

9

Corruption Control

A people that values its privileges above its principles soon loses both.

—Dwight Eisenhower

One indication of failure to develop a robust ethics infrastructure in institutions is the presence of corruption. Because most of it is clandestine, no one really knows the magnitude of corruption—it is only possible to discuss the actual exposure of corruption. This secrecy makes it difficult to accurately gauge overall severity and trends; corruption may not be known to exist and, if discovered, may not be reported. Still, media coverage is more intensive (the sheer quantity of information) and extensive (the geographic spread of information) today than ever before, as pervasive corruption seems to be a common reality in the life of institutions. The previous chapter was an affirmative attempt to construct an ethical infrastructure in organizations; this one targets the absence of ethics by examining corruption and ways to deal with it. Objectives include an understanding of

- the scope and definition of corruption,
- root causes of corruption in human nature and American history,
- individual and organizational ethical failure,
- moral hazards and gift-giving,
- the role of scandals in civic life,
- reform efforts, and
- invalid reasons for not dealing with corruption.

An administrator can be lulled into a false sense of security if she assumes that organizational “right-doing” programs discussed in the last chapter will prevent wrongdoing. Given human frailty and institutional dysfunctions, there will always be the potential for corruption. That does not, however, relieve individuals and institutions of the obligation to mitigate it.

SCOPE AND MAGNITUDE OF CORRUPTION TODAY

The greatest evil is not now done in those sordid dens of crime that Dickens loved to paint...but is conceived and ordered...in clear,

carpeted, warmed, well-lighted offices, by quiet men with white collars and cut fingernails and smooth-shaven cheeks who do not need to raise their voices.

—C. S. Lewis

Public and private organizations in the United States lose at least 6% of annual revenue (over \$994 billion/year) to corruption, according to the Association of Certified Fraud Examiners (2008). One in four businesses loses more than \$1 million annually; 76% of companies believe the problem is getting worse, and 76% believe the worst fraud could be prevented through adequate controls. In government, much of the public believes that government wastes nearly half of its tax dollars; expert estimates of spending lost to waste, fraud, or abuse range from 2% to 7% (Cooper, 2009; Nye, Zelikow, & King, 1997).

Simple dollar losses in direct expenditures are an inadequate measure of total costs of corruption. For example, related expenses include legal fees, internal investigations and remedial actions, lost time and productivity, training, recruitment, and opportunities forgone due to damaged credibility. Burke, Tomlinson, and Cooper (2011, 16) argue that the price of corruption is “huge and includes less organizational and country growth, lower levels of public spending on education and healthcare, less revenue from taxes, greater political instability, and lower levels of direct foreign investment.” The levy paid by society is not evenly distributed, as wrongdoing (a) harms the poor severely (by diverting services from those who need them the most), (b) strangles commercial growth (by driving legitimate companies out of business), and (c) undermines support for public initiatives (by creating the perception that all programs are corrupt). Stated differently, when competent government and business—which provide the basis for economic development—are eroded, the only winners are the corrupt; the gains from corruption are specific and immediate, while the harms are diffuse and long-lasting.

While overall crime rates in the United States have flattened in recent years, there has been a marked increase in white-collar crime according to federal and state officials.¹ Despite the fact that corporate crime costs easily dwarf those of ordinary street crime, the federal government does not track the incidence and magnitude of the damage corporate crime causes—there is no national database for these crimes and their disposition. Even when enforcement of relevant anticorruption laws occurs, the penalties are often so low that they are easily absorbed as a cost of doing business.² Not surprisingly, there is no shortage of problems, as news reports revealed “breathtaking” corruption in the wake of Hurricane Katrina in 2006 and that “pandemic” corruption occurred during the attempted reconstruction of Iraq (Rich, 2007). One in-depth study (Ashforth & Anand, 2003), in fact, examined how easily corruption becomes institutionalized—and normalized—in organizations to the point that it not only can neutralize the stigma of deviant conduct, but also can rationalize wrongdoing in socially desirable terms.

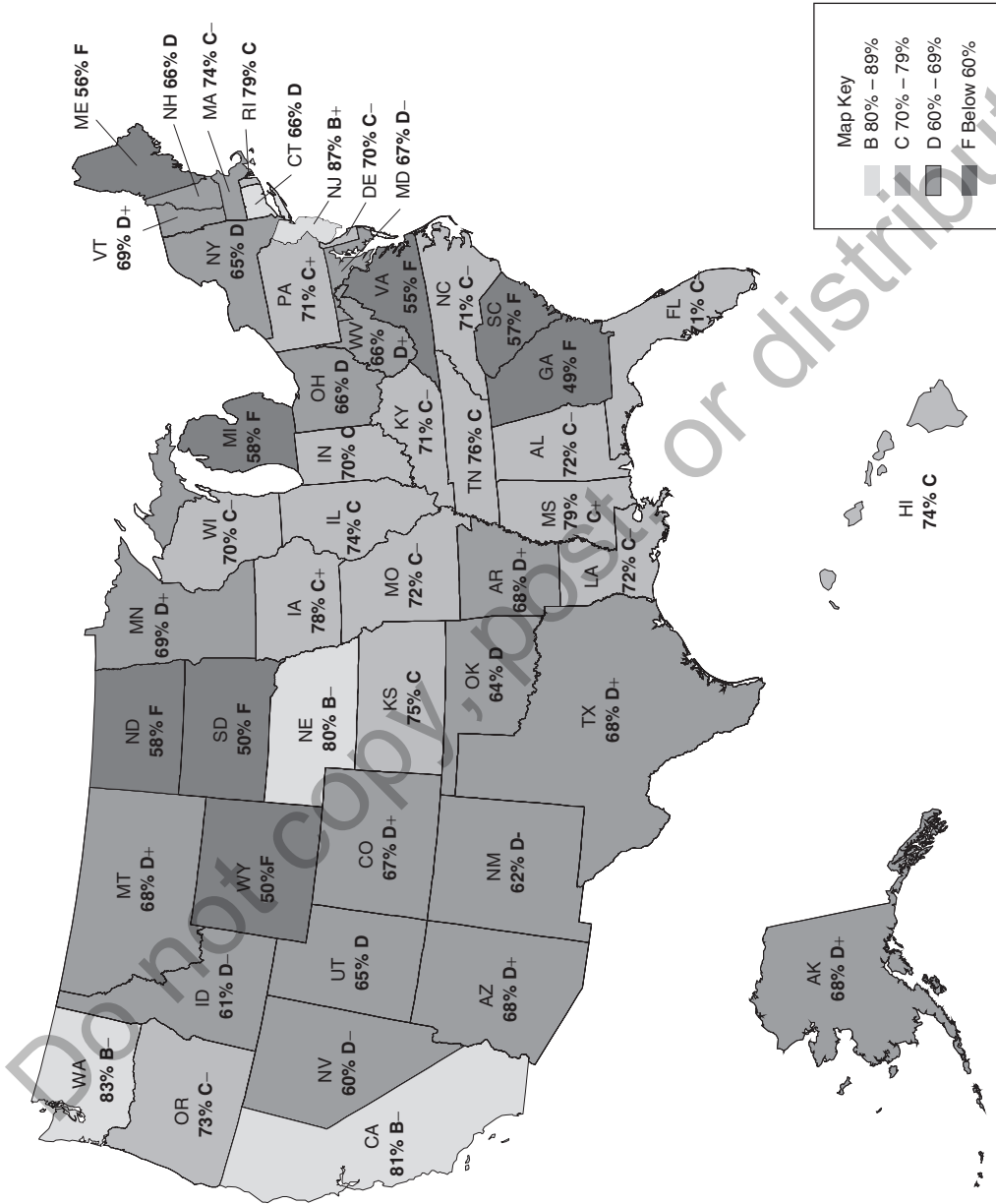
Other recent indicators of ignoble behavior in public and private sectors include the following:

- Every year the Multinational Monitor (<http://multinationalmonitor.org>) publishes its “Ten Worst Corporations of the Year,” complete with a detailed analysis. A recent listing included AOL-Time Warner, Bank of America, Coca-Cola, General Electric, Wal-Mart, Merck, Monsanto, Nestle, News Corporation (owner of Fox News), Hardee’s, Abbott Laboratories, Dow, Xerox, and numerous others who engaged in civil and criminal wrongdoing (many enterprises are repeat offenders).
- A study of the *Fortune* 100 found that 40 of the firms engaged in unethical behavior, suggesting that “the level of misconduct . . . is the highest in American history” (Clement, 2006, 317).
- The Governmental Accountability Project (<http://www.whistleblower.org>) publishes an annual “Hall of Fame” and a “Hall of Shame,” consisting of business and governmental organizations.
- Citizens for Responsibility and Ethics in Washington monitors government ethics, bringing egregious conduct to light and holding officials accountable for their misconduct (<http://www.citizensforethics.org/>); it also maintains an annual list of the top 10 scandals.
- The “Political Graveyard” (<http://politicalgraveyard.com>) is an extensive catalogue of transgressions by politicians.
- Transparency International (<http://www.transparency.org>) compiles a yearly “Global Corruption Barometer” and the “Corruption Perception Index.”
- Global Integrity (<http://www.globalintegrity.org>) publishes an annual report and index that tracks governance and corruption trends.

