Marwari industrialists are quickly learning that rapid growth requires access to capital and bankers on Wall Street, London or Hong Kong as well as institutional investors, who want a more transparent company and a more liquid stock.

Income

We can see the link between income and fairness, measured by freedom from corruption, in the correlation between the two. Figure 2 shows that in general countries with higher income per capita have greater freedom from corruption. Income is also correlated with fairness, measured by levels of trust in people outside the family. Countries with high levels of trust usually have high income-per-capita. Freedom from corruptions in Italy and Turkey is lower than predicted by their income-per-capita, explained in part by their relatively low levels of trust. Conversely, freedom from

corruption in Australia and the Netherlands is higher than predicted by their income-per-capita, explained in part by their relatively high levels of trust.

Paldam (2002) and Treisman (2000) proposed that the link between high income and low corruption is due to the spread of education and the creation of a middle class in countries with higher income, while Kaufman and Kraay (2002) argued that it is lower corruption that promotes economic development and higher income. The relationship between income and corruption is also likely due to our primate nature. Frans de Waal, a primatologist, noted that people with resource barely sufficient to sustain them find it hard to attend to the needs of others and describes the relationship between altruism and resources as a floating pyramid:

> Altruism is bound by what one can afford. The circle of morality reaches out farther and farther only if the health and survival of the innermost circles are secure…People on the brink of starvation can afford only a tiny tip of the moral pyramid…As soon as the immediate threat to survival is removed, members of our species take care of kin and build exchange networks with fellow human beings both inside and outside their group. (p. 213-214).

Income inequality matters as well. Klitgaard (1988) and Rose-Ackerman (1978, 1999) noted that when income inequality is high the rich have more to lose through fair political, administrative and judicial processes. They also have greater resources to prevent these losses through bribery and lobbying. And while the poor have much to gain from combating corruption, they have few resources to counter the power of the rich. You and Khagram (2005) found that high income inequality is indeed associated with high levels of corruption.

The relationship between corruption, income, and income inequality poses challenges to societies since rapid increases in income-per-capita are often associated with increasing income inequality. For example, Browne (2006) wrote about Zou Tao of Shenzhen, China who "has become and unlikely hero in this profit-driven city of half-built apartment complexes and luxury villas: He is calling for a boycott of the real-estate market." (p. A1) Benefits from the property boom in China have flowed unevenly. Half the 20 wealthiest people in China are in real estate yet the income of 70 percent of Beijing population is insufficient to buy a home.

Browne wrote:

> Behind the surge lie contradictory priorities that arose over two decades of fast growth. Leaders in Beijing, fearful of the social unrest income disparities can cause, are eager to develop affordable mass housing. Yet city government, competing with one another to expand their economies and build infrastructure, rely heavily on land sales to developers and taxes on expensive property.

Education

Bernstein (2006) wrote about his time as a child, shopping with his father. The father would return to store clerks change paid in error and use the opportunity to stage "miniature morality plays" for his son. Teaching fairness to children is especially important because children have to special ability to learn. Camerer (2003) wrote that teaching children the norms of fairness is akin to a process where "a piece of exposed film gradually becomes a picture in a chemical bath; but what chemicals are used affects the exposure." (p. 67).

Children become increasingly attuned to norms of fairness as the mature. Harbaugh, Krause and Liday (2003) found that the behavior of the youngest children

conformed best to the predictions of self-interest theory. The offers of 2nd graders in the Ultimatum game were the lowest. But older children are much more generous. They wrote:

> This result gives a new twist to work by others on cross-cultural differences in economic behavior. Explanations of these cultural differences are either really about genetic differences, or they require that there be some way that different cultures persuade people with the same genes to behave differently. We suggest that this latter process happens in childhood, and we provide evidence of substantial behavioral changes in sample of children from the same culture, over ages 7 to 14. (p. 28).

Education continues long after childhood. Adults are taught mathematics, accounting and economics and they are also taught norms of fairness, codes of ethics and the law. For example, students can learn that insider trading violates the law. Some students internalize laws prohibiting insider trading and come to consider insider trading as unfair, not only illegal. Other students might question the economic rationale of insider trading laws or their fairness, but know that insider trading is illegal.

We can see the effect of education in differences between the perception of the fairness of insider trading by finance professionals and university students. Professionals in each of the eight surveyed countries considered Bond's behavior less fair than students, often by substantial margins. For example, 36 percent of students in the United States rated Paul Bond's behavior completely fair or acceptable while only 5 percent of finance professionals in the United States rated Bond's behavior so. Similarly, 76 percent of Indian students rated Bond's behavior completely fair or acceptable while only 49 percent of Indian professionals rated Bond's behavior so. (See Figure 1).