The need for watchdog programs was dramatically illustrated by a 2010 U.S. Inspector General for Iraq Reconstruction report. It found not only that 96% of the \$9 billion reconstruction monies were unaccounted for by the Defense Department, but also that the expenditures resulted in few successful reconstruction projects (Spoth, 2010). At the state level of government, a recent study measured the risks of corruption, as reflected in the strength of laws and policies designed to ensure transparency and accountability in government. It revealed that most states avoid public scrutiny; do not enact or enforce ethics laws; cut, consolidate, or eliminate auditing agencies; and allow corporate interests to dominate policy (Center for Public Integrity, Global Integrity, & Public Radio International, 2012). A state-by-state assessment of their vulnerability to corruption is shown in Figure 9.1. Such initiatives challenge the idea that corruption is someone else’s problem and instead document the need for change. To that end, the discussion continues with a definition of corruption.

FIGURE 9.1

State Vulnerability to Corruption



Source: Center for Public Integrity, Global Integrity, & Public Radio International (2012).

Note: The numbers represent each state's integrity score. A high score (and letter grade) corresponds with a low vulnerability to corruption; a low score corresponds with a high vulnerability to corruption.

DEFINING CORRUPTION

Corruption is the abuse of position or power—a violation of public trust—often for personal gain by an individual or institution in the public or private sector. Government or business employees can be corrupt and organizations can be systemically corrupt.² The term is derived from the Latin *corrumpere* for “distort.” The word appeared in English medicine during the 14th century in reference to decomposition of the body, and subsequently has referred to moral decay. Government is often an accessory to corporate corruption—and vice versa (Gitlow, 2005), as the public and private spheres are deeply intertwined and can collude for mutual benefit. Regulatory negligence, for instance, can enable corporate malfeasance, and the latter can reveal the former.

There are many kinds of corruption such as bribery, nepotism, misappropriation of funds, kickbacks, extortion, spoils, and conflict of interest. Incidences differ in scale (small vs. large) and duration (isolated vs. repeated incidences). Thus small-scale corruption could range from a single \$50 bribe to routine payments of such amounts, whereas large-scale corruption could be either rare (a one-time \$50,000 bribe) or repeated (systemic corruption). Reaction to each of these types—and their impact on business and government—can vary, from indifference to outrage (Thompson, 2000).

Corruption at the individual level can also be understood using role theory (Dobel, 1999). Thus, role distortion—the use of position for personal gain—may or may not involve massive greed. Whatever the form of wrongdoing, corruption violates public trust and generates unnecessary costs. Role failure occurs when an individual assumes office with laudatory goals, but either loses sight of them or confuses them with his own views. Ethical violations may stem not only from failure, but also from success (e.g., in the biblical “Bathsheba Syndrome,” the highly regarded King David seduced Bathsheba with disastrous results including failed cover-ups, deaths, and dishonor with extreme personal misery). Senior executives feel invulnerable, control resources, and believe they are entitled to make up their own rules (“The fish rots,” the saying goes, “from the head.”). But rank-and-file employees also engage in dubious behaviors to rationalize and compensate for low salaries. Both the powerful as well as powerless can be corrupted (Bowman & West, 2007).

Finally, role rejection occurs when officials disdain public stewardship. Such people consider the workplace an extension of private life. They take advantage of the trust society places in institutions by exploiting opportunities for self-enrichment and rewarding friends. At the extremes of corruption, those with specific skills and access to valuable information become vulnerable to organized crime as it expands operations (Camilleri, 2011). Indeed, criminal networks overlap and cooperate with terrorists, a synergy that is growing because similar conditions give rise to both and because both depend on mutually beneficial relationships with well-known banks to launder their monies (Perri & Brody, 2011; Saviano, 2012).

There is no employee perpetrator profile, as wrongdoers may be very much like most people (Albrecht, Sanders, Holland, & Albrecht, 2011). Some analysts find the “20–60–20” rule to be useful. At the two ends of the spectrum, 20% of employees will always do the right thing and 20% will always be involved in wrongdoing when there is opportunity, high

reward, and low risk. The remaining 60% may or may not be unethical depending on organizational culture (Brooks & Dunn, 2010) and which 20% component is the most influential. Corruption incurs the loss of legitimacy and effectiveness, adds to taxpayer burden, and increases openings for organized crime. Given the implications, the causes of corruption demand attention.

CAUSES OF CORRUPTION AND EVOLUTION OF ANTICORRUPTION STRATEGIES

Give a man a gun and he can rob a bank. Give a man a bank and he can rob the world.

—Anonymous

Root causes of corruption, according to Mahatma Gandhi, include wealth without work, pleasure without conscience, knowledge without character, commerce without morality, science without humanity, worship without sacrifice, rights without responsibilities, and politics without principles. Gandhi's causes often explain corruption in the worlds of government, business, and nonprofit organizations.

Government

In the public arena, the incubus of corruption provided much of the impetus for modern administration, which sought to address corruption by improving the quality of both personnel (via the merit system) and procedures (e.g., lowest bid, audits, council-manager government, and conflict of interest regulation). The evolution of corruption control can be depicted in stages with overlapping legacies, shown in Table 9.1. For each stage—the legacies of which remain today—the strategy, causes, prescriptions, and implications are outlined. For example, the strategy of the Progressive Movement at the turn of the 19th century was emphasis on professionalism to replace amateur, partisan administration. Important reforms included the creation of independent regulatory commissions and nonpartisan elections. Largely a response to scandal, however, the focus on corruption can come at the expense of effectiveness and efficiency when reforms become so burdensome as to defy common sense (Anechiarico & Jacobs, 1994). Thus, while the changes in each era were well meaning, they can lead to counterproductive actions in which the public good was not served. Regulations designed to prevent corruption, for instance, can be so burdensome that they may actually encourage more corruption.

Business

In the private sphere, revelations of slush funds and secret payments were regarded as a detriment to foreign policy, the image of American society, and citizen confidence, and led to the 1977 Foreign Corrupt Practices Act. Intended to prevent bribery of foreign officials, the law requires that firms maintain a responsible internal accounting control system. As of 2012, 78 corporations were under investigation for possible violations of the Act (Wayne, 2012).

TABLE 9.1

Visions of Corruption Control: Strategies, Causes, Prescriptions, and Implications

Corruption Control Vision	Anti-patronage (1870–1900)	Progressive (1900–1933)	Scientific Management (1933–1970)	Panoptic (1970–1990s)	Revisionist (1990s–Present)
Strategy	Credential and competence testing	Professionalism	External control	Law enforcement	Public entrepreneurship
Perceived causes of corruption problem	Partisan control of personnel	Partisan, unprofessional administration	Inadequate organizational controls	Inadequate monitoring	Bureaucratic pathology
Key policy prescription	Merit system	Electoral reform, independent regulatory commissions, administrative expertise, apolitical administration	Government reorganization and centralization	Surveillance, investigation, fiscal controls	Market privatization
Implications for public administration	Peer enforcement of norms, personal controls	Enforced standards of efficiency	Oversight of agencies and appropriate span of control	Strong investigative and auditing agencies	Decentralized debureaucratized structures, deemphasize corruption control

Source: Anechiarico and Jacobs (1994, 466).

Corruption also led to the following 1991 U.S. Federal Sentencing Guidelines:

1. The firm's standards must be tailored to its business operations.
2. Top leadership must be personally involved in the program.
3. Corporations must not delegate significant discretion to those who have shown themselves inclined to deviant conduct.
4. The policy must be effectively communicated throughout the company.
5. Businesses must have compliance standards and reporting systems.
6. There must be disciplinary procedures in place to address problems.
7. Companies must respond to offenses, report them to the government, and seek to deter future issues.

The statute mandates that firms develop programs that can then be used both as a deterrent to wrongdoing and as a means to limit corporate liability. Organizations are expected to create an ethical climate, develop an active oversight program, identify risk factors and offer training, and reduce the opportunities for, and increase the risks of, malfeasance. Often, the provision of a proper climate includes the creation of codes of ethics, ethics audits, ethics officers, and other components of an infrastructure discussed in the previous chapter. One reason why corporations might encourage whistleblowers (Chapter 10) to report problems internally may be so that they can turn themselves in and qualify for leniency.

Another technique is the use of "honest services" fraud and conflict-of-interest legislation (18 U.S.C. & 1346). It requires that public and corporate officials act in the best interests of their constituents or employers by criminalizing schemes to defraud victims of "the intangible right of honest services," including the right to good government (Schwartz, 2009). Thus, a decision maker can be charged with depriving others of that right, if they put her own interest or those of another person above the interests of citizens or shareholders.

David Brooks (2010) noted that after the controversial Viet Nam War and the Watergate scandal, an "ethos of exposure" swept American culture. According to this view, the political and corporate elite, while appearing to be upstanding, are actually corrupt. The private lives of officials, once considered inconsequential, became at least as prominent as their performance. In many cases, the exposure ethos elevated the trivial above the significant while simultaneously corroding faith in the nation. Transparency has been dramatically magnified in the last generation by the development of the Internet and the proliferation of media outlets. As web-based public information sharing portals become more common (Chapter 11), scandals once revealed by employees may be teased out from aggregate data by citizens. The historically low rate of waste in the 2009 federal stimulus package, for example, has been credited to Recovery.Gov: Track the Money (www.recovery.gov), an official website that provides public access to Recovery Act spending and allows for reporting of potential corruption (Exhibit 9.1).

EXHIBIT 9.1**The 2009 Federal Stimulus Bailout Program**

The New New Deal: The Hidden Story of Change in the Obama Era, by Michael Grunwald (2012), argues that the “unprecedented \$800 billion package of spending and tax cuts” was fraud-free and exceptionally well managed. The Recovery Act prevented the economy from total collapse by providing funds for electronic health care records, information technology, green energy, and high-speed rail infrastructure projects. Yet “more Americans think Elvis Presley is still alive than think that the stimulus was a success”—even Obama seldom mentions it (Clark, 2012).

Observers predicted that government would lose over 5% of the funds to fraud, but just 0.0001% consisted of questionable payments. The sources of the conventional wisdom about the failure of the stimulus law include, according to Grunwald, incompetent White House communication, political opposition to the bailout, an unquestioning media, and bad timing (the act was passed when the country was losing hundreds of thousands of jobs a month). Examples of the misuse of funds reported by a credulous media—a train to Disneyland, millions for government furniture, honeybee insurance, sod for the National Mall—were found to be false.

Source: Clark (2012).

Nonprofit Organizations

The nonprofit sector is not immune from issues of corruption, asset manipulation, and fraudulent statements. Headline stories have exposed conflicts of interest, bribery, unlawful gratuities, economic extortion, as well as illegal financial and nonfinancial statements with growing frequency. Given the size and scope of the sector with its \$665 billion in revenues, 12 million employees (Stephens and Flaherty, 2013), and 65 million service recipients (Greenlee, Fischer, Gordon, & Keating, 2007), it is a ripe target for wrongdoers. Using data from the Association of Certified Fraud Examiners (2005), it can be estimated that fraud losses in the nonprofit arena amount to around \$40 billion annually.

The Red Cross, United Way, Boy Scouts of America, and other high-profile organizations have been embarrassed by disclosures of corruption in recent years. Other examples abound here and abroad:

- Potential donors seeking to provide assistance to Hurricane Katrina victims were likely deceived by more than 2,000 fraudulent Internet sites soliciting contributions (Aviv, 2005).
- The former CEO of the National Kidney Foundation Singapore was charged with corruption and jailed for questionable business practices, ranging from conflicts of interest to misrepresentations of organizational performance and wasteful spending (see Rowe & Dato-on, 2013, 94–107).
- The Association of Community Organizations for Reform Now (ACORN) was busted for voter registration fraud and for employees caught on videotape facilitating tax fraud and covering up a child sex slavery ring (McRay, 2009).

- The bankruptcy filing of the Miami-area James E. Scott Community Association listed \$3.4 million in liabilities and only \$1.7 million in assets after it lost government contracts over fears about its financial management. The charity had been administering programs for infants, teenagers, and the elderly in the city's poorest neighborhoods (Grimm, 2010; "Miami-Area Social-Service Charity," 2009).
- Another nonprofit, the MDHA Development Corporation, received \$16 million from Miami Dade County as well as land and other assets, but finished just one affordable housing project, a bungled effort with months of delay and building breakdowns (Cenziper, 2006).

How can nonprofits curb corruption and protect both their reputations and funding base? Greenlee and her colleagues (2007, 688–691) provide numerous strategies. Some suggestions include (a) establishing clear lines of authority, (b) creating proper procedures for authorizing transactions, (c) auditing monthly financial transactions in addition to an annual audit, (d) training volunteers about theft risks, (e) recruiting quality, independent board members, (f) creating an audit committee to detect or deter financial mismanagement, (g) completing background checks on employees with access to cash or assets, and (h) providing whistleblower protection.

Beyond root causes of corruption as manifested in government and in business and nonprofit organizations, how else can individual and collective moral failure be explained?

INDIVIDUAL AND INSTITUTIONAL MORAL FAILURE

There is no right way to do a wrong thing.

—Howard S. Kushner

Individuals

Personal moral lapses can stem from the human genius for self-serving rationalization. Anand, Ashforth, and Joshi (2004) highlight seven rationalization techniques and provide examples of each (Table 9.2). Most of these psychological defense mechanisms—used to mask the true reasons for behavior—cannot withstand the “front-page test” (“Would you be willing to see your actions in the newspaper?”), but two additional common excuses not included in the table warrant comment: contingent necessity (“If I don’t do it, someone else will”) and ignorance (“I didn’t know”).

First, conduct must be judged on its merit, not on a vague possibility what a nameless “someone else” may or may not do. That is, ethics is about personal responsibility. One individual may not be able to do everything that needs to be done, but she can improve conditions around her by avoiding unethical behavior, setting an honorable example, and strengthening her character (Chapter 6). Second, what officials do not know may not be their fault, but it is their responsibility—they are accountable for organizational climate and due diligence. The

official's obligation is not fulfilled unless everything possible is done to ensure proper standards of practice. Establishment of an ethical infrastructure (Chapter 8), ethical audits, consultations with legal and human resource professionals, and "management by walking around"—and listening—can help verify that thoughtful attention to this duty takes place. Not only do ordinary people populate the ranks of the corrupt, but many organizations are also prone to criminality (Ashforth & Anand, 2003).

TABLE 9.2 Rationalization Techniques: Description and Summary

Category	Rationalization Technique	Description	Examples
Justification	Appeal to higher loyalties	The actors argue that their violation of norms is due to their attempt to realize a higher-order value.	"We answered to a more important cause." "I wouldn't report it due to loyalty."
	Denial of injury	The actors believe that no one is harmed by their actions; so the actions aren't corrupt.	"No one was really harmed." "It could have been worse."
Social excuses	Denial of victim	The actors counterblame for their actions by arguing that the violated party deserved it.	"They deserved it." "They chose to participate."
	Social weighting	The actors assume a practice that moderates the salience of corrupt behavior: condemn or compare	"You have no right to criticize us." "Others are worse than we are."
Contextual excuses	Denial of responsibility	The actors engaged in corrupt behavior perceive that they have no choice but to participate.	"What can I do?" "It is none of my business what the corporation does overseas."
	Denial of illegality	Actors excuse corrupt practices on the basis that their actions are not illegal.	"There's no law against it."
	Metaphor of the ledger	The actors rationalize that they're entitled to indulge in deviant behavior because of their accrued credits.	"We've earned the right."

Source: Adapted from Anand et al. (2004, 11).

Institutions

Failure on the part of the organization to avoid corruption may originate from the nature of work itself, groupthink, management-induced fear, or retaliation. Awareness of individual and institutional pressures is the initial step toward addressing them. Consider two cases, one focusing on the private sector and one on the public: moral hazard and gift-giving.