Enforcement

People differ, even if they live in one society. For example, Frohlich and Oppenheimer (2001) found that while 26 percent of Proposers in a Dictator game played in the United States offered Respondents 50 percent of the pot, consistent with pure fairness 47 percent offered nothing, consistent with pure self-interest.

Slemrod (2006) noted that not everyone evades taxes by the same proportionate amount. Some people are less honest than others and some are more willing to gamble, hoping that they would not be caught. But the propensity to evade also depends on different opportunities and rewards for evasion. People who receive their income in cash find it easier to evade taxes than people who receive their income in checks, and people who stand to gain thousands by evasion might succumb to temptation more easily than people who stand to gain only hundreds.

Slemrod wrote that most of the gap between taxes paid and taxes that should be paid is in individual income tax and that gap is mostly due to underreported income, not overstated exemptions, deductions, adjustments or credits. He added that:

> [T]he most striking and important aspect… is the huge variation in the misreporting percentages by type of income (or deduction). The IRS estimates that only 1.2 to 1.4 percent of wages and salaries are underreported, and between 3.9 and 5.7 percent of taxable interest and dividends, are unreported. What wages and salaries, interest receipts, and dividends share in common is that they are all subject to information reports to the IRS. Self-employment business income is not subject to withholding or information reports, and its estimated noncompliance rate is sharply higher – an estimated 53.1 to 55.5 percent for non-farm proprietor income. (p. 6-7)

Enforcement and penalties deter tax evasion. Dubner and Levitt (2006) wrote that an independent poll conducted for the IRS found that 96 percent of respondents agreed that

'it is every American's civic duty to pay their fair share of taxes,' and 93 percent agreed that everyone 'who cheats on their taxes should be held accountable.' But when asked what influences their decision to pay taxes honestly, 62 percent answered 'fear of audit,' while 68 percent said it was a fact that the IRS already knows their income from reports by third parties. (p. 26).

Technology, especially information technology, is effective in deterring and detecting tax evasion. For example, in 1986 seven million dependents suddenly vanished from the United States' tax rolls when tax payers were required to put the Social Security numbers of their dependents on their tax returns. Similarly, technology is effective in deterring and detecting violations of trading regulations. Technology that monitors trading and the identity of traders helps the SEC and Department of Justice nab inside traders. The SEC's attention was recently drawn to robust trading in Reebok's options before an announcement of its merger with Adidas and the investigation resulted in charges of insider trading. (Anderson and de la Merced, 2006)

Deficiencies in technology impede deterrence and detection of trading violations. Davies (2006) wrote about NYSE specialists who "profited illicitly by trading for their firms' own accounts before filling customers' orders or by interfering in trades between customers, grabbing better price for themselves." (p. BU1) The case was difficult to prove because of an incomplete electronic trail of orders and transactions. Davies wrote that "The allegations highlighted weaknesses in the NYSE's market-surveillance and regulatory programs." Subsequently, Lucchetti and Davies (2006) wrote that "The NYSE, as part of its overall efforts to improve its self regulation, has installed video cameras and

other technology on the trading floor that the Big Board says will reduce the opportunity for specialist abuse." (p. C1)

Conclusion

Ethics, fairness, trust and freedom from corruption are all parts of social capital and social capital matters in financial markets because investors consider not only their tradeoff between risk and return based on available information but also their trust in the accuracy of information and the fairness of markets. Deficiencies in ethics and fairness mark all countries but such deficiencies are more pronounced in some countries than in others.

Levels of corruptions are higher in some countries such as India, than in others, such as Australia. The scores of India, Turkey, Tunisia and Italy on the Corruption Perception Index are lower than those of Australia, the Netherlands, the United States and Israel. Rankings by perceptions of the fairness of insider trading generally follow rankings by corruption. A survey presented in this article shows that finance professionals and university students in India, Turkey, Tunisia and Italy perceive insider trading as more fair than professionals and students in Australia, the Netherlands, the United States and Israel.

Why are levels of corruption higher in some countries than in others? Why is insider trading considered fairer in some countries than in others? And what can institutions, such as the CFA Institute, do to improve levels of ethics and fairness? These are the questions I try to answer in this article. I discuss four factors that affect social capital, culture, income, education and law enforcement.