Moral hazard refers to undue risks that organizations and people are likely to take if they are not responsible for the consequences (as when financial firms make high-risk investments with federally insured taxpayer money and are subsequently bailed out). Shirking fiduciary responsibilities, and protected from failure by government, such conditions increase moral hazard, inhibit trust in institutions, and permit failed capitalists to become corporate socialists.⁴ Eduardo Porter (2012) puts it this way:

Bigger markets allow bigger frauds. Bigger companies, with more complex balance sheets, have more places to hide them. And banks, when they get big enough that no government will let them fail, have the biggest incentive of all. A 20-year-old study by the economists Paul Romer and George Akerloff pointed out that the most lucrative strategy for executives at too-big-to-fail banks would be to loot them to pay themselves vast rewards—knowing full well that the government would save them from bankruptcy.

A defense against moral hazard constitutes a system of controls that prevents firms from taking risks with other people's money—and at their expense—in the first place. The New Deal stock market regulations are an iconic anticorruption system. Yet those provisions were repealed in the late 1990s. In their place, Congress deregulated the financial sector and allowed Wall Street to self-regulate, abandoning the idea that markets need oversight: The result was one of the biggest crime waves the country has ever experienced.

Turning to gift giving in public service, the practice is often regulated—unlike business norms wherein such good-will courtesies are common. These prohibitions, however, are frequently criticized as ineffective, on the grounds that most individuals do not sacrifice their honor for gifts.⁵ The premise of this contention—predicated on valorizing self-interest and invalidating moral concern—may be correct: many officials are not “for sale.” As legendary California Assembly Speaker Jesse Unruh used to say of lobbyists, “If you can't eat their food, drink their booze and (expletive deleted) their women, and then vote against them, you have no business being up here.”⁶

Yet as discussed in Chapter 7, the conclusion—that inducements are acceptable—must be rejected as pernicious for three reasons. First, it is difficult to discern a defensible reason (as opposed to an expedient or self-serving reason) why an official should expect gratuities. Next, corruption requires nothing crass as a *quid pro quo*, because such offerings introduce the possibility of favoritism. Bribing is generally not the issue; rather, it is access and the attendant appearance of impropriety, conflict of interest, entitlement, influence peddling, and self-dealing. The challenge for administrators to avoid corruption intensifies when the

ethics of an action are unclear, as in the case of transition from public to private employment (Case Study 9.1).

Individual gifts, third, can help create organizational corruption—the creation of a system that encourages decisions based not on the substance of issues, but rather on friendships and cronyism among the political and financial officialdom. Immersed in a culture of the comfortable,

the process of influence doesn't have to involve raw corruption (although that happens too). All that it requires is the tendency to assume that what's good for the people (those who you associate with the most), must be good for the economy as a whole. (Krugman, 2011)

As Dan Ariely (2012) points out, people are social creatures. Someone gives a person a present—even, or perhaps especially, a small one—and the recipient tends to feel a debt of gratitude. That sense of indebtedness subtly influences perceptions and behavior by the need to clear a perceived debt. Gifting, in short, is a technique of power exercised by one party over the other. Lobbyists spend a small part of their time with politicians on official business and most of the time “trying to implant a feeling of obligation and reciprocity in politicians who they hope will repay them by voting with their interest in mind” (78).

The financial industry, for instance, creates conflicts of interest, nurtures them, and the banking and political elite benefits from a shared ideology—a belief system that the continued existence of Wall Street firms, and business as usual, is in the best interest of the economy. It is not necessary for the wealthy to buy a lawmaker's vote. Rather, they “buy his mind” (Reich, 2011, 110). The most recent financial debacle—the third in 20 years after the Savings and Loan disaster and the Enron Era—is at heart a political crisis. Financiers elicit cooperation from elected officials who depend on them in the form of gifts, campaign donations, and future employment.

Accordingly, those jurisdictions lacking workable gift regulations and tax-supported campaigns for office should consider them. The imperative of serving citizens before self ought to be enough for a public official. Why should presents, cash donations, and promises of impending jobs be routinely anticipated? Does anyone really think that they are offered in the name of “good government”? Perhaps Plato said it best, “The servants of the nation are to render their services without any presents. The disobedient shall, if convicted, die without ceremony.” Admittedly, prohibiting inducements may not be the pre-eminent issue—as long as privately funded political campaigns continue, the biggest source of corruption is legal—but it is a good place to begin.

Individual and institutional moral failure stems from a variety of sources, many of which are manifested in moral hazards and gift-giving. When corruption is revealed, the dishonor it produces may have serious and long-lasting effects. The next section examines such *con- tratemps* with particular attention to government and corporate roles in recent events.

SCANDALS: TYPES AND IMPACTS

Corruptio optimi pessimum (The corruption of the best is the worst).

—Latin proverb

Types of Scandals

Scandals reveal opportunities for the public to obtain information not otherwise available. As they occur in public service, these issues often have shared characteristics:

- There is no clear connection between the gravity of misdeed and the controversy.
- Their impact may depend on electoral cycle, partisan balance, presidential or gubernatorial approval ratings.
- Good journalism is bad business (expensive investigatory journalism), and bad journalism is good business (sensationalized coverage of sex peccadilloes).
- Republican scandals reinforce the conservative claim that government is corrupt, while Democratic scandal undercuts the liberal view that government can be trusted to do good. (Brooks, 2012)

A scandal refers to actions or events involving transgressions that become known and are perceived to be sufficiently serious to merit a public response (Thompson, 2000).

Several types of revelations combust in spectacular ways and are based on the fatal attraction of sex, money, or power (Thompson, 2000, 122). Sex incidents may or may not involve criminal offenses, but generally reflect actions that are regarded as hypocritical or unseemly. The more citizens have to rely on the character and discretion of officials, the more significance is given to personal weaknesses—especially if they affect broader issues of public concern. Financial scandals, second, disclose improper linkages between economic and political powerbrokers, and often involve violations of law because there is a well-developed set of statutes that cover them (this does not mean that such cases are easily resolved; see Case 9.1 on page 185). Yet the mere presence of legislation means little, if laws are ignored or if ongoing investigations confront statutes of limitations.

There has been, for example, a stunning lack of accountability for the crimes that helped create the gravest economic crisis since the Great Depression. In a mockery of the rule of law, there has not been a single prosecution of a major Wall Street bank or executive for what the FBI termed “an epidemic of fraud” that blew up the entire economy (Morgenson & Story, 2011; “No Fault Corporate Crime,” 2012; Dwyer, 2013). The same can be said for the 2001 terrorist attacks, the torture of detainees during the Iraq War, and the 2010 BP Deep Water Horizon oil spill. No one was terminated, no one resigned, and no one took responsibility. There has been, in other words, a *de facto* decriminalization of unethical behavior by banks that are above the law and beyond the discipline of the market. One of the world’s largest banking groups, HSBC, for example, admitted to laundering billions for drug cartels and violating critical bank laws, including the Bank Security Act and the Trading With the Enemy Act (Protess & Silver-Greenberg, 2012).

Abuses of power, third, often do not involve extraneous factors like sex and money, but the illicit use of power itself. As Teddy Roosevelt observed, “You cannot give an official power to do right, without at the same time giving him the power to do wrong.” Scandals reveal activities that transgress the rules of governance in the acquisition and exercise of power. The preemptive war against Iraq as a response to the 9/11 terrorist attacks, for instance, was described by the chief official in the White House situation room on 9/11 as making as much sense as “invading Mexico after the Japanese attacked us at Pearl Harbor” (Clarke, 2004, 30–31).

Finally, sometimes scandals can stem from power but entangle money and sex—or just plain waste. An imbroglio involving sex, money, and power occurred in the Department of Interior’s Minerals Management Service, a unit responsible for collecting \$10 billion in royalties (one of the federal government’s largest sources of non-tax revenues). Regulators accepted bribes, negotiated for industry jobs, engaged in illicit drug use and sex with oil company employees, falsified reports, and waived regulatory requirements. In the wake of the 2010 Deep Water Horizon blowout, the agency was renamed and reorganized. An instance of waste, in a time of fiscal austerity, was revealed by the General Services Administration (GSA) Inspector General in 2012—a lavish 2010 Las Vegas conference at a cost of \$823,000. The convention featured mind readers, magicians, clowns, souvenirs, and expensive dinners. Some of those involved received bonuses. The agency head resigned, all travel expenditures and conferences were suspended, and a thorough review of personnel and planning practices was undertaken. Ironically, the U.S. Office of Government Ethics evaluated the GSA during the time it was planning the convention, and praised it for using exemplary practices, while failing to address known risk factors that could have prevented the problem (Epstein, 2012).

Impacts on the Government Service, Business, and Nonprofit Sectors

If our civilization is destroyed, disaster will not be by...barbarians from below. Our barbarians come from the top.

—Henry Lloyd, *Wealth Against Commonwealth*

Government Service. Sex, financial, and power scandals belie the idea of public service: These abuses are problematic for democracies as they subvert governmental legitimacy and obstruct the rule of law.⁷ It should be noted, though, that such events have a Janus-faced nature about them (Garment, 1991). On the bright side, they can be seen as actually stabilizing the political system. The contention is that it needs pathologies for purification purposes, as exposures take the abstract values of democracy (such as due process and equal protection) and make them tangible. As a result, it is said that “the process works,” and the system deserves support. What began as abuse of self-government culminates in a celebration of its values. Scandals also satisfy the need for the citizenry to participate, albeit vicariously, in

public affairs. On the dark side of the Janus-face, revelations may not have the claimed beneficial effects. The lesson of the Watergate affair in the Nixon administration was not so much that the rule of law was effective, but that few citizens since then wanted to experience a failed presidency again (Pierce, 2012).⁸ Worse, scandals can become an alternative to dealing with important societal issues. Perversely, this strategy to divert public attention away from failure can include fake scandals that spawn faux outrage that obscures actual, less easily reported problems. Such non-incidents (e.g., rejecting documentation of President Obama's birthplace) create a culture of mistrust.

The result of real and specious scandals is that it is more difficult to govern. Ethics can even be used as a weapon to discredit reformers—all that may be necessary is a well-financed misinformation campaign aimed at their personal and professional lives to frustrate reform. Instead of stabilizing the system, Garment (1991) argues, scandals destabilize it as they are morally repugnant, economically distorting, and politically de-legitimizing. As a consequence, we feel “perpetually dirty,” have contempt for everyday politics, and believe that the system is dishonorable. Instead of eliminating corruption, even those incidents that are “successfully” resolved damage public trust.

Business. In every era marked by rapid technological change, entrepreneurial zeal is apt to be attracted to the lure of quick riches. The cavalcade of corporate scandals since the turn of the 21st century should not be surprising. Yet merely pointing out that dishonesty is not the norm in business is insufficient. For all the attention to the Wall Street crime wave, significant audit and accounting issues persist. The federal government's response to the crisis—to re-establish the status quo as soon as possible—is also not unexpected, given that the officials responsible for financial law enforcement are the same people who played important roles in the financial sector when it imploded. “There is an awful lot to do in the world of corporate fraud,” according to the FBI (Johnson, 2006). Further, there are ongoing lobbying efforts to thwart the landmark 2002 Sarbanes-Oxley Act (intended to curb accounting abuses) and the 2010 Dodd-Frank legislation (designed to prevent another 2008-style meltdown of the financial system) (Chapter 10). As irresponsible stewards of the power surrendered to them through deregulation, investment firm CEOs wrecked the economy, received bailouts from the federal government, and are richer than ever (Dionne, 2010). “The dogma of ‘free markets,’” Bill Black (2012) points out, “has turned into an anti-regulatory creed that produces an environment so criminogenic that it drives our recurrent, intensifying financial crises.” Ironically “the spectacular failure of financial markets,” writes Michael Sandel (2012, 12), “did little to dampen the faith in markets generally,” as public opinion polls showed that Americans blamed the government more than Wall Street for the scandal.

It is doubtful, in any case, that recent reforms have been institutionalized as the nation has yet to grasp the depth of the problem. There is a big difference between being accountable and being held to account. For instance:

- State and federal changes made in the early part of this century did little to prevent the 2007–2010 credit crisis (Chapter 1). In fact, investigations into banking practices—including widespread fraudulent documentation of mortgage loans—have

not yet come to closure. (Note: Mortgage-backed securities are the biggest asset class in the world.)

- White-collar crime federal sentencing guidelines (www.ussc.gov/orgguide.htm) discussed above, which place responsibility for establishing an ethical organizational culture on top executives, were recently changed from mandatory to advisory in nature (also see Chapter 10).
- In contrast to the Savings and Loan scandal and the Enron Era, there have been very few investigations, many fewer prosecutions during the Great Recession, as miscreant financiers avoided jail, made sweetheart deals, and collected millions in bonuses while many citizens lost much of their life savings, their jobs, or their homes.
- The long-standing practice of permitting an organization or individual to neither admit nor deny wrongdoing (“no-fault” corruption) might encourage compliance, but also enables widespread recidivism; it overlooks, in addition, that guilty pleas make it easier for victims to recover damages and take advantage of law that treats past offenders differently than one-time perpetrators.
- The epic corruption by military contractors reached twice the amount of money (adjusted for inflation) expended to rebuild Iraq as it did to rebuild Japan—“an industrialized nation three times the size, two of whose cities had been incinerated by atomic bombs” (Rich, 2007).
- Major investment banks are “dismissive, even defiant” when criticized for “business as usual” investment and compensation practices supported by bailout money (Anderson, 2009); “they were embarrassed for about 15 minutes,” grew bigger than ever, and worked to block or repeal reforms (Clark, 2013).

At issue is not merely honest bookkeeping, but the fact that governance of corporations and capitalism as a whole becomes increasingly predatory (Ferguson, 2012). Free markets are supposed to allocate capital efficiently to the benefit of everyone, but only if subject to meaningful oversight. Many corporations no longer exist to produce goods; rather, they are owned by global speculators and institutional investors who demand short-term profits, often achieved by eliminating jobs and slashing wages. Instead of building industrial capacity and public works infrastructure, investment banking created financial innovations for the sake of profit at the expense of social value. Indeed, much of the problem is what is legal when firms are rewarded for lobbying clout rather than contributing to the economic health of the nation. As Senator Richard Durbin (D-Ill.) said in 2009, despite having caused the crisis, the same financial firms “are still the most powerful lobby on Capitol Hill. And they, frankly, own the place” (quoted in Friedman, 2011).

Perhaps the best illustration of this is the “shadow banking system”—unregulated, dangerous, speculative credit derivative markets which changed the way Wall Street made money—that played a key role in creating the 2007–2009 recession and its continuing after effects. Shadow banking accounts for more assets than those held by the traditional banking system (Cowen, 2013). A particularly destructive form of capitalism, these opaque markets offer little or no social or economic purpose, while tying up billions of dollars that could

otherwise be used to finance businesses to create jobs and produce goods and services. Much more of the system's assets are devoted to trading corporate securities than to supporting long-term investment in productive assets. Derivatives—what Warren Buffet called “weapons of mass financial destruction”—were devised to distribute risk broadly so that they made the system safe. But “they interlocked risk so completely that they brought the system down” (Meyerson, 2011) to the point that Wall Street banks stopped lending even to each other. This is an example of the financial industry detached from the real economy it is supposed to serve (Brady, 2011; Pearlstein, 2012). In short, the impact of scandals makes it difficult to govern, to hold public and corporate officials accountable, and to chart reform.

Nonprofits. Not-for-profit organizations are also adversely impacted by scandals. Stories of the misdeeds tarnish the reputation not only of those smeared with the taint of corruption, but also legitimate programs that might lose favor in the public's perception. Damaged reputation can sour potential donors who may withhold cash because of real or actual misdoings. Nonprofits are especially susceptible to fraudsters because of their characteristics such as a trusting atmosphere, revenue streams that are hard to verify, insufficient knowledge and experience in business and financial matters, and unpaid volunteer boards of directors (Douglas & Mills, 2000). Add to this the legal system's inconsistent approach to pursuit of white-collar criminals in the nonprofit setting (Croall, 2003) and problems may escape detection and be allowed to fester. Because of these vulnerabilities it is important for nonprofits to protect themselves by fortifying their ethical infrastructure (Chapter 8) and by standing up for integrity.

AVENUES FOR REFORM

Power concedes nothing without a demand.