Social capital, including fairness, is generally higher in economically developed countries where incomes are high and markets play a prominent role than in less

economically developed countries. For example, people in the economically developed United States are more generous in the division of a pot of money between themselves and a stranger than people in the less developed Amazonian Machiguenga.

Ensminger (2004) noted that the idea that people in developed market economies are more fair-minded than people in societies where markets play less prominent roles seems counterintuitive since markets are often accused of undermining the moral foundations of society. But she found support for the idea in the work of earlier scholars, such as Montesquieu, who recognized that market economies promote trust and fairness. She quoted Montesquieu writing "wherever there is commerce, manners are gentle… commerce polishes and softens barbaric ways." (p. 81). In turn, trust and fairness contribute to economic development. As Alan Greenspan (1999) said in a commencement address, "Without mutual trust, and market participants abiding by a rule of law, no economy can prosper."

Globalization is a potent tool to increase both income and fairness. When an Italian family business puts most of its production in Vietnam and China it increases income in Vietnam and China, as well as in Italy. Globalization also increases trust and fairness since extending business beyond one's family requires extension of trust and fairness beyond one's family. Anything that institutions, such as the CFA Institute, can do to foster globalization will likely foster higher income and greater trust and fairness.

The positive effect of markets described by Montesquieu might well operate side by side with a negative affect. Hirschman (1982) wrote: "The constant practice of commercial transactions generates feeling of trust, empathy for others… but on the other

hand… such practice permeates all spheres of life with the element of calculation and of instrumental reason." (p. 1483). Indeed differences in the behavior of people of the same society show that some gravitate toward fairness while others gravitate toward self-interest. For example, Frohlich and Oppenheimer (2001) found in an experiment in the United States that 26 percent of people who had sole power to divide a pot of money between themselves and a stranger offered that stranger 50 percent of the pot, consistent with pure fairness. But 47 percent of people took the entire pot for themselves, consistent with pure self-interest.

Education, including education about the law, is useful in tilting the behavior of people toward fairness and so is enforcement of the law. The surveys of eight countries in this article shows that finance professionals in all countries perceive insider trading as less fair than perceived by university students. The difference in perception is likely due to education by institutions such as the CFA Institute. Some finance professionals have come to perceive insider trading as unfair. Others might believe that insider trading is fair and should be made legal but nevertheless know that it is illegal. Perceptions of the fairness of insider trading vary greatly from country to country, even among finance professionals. The global reach of the institutes such as the CFA Institute can be a force for changing perceptions, especially in countries where insider trading and other trading violations are generally perceived as fair.

Education is useful but not powerful enough. People know that the law mandates paying taxes and agree that they should pay their taxes honestly. Yet many people cheat on their taxes. When asked what deters them from cheating, most people point to fear of an

IRS audit and the fact that the IRS already knows this income from employer reports. Even the best moral and legal education will not persuade some people to refrain from insider trading when tempted by seemingly easy thousands or millions. Law enforcement, aided by technology such as computer logs of trading and video cameras on floors of exchanges, must supplement education. Institutions such as the CFA Institute can do their share by advocating vigorous enforcement of the law and vigorously enforcing their own code of ethics.

I end with Alan Greenspan's words to students at a commencement address:

> Our forefathers bestowed upon us a system of government, and a culture of enterprise, that has propelled the United States to the greatest prosperity the world has ever experienced…
>
> Our system works fundamentally on individual fair dealing. We need only look around today's world to realize how rare and valuable this is.
>
> While we have achieved much in this regard, more remains to be done.

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Table 1: A comparison of countries by fairness scores on the Paul Bond vignette and by freedom from corruption, trust, enforcement of insider trading laws and stock market participation.

Country	Fairness Rating of Paul Bond by Professionals	Rank	Fairness Rating of Paul Bond by Students	Rank	Freedom from Corruption[2]	Rank	Trust Score[3]	Rank	First year of enforcement of insider trading laws[1]	Rank	Stock Market Participation[2]	Rank
U.S.	1.30	1	2.23	1	7.6	3	45.4	3	1961	1	26.0%	2
Netherlands	1.34	2	2.3	2	8.6	1	46.2	2	1994	3	14.0%	3
Australia	1.76	3	2.45	4	8.8	2	47.8	1	1996	4*5*6	40.4%	1
Israel	1.77	4	2.35	3	6.3	4	NA	NA	1989	2	NA	NA
Italy	2.22	5	2.92	7	5.0	5	26.3	5	1996	4*5*6	7.0%	4
Turkey	2.23	6	2.58	6	3.5	7	10.0	6	1996	4*5*6	1.2%	6
Tunisia	2.33	7	2.49	5	4.9	6	NA	NA	Not Yet Enforced	8	NA	NA
India	2.49	8	2.95	8	2.9	8	34.3	4	1998	7	3.3%	5

1. From Bhattacharya & Daouk (2002), Table 2.
2. From Corruption Perception Index, 2005.
3. From Knack & Keffer (1997), Data Appendix.