—Frederick Douglass

A more successful, less crisis-prone financial system would include initiatives such as

- establishing a national commission on corporate crime;⁹
- restricting the use off-shore tax havens;
- strengthening conflict of interest rules;
- limiting stock options;
- using the authority federal and state law enforcement agencies already have;
- acknowledging that fines and court settlements, “which don't even rise to the level of a minor inconvenience” (Gongloff, 2012), are meaningless unless coupled with executive exposure to criminal and civil liability;
- improving business accountability to not only company stockholders, but also societal stakeholders by enacting legislation that prohibits making a profit at the expense of the environment, human rights, public safety, the welfare of the community in which the corporation operates, or the dignity of employees (several large cities have passed a

Code for Corporate Citizenship or “responsible banking” ordinances which require banks to reveal their impact on the community and/or require city officials to only do business with banks that are responsive to local needs);

- forbidding corporate lawbreakers the right to bid on governmental contracts which are a significant source of business for most major companies;
- establishing a reparations fund—like the BP fund to reimburse 2010 Gulf oil spill victims—for Main Street victims of Wall Street avarice—the source of revenues would be a “Robin Hood” tax (Exhibit 9.2); and
- enacting a corporate “death penalty” by revoking the firm’s charter after three criminal convictions (Exhibit 9.3).¹⁰

EXHIBIT 9.2

Robin Hood Tax

The “Robin Hood” tax would offset the cost of the financial sector–caused recession, suppress high-risk and high-speed trading that caused the crash, and limit the casino culture of Wall Street. The United States not only had this tax in the past (1914–1966), but also doubled it during the Great Depression to help pay for recovery. Revenues would be collected on financial transactions detailed in the proposed Wall Street Trading and Speculator Tax Act. The tiny levy, 0.03% of each transaction, is able to generate significant funds due to high frequency of billion-dollar trades (Gerard, 2012; van Gelder, 2002). The nation charges sales taxes on many consumer goods, but nothing on the sale of stocks, bonds, and derivatives—at a time when many other nations use the Robin Hood tax. Added impetus for this reform was provided by the May 2012 \$5 billion loss sustained by JPMorgan and the credit downgrades of 15 major banks the next month. This was followed by the global Libor interest rate exposé. Even after being bailed out by the taxpayer in 2008, it was evident that banks continued to speculate and fail to protect themselves from future crashes. Critics maintain that banks need adult supervision.

Reforms specifically targeting banks include capital requirements, standardized and transparent derivatives, and independent auditing. Absent regulation, “capitalism’s most dangerous enemies are capitalists” (Samuelson, 2008), not unlike the communists who destroyed communism. A “criminogenic” environment is created by speculation, chicanery, and outright fraudulent behavior. Analogous to Gresham’s Law (counterfeit money drives legal currency out of circulation), regulatory negligence and corporate excess permit bad behavior, allowing honesty to wither.

Indeed, banks, according to U.S. Representative Maxine Waters (D-Calif.) (2012), “will fight against regulation even when it is in their own best interest.” Thus, the head of JP Morgan acknowledged before Congress that reckless trading fueled by “greed, arrogance, hubris, and lack of attention to detail” continues, even as the industry resists rules to curb its toxic practices (“Mr. Dimon,” 2012). In recent years, leading financial firms have been caught committing fraud, financing terrorists, and laundering money. For example, transgressions

EXHIBIT 9.3

Corporate Charters

I believe . . . that banking institutions are more dangerous than standing armies.

—Thomas Jefferson

A potential reform strategy is to reinvigorate corporate charters, the legal instruments by which state governments incorporate businesses (Kelly, 2001). Historically, corporations were creatures of, and subordinate to, state governments. The Founders understood that “we the people” would be sovereign over not only the political, but also the economic system. Since corporations were seen as a threat to democracy—the American Revolution was a reaction to British trading companies—citizens determined whether corporations had the right to exist. Indeed, Thomas Jefferson wanted an Eleventh Amendment to prevent companies from dominating entire industries or having power to influence government. He saw this as necessary because the Bill of Rights does not protect people against private institutions (employees, for instance, have no powers of free speech). The main reason it was not incorporated into the Constitution was that it was deemed unnecessary given the state-chartering process.

Corporations possessed no authority, as legislatures set the terms of their existence—public corporations were not private enterprises and not run to maximize shareholder value. It was a privilege to serve the commonweal. The public governed corporations by detailing rules and defining operating conditions in charters (few were granted, and then only after legislative debate). In short,

- corporations had to serve a public purpose;
- they were limited to what business they could pursue (they could not buy other businesses) and could amass only certain amounts of wealth;
- there was a 15- to 20-year limit to the charter, subject to renewal;
- corporations were prohibited from lobbying;
- the penalty for abuse was not a fine or plea bargain, but charter revocation; and
- stakeholders were to be treated responsibly by corporations. (Hightower, 2003)

In 1886, however, a Supreme Court ruling—*Santa Clara vs. Southern Pacific Railroad Co.*—was widely misinterpreted to mean that corporations were “persons” with the same inherent, inalienable rights, freedom, and mobility as human beings (Hartmann, 2010). In subsequent years, courts established new doctrines (freedom of contract, managerial prerogative) to weaken state laws and citizen sovereignty over corporations, as they bestowed on corporations authority over investment, production, and organization of work (Grossman, 2001). The result: Shareholder primacy over public interest was established and the role of government changed from defining corporations to attempting to regulate them. Corporations, accordingly, have claimed such rights as the Fourteenth Amendment right to stop cities from favoring local businesses over chain stores, the Fourth Amendment right against search and seizure to prevent surprise inspections of companies, and the First Amendment right to free exercise to spend unlimited monies in political campaigns. Many states, nonetheless, still retain formal charter revocation authority, and some businesses—notably those that are small with little political power—may lose their charters.

In 1976, a Supreme Court decision equated free speech with spending, resulting in corporations having the biggest, wealthiest, and most undemocratic voice in electoral process. This was dramatically reinforced by the Court's 2010 *Citizens United vs. Federal Election Commission* decision, which removed limits on corporate contributions to political campaigns. Businesses are now able to tell employees which politicians they support, in effect, campaigning and collecting donations in the workplace. The implication is that "the rich and powerful transform free speech—our most important tool of bottom-up self-government—into a means of allowing top-down control" (Epps, 2012). Revisiting the origins of corporate charters, in brief, may hold promise as a reform strategy, one that might merit national standards for large corporations—the issuance of federal charters.



CASE STUDY 9.1

Applying Philosophical and Behavioral Ethics Approaches: Public to Private Employment on Similar Work

Craig Weatherford has worked for many years in Metropolitan County government. Trained as an engineer, his job is to conduct evaluations for the county zoning board regarding engineering features of filed petitions. Weatherford decides to retire. He then opens a consulting business and does similar work in the private sector. Given his prior experience in government, he is approached by a fellow engineer from a development firm who is petitioning the county zoning board for a variance. Weatherford agrees to represent the client and is slated to offer expert testimony before the board regarding the technical soundness of a large water system and the ecological consequences for surrounding jurisdictions. Previously, while employed by the county, Weatherford had completed preliminary assessments of this petition. His status as an expert witness for the company was challenged by citizen groups who opposed approval of the zoning variance. They questioned Weatherford's involvement in this issue. Now, he is uncertain about whether to continue to testify and represent his client.

Results-Based Analysis. Like the case in the last chapter, this case study can be examined using both philosophical theory and behavioral ethics. Beginning with the former, a results-based analysis focuses on the greatest good for the greatest number. Thinking broadly about

the case, it is hard to argue that allowing one side of a dispute to use insider knowledge not available to the other side serves the greater good, especially when it creates an unlevel and unfair playing field. More narrowly, Weatherford may be viewing results differently. He thinks his experience will likely enable him to be successful in persuading the board to approve the variance. Weatherford's clients would be pleased if he prevailed and his business would likely flourish as a result. He doubts that there would be any mistakes in his testimony because he has intimate knowledge not only about board policies and procedures, but also regarding the nuances of the case based on his preliminary review. Nonetheless, the advocates opposing the variance will question the legitimacy of the process if the board relies on testimony from someone with the unfair advantage of inside information.

Weatherford is aware of his vulnerability to the charge of trading on insider knowledge, which undoubtedly will be emphasized by those opposing the variance. He is concerned that this allegation might be effective and undercut his credibility. Failure to win the variance for his client could damage his reputation for competence and lead people to question his integrity. He worries: Is he putting the end of achieving the variance ahead of the ethics of his profession regarding "avoiding the appearance of impropriety"? He realizes that there may be legitimate concerns regarding the ethical permissibility of his private employment following public service, but he is unwilling to withdraw.

Rule-Based Analysis. A rule- or principle-based analysis considers what is good for one is good for all. The privileged information is not available to all stakeholders. Weatherford does not seem willing to recognize that he may resent it if everyone was allowed to use the information in the way he intends to use it. Is giving an unfair advantage to one side of a dispute a practice he would want to universalize? Probably not, but he may feel that while the rules regarding conflict of interest and inside information are found in the relevant provisions of professional ethics codes, these provisions are vague and subject to interpretation. Further, he knows he is qualified professionally to evaluate the proposal objectively.

Weatherford recognizes he has an edge in this dispute because of his prior experience, but he also knows he will confront charges that he is violating standards. Despite fears that the citizen group would approach the media and publicly criticize his role, he is convinced that he can defend the variance on the merits and that the facts are on his side. The professional ethic requires him to represent his client to the best of his ability. Withdrawal from the case means failure.

Virtue-Based Analysis. A virtue ethics approach focuses on whether the decision makes him and his community better. Weatherford has promised to represent his client and to appear before the board; he is convinced that the variance will advance the community's interest and is loath to renege on this promise. Does he walk away from his client and give up midway through the case? Does he wither in the face of criticism? He thinks it is important to stand up and to be an effective advocate for those who are paying for his services. He owes them his best effort. He would not deny that his prior experience is an asset, but he would not apologize for using his skills acquired in civil service.

Yet does he have an unfair advantage over his opponents? Would the decision to continue pursuing the case reflect the actions of a person of good character? Can he look himself in the mirror and comfortably conclude he could live with himself if he continued to pursue the case? If not, he should withdraw. He wants to be prudent by carefully weighing the pros and cons of the case and consulting colleagues for advice before deciding definitively.

Behavioral Ethics-Based Analysis. Prior to a decision, however, it is important to consider insights from behavioral ethics that lead to consideration of other possible, sometimes unconscious, motivations and intuitions at play in Weatherford's actions. Recall that it is a universal human condition that people think that they are better than they really are. Self-serving bias, thus, can often influence decisions; Weatherford is likely making judgments based on what would advance his self-interest. The "want" and "should" selves might have been at odds with each other: He may have failed to distinguish between his emotional and impulsive "want" choice to take the case and the more thoughtful and deliberative "should" choice. This bounded ethical awareness could help account for the acceptance of the case and agreement to testify without giving sufficient attention to the possible appearance of impropriety. He may have framed the situation as one that he could win rather than considering the ethical implications, rationalizing that the rules on conflict of interest were vague and inapplicable. Upton Sinclair's famous line, "It is impossible to make a man understand something if his livelihood depends on not understanding it," comes to mind.

Source: Online Ethics Center for Engineering (2006).

include the 2012 LIBOR (London Interbank Offered Rate) interest-rate rigging scandal (which affects the cost of borrowing for corporations and consumers) as well as JP Morgan Chase's 2013 \$6.2 billion trading fiasco (Morgenson, 2013). There is, in short, no shortage of ideas to reform the system; what is missing is political will.¹¹

An indicator of the validity of reform is the inability of opponents to make an honest case against them. The implacable, tenacious power of existing stakeholders cannot be underestimated. An important consideration in enacting change is what may happen when and if they are implemented. Many white-collar crimes are extraordinarily complex, and public service frequently does not have the necessary expertise and funding to pursue them in court. In addition, resource-poor government prosecutors typically face well-financed corporate defense teams (e.g., Enron's Kenneth Lay and Jeffery Skilling's legal defense cost at least \$70 million). Business corruption in recent years is not just a corporate failure, but also

a failure of governmental oversight eviscerated by deregulation. Indeed, the sheer volume of cases simply overwhelms prosecutors.

The inability or unwillingness to employ anticorruption approaches amounts to the institutionalization of corruption that not only degrades democracy and the rule of law, but also imperils the future of the nation. Even the most egregious failures do not seem to be consequential to policymakers or banking officials. Evidence matters much less than a narrative that supports their interests. In a fact-free environment, unaffected by conventional understandings of facts, no one pays the price for disinformation. Reality-based governing is at risk. In many respects, America has become a society that cannot self-correct. Edward Wyatt (2012) says this about the Securities and Exchange Commission:

Critics of the agency have raised concerns about its settlement practices over the last decade. According to the *New York Times* analysis of enforcement cases, nearly all of the biggest Wall Street firms have settled fraud cases by promising never to violate the law that they had already promised not to break, usually multiple times. In addition . . . those settlements also repeatedly granted exemptions to the biggest Wall Street firms from punishments intended by Congress and regulators to act as a deterrent to multiple fraud violations.

The 2011 Financial Crisis Inquiry Commission faulted two administrations and regulators with permitting fraudulent lending practices, bundling of toxic loans for sale to investors, and risky bets on securities backed by the loans. One commentator explained the importance of this finding, saying, “The greatest tragedy would be to accept the refrain that no one could have seen this coming and thus nothing could have been done. If we accept this notion, it will happen again” (Chan, 2011).

Indeed, with the fifth anniversary in 2013 of the Wall Street debacle, several self-serving rationalizations—that no one saw it coming and bailing out the banks was the only responsible choice—attempted to provide exoneration of those responsible (Prasch, 2013). To the contrary, it was predicted by many analysts and economists (none of whom were later elevated to responsible positions in government or business). An alternative choice to subsidizing bankrupt investment firms would have been follow the 1984 Continental Illinois bank collapse (one of the nation’s largest banks) which was taken over by the Federal Deposit Insurance Corporation, the agency with extensive experience with resolving failed financial institutions.

Except for these widely overlooked studies, there have been no other authoritative examinations of the role that financial institutions played in the worst recession since the 1930s, no financial settlements proportionate to the crisis, and no criminal indictments of megabank executives. Stanford University economist Anat Admati (2013) wrote that huge banks

take enormous risks that endanger the economy. . . . We will never have a safe and healthy global financial system until banks are forced to rely much more on money from their owners and shareholders to finance their loans and investments.

Wall Street firms, whose resources easily surpass those of state and federal governments, may not only be too big to fail, but also too big to investigate, prosecute, and jail.²⁹ Operating with impunity, the banking industry continues to imperil American society as crime without punishment prevails. Prosecutorial passivity in the face of overwhelming evidence remains, but seemed to be changing in 2013. Federal criminal charges were leveled against the major hedge firm SAC Capital Advisors, and the nation's largest bank, JPMorgan, confronted multiple investigations by the U.S. Justice Department, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (Douglas, 2013; Lattman & Protes, 2013). Late in the year SAC plead guilty to insider trading and paid a \$1.23 billion fine, and JP Morgan settled for \$13 billion, the largest fine ever levied by the government (it represents one-half of the bank's 2012 profits). No individuals at either institution were held accountable ("JP Morgan Pays," 2013).

CONCLUSION

Only they deserve power who justify its use daily.

—Dag Hammarskjold

No organization is corruption-proof. Dishonorable behavior is often easy, it pays, and getting caught is improbable. However, ignoble conduct cannot be minimized, as the costs of corruption are intolerably high in a democracy. Paradoxically, Daniel Kaufmann (2005) argues, "You don't fight corruption by fighting corruption." Most jurisdictions do not need more politically expedient studies, anticorruption campaigns, laws, and agencies to serve as a scapegoat for lack of progress or a wall behind which to shield wrongdoing. What is needed is to (a) use the authority already present to pursue fundamental, systemic reforms; (b) end the deliberate underfunding of law enforcement and the judicial system; and (c) fortify a merit-based public service to deter and detect corruption.

For example, while the Securities and Exchange Commission charged 100 firms and 545 executive officers in connection to the 2008 economic collapse, the commission's budget is a fraction of those found in Wall Street firms. Further, federal regulations restrict the size of fines—most of which, in any case, are covered by corporate insurance policies. Investigations of institutions at the center of the debacle—Goldman Sachs, Lehman Brothers, Countrywide Financial, American International Group—have been dropped. Stated differently, the financial crisis has been exacerbated by a violation of the fundamental principles that make democracy and capitalism work: accountability and equal justice (Judson, 2011).

In the meantime, it is useful to respond to common reasons for not dealing with corruption:

1. "Corruption is everywhere." The statement not only is self-defeating, but also makes an assumption that is contestable. Poor health is worldwide, but no one concludes that treating it is a bad idea.
2. "Corruption is culturally determined." While cultural diversity is a fact, there are some practices condoned by none. No culture, for example, condones outright bribery.