Paul Bond is a lawyer at the Brown & Long law firm. One day while standing outside his office at Brown & Long he overheard John Grand, another lawyer at the firm, talking with an associate about his work on a proposed purchase of the Pillow company by the Down company for $120 per share. Paul Bond had no role in the work on the proposed purchase of Pillow and Brown & Long represented only Down, not Pillow. Paul Bond bought 1,000 shares of Pillow for $70 per share. Please rate Paul's behavior as:

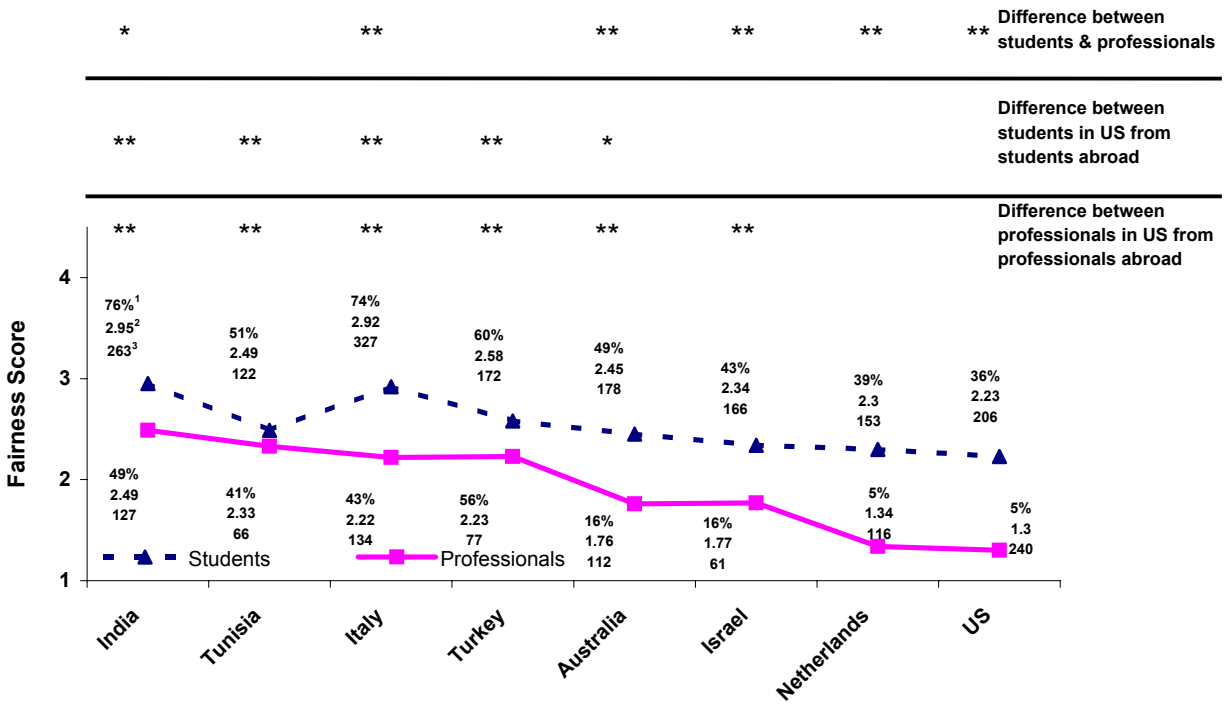
A) Completely Fair (4 points)
B) Acceptable (3 points)
C) Unfair (2 points)
D) Very Unfair (1 point)

Fairness score is a weighted average where Completely Fair rates 4, Acceptable rates 3, Unfair rates 2 and Very Unfair rates 1.

Correlation between measures

	Corruption Score	Trust Score	First Year of Enforcement	Stock Market Participation
Paul Bond Professionals	0.88	0.69	0.64	0.62
Paul Bond Students	0.78	0.51	0.60	0.60

Figure 1: A comparison of countries by fairness scores of Paul Bond.



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[1] Percentage of respondents who rated the behavior as completely fair or acceptable.

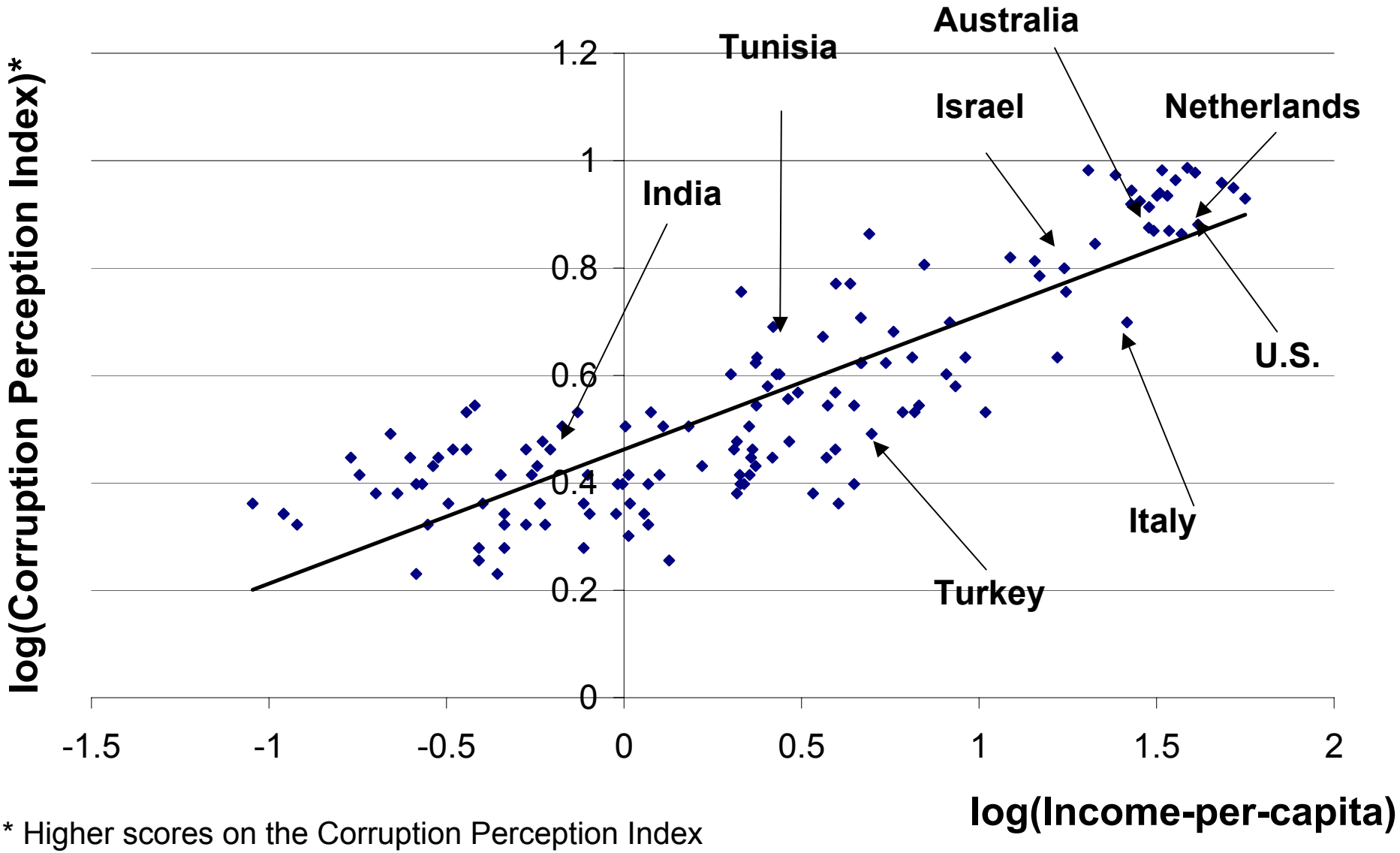
[2] Fairness score is a weighted average where Completely Fair rates 4, Acceptable rates 3, Unfair rates 2, and Very Unfair rates 1.

[3] Number of respondents

* Statistically significant at the 5% level.

** Statistically significant at the 1% level.

Figure 2: The relationship between income-per-capita of countries and their freedom from corruption.



* Higher scores on the Corruption Perception Index correspond to greater freedom from corruption.