Exaggerating the importance of culture is often a facade for practices grounded in self-interest. When this happens, it may pre-empt policies to change culture and save it from itself (Chapter 3).

3. “Cleansing society of corruption requires vast change taking many years.” While evil has been present for centuries, so has honor. There is no time like the present to close loopholes, create incentives and deterrents, and augment accountability. The objective is to change the perception of corruption from a low-risk, high-profit enterprise to one that is a high-risk, low-profit peril.
4. “Worrying about corruption is pointless; with free markets, corruption will disappear.” Corruption can easily inflict serious harm on free markets, as today’s Wall Street scandals, like the Enron Era and Savings and Loan disasters before it clearly demonstrate. Widespread misdoings have been exposed, annihilating the myth of self-regulating markets. Yet that does not stop many decision makers from fighting for the continuation of the same failed policies that caused the disaster. Markets, as imperfect human-created constructions of reality, eventually may be self-correcting, but not without considerable damage to society (adapted from Klitgaard, MacLean-Abaroa, & Parris, 2000).

In brief, the beginning and end of wrongdoing starts with each person. It is important to be aware of the types of circumstances likely to disorient one’s moral compass and the rationalizations used to excuse dubious behavior. If corruption problems are ignored, we will not be able to deal with them—they will deal with us.

To combat corruption, a strong civil society (legitimacy of open debate, reform movements, institutions designed to serve the commonweal), clear vision for reform, vigorous political leadership, and rigorous monitoring of progress are necessary. Unfortunately, these critical elements seldom emerge simply because they are needed. The combination of circumstances necessary to attract national attention occurs so rarely that once reforms pass, it is unlikely that such issues will gain widespread attention for some time to come. It has been some six years since the near-collapse of the economy, and the problems that caused it remain.

The spreading scourge of corruption and the resulting systemic failures on Wall Street should mandate active, disinterested governmental regulation rooted in a “sober, conservative assessment of the human capacity of mistake and self-delusion, not to mention avarice and chicanery” (Meyerson, 2011). The economy should be a servant, not a master, of human needs. Until genuine reform is achieved, major scandals can be expected in the years ahead. The indelible lesson to date is that perpetrators can act with impunity. Discredited financial firms are transforming themselves into a larger, more centralized, and more virulent form, as they continue to corrupt the political system through campaign donations. At some point, a choice will have to be made: rescue investment banks or civil society.

The disposition to admire and almost worship the rich and the powerful is the great and most universal cause of the corruption of moral sentiments.

—Adam Smith

NOTES

1. Actual data are difficult to obtain for the reasons already noted and because statistics are ambiguous due to definitional issues. At the same time, Kaufmann, Kraay, and Mastruzzi (2006, 3–4) argue that imperfect proxies—informed stakeholder perceptions, institutional practices, project audits—furnish useful measures of corruption. In fact, “there should be no presumption that objective data is necessarily more informative than data that relies on survey responses from firms and citizens about the reality (of corruption) on the ground.”
2. For a running commentary on these matters, see <http://www.corporatecrimereporter.com>. An interesting group of articles on white-collar crime can be found in the June 6, 2004, *New York Times Magazine*.
3. Mark Warren (2006) argues that the focus on corruption should be on how it undermines the processes of democracy. It does so by limiting the capability of governments to be responsive to the people when it excludes citizens from decisions that affect them.
4. Moral hazard is most often applied to individual consumers rather than too-big-to-fail institutions. “A lot of energy has gone into arguing that higher workers’ comp payments, for example, make workers careless,” writes Shaila Dewan (2012). “Far less is said about how lower workers’ comp invites moral hazard for employers, making them less attentive to workplace safety.”
5. See gift-giving “point-counterpoint” feature in *Public Integrity*, 4(1) (Winter 2002); also examine Schultz (2010).
6. As noted in Lou Cannon, *Governor Reagan: His Rise to Power* (New York: Public Affairs, 2003).
7. The citizenry may have a pragmatic view toward many transgressions, overlooked so long as the elected official does not lie about them and can still be effective by providing for constituency needs. As one politico said, “[P]eople love a titillating story, but they care much more about who can deliver for them”—a fall from grace, followed by redemption, is the classic religious model of salvation. After reviewing the numerous sex scandals and the growing tolerance of some behavior, columnist Lenore Skenazy (2008) observed, “We are officially adults now, just like the French people but without the delicious pastries and nude first lady.”
8. Charles Pierce (2012) writes that “if the lessons of Watergate really were that ‘the system’ worked and that ‘the people’ triumphed,” then Ronald Reagan would have been impeached for the Iran-contra affair, George W. Bush would not have gotten away with what his 2000 campaign did in Florida (to say nothing of what was done once in office), and Barack Obama would be under much more pressure than he is for continuing many of the Bush-Cheney civil liberties policies. “The lasting lesson of Watergate,” Pierce writes, “is that self-government was too dangerous.”

9. In the 2012 State of the Union address, the president pledged to create a financial crimes task force to investigate the banking crisis. Over a year later, there have been no investigations or prosecutions.
10. For additional ideas dealing with corporate disclosure, citizen rights, employee participation, and related issues, see Kelly (2001) as well as <http://multinationalmonitor.org> (click on archived issues, July/August 2002, Corporate Reform After Enron, especially the "Introduction"), www.citizensforethics.org, www.corporatecrimereporter.com, and www.corpwatch.org. Also refer to "USA: 12 Things to Do Now About Corporations" (van Gelder, 2002).

On a lighter note, defense attorney Edward W. Hayes created several measurements for gauging the ups and downs of Wall Street: the HEGI and the HESI (the High End Girlfriend Index and the High End Stripper Index). When the financial sector's business is good, traders and bankers spend enormous sums of money on high-end girlfriends and in the VIP rooms of Manhattan's pricey strip clubs (Richberg, 2008).

11. Yet citizens do not have to wait for politicians to act; they can be imaginative when the need arises. In the classical Greek play *Lysistrata*, the women of Athens go on strike, refusing to have sex until war ended. Peace negotiations were quickly concluded (also see Miller, 2005). Likewise Liberia's women used the same strategy in 2003 to campaign for peace, as did women in Togo to demand the resignation of the country's president (Associated Press, 2012). In addition, as part of a 2012 Spanish national strike protesting austerity measures, the executive-class escorts refused bankers until they opened up credit lines to middle-class families and small businesses. Madrid's largest prostitute trade association (Moran, 2012), said, "We are the only ones with real ability to pressure (bankers)." Apparently, the idea for the strike came after one of its members pressured a bank employee to grant a loan to a struggling citizen by withholding her services.
12. Nonetheless in 2007 the Justice Department decided to prosecute baseball star Roger Clemens for lying to Congress about steroid use (he was acquitted in 2012), while failing to prosecute government torturers and white-collar criminals.

FOR DISCUSSION

1. To the extent that people tend to think of themselves as more ethical than others, they may overestimate the degree of improper conduct in organizations. They then might modify their own behavior accordingly, with the result that corrupt behavior expands. Critique.
2. Comment:
 - a. "Behind every fortune lies a crime." —Balzac.
 - b. "Behind the ostensible government sits enthroned an invisible government owing no allegiance and acknowledging no responsibility to the people. To destroy this invisible government, to befoul the unholy alliance between corrupt business and corrupt politics is the first task of the statesmanship of the day." —Theodore Roosevelt.

- c. "One of the most important duties of government is to put rings in the noses of hogs." —William Jennings Bryan.
 - d. "It is easy to get into trouble and hard to get out." —Anonymous
3. Choose a, b, or c for examination.
- a. The nation's nonprofit groups were held in high esteem immediately after September 11, 2001. In the months that followed, however, questions about the practices of the United Way, the American Red Cross, and others caused public confidence in not-for-profits to plummet. A survey conducted several years later by Paul Light (Brookings Institution) found public trust in nonprofit organizations had not been regained. Assuming that attitudes are slow to change, how can high esteem and confidence be restored?
 - b. It is said the major banking institutions are "too big to fail." How does this explain (if it does) the failure to indict individual bank executives—an action that would not endanger the economy?
 - c. Corruption tends to prevail when the state is captured by elites who use it for their own purposes. Comment on this claim in the context of such concerns as campaign finance, low voter turnout, millionaires winning office, lack of competition for many congressional seats, absence of political attention to major issues affecting the average voter, and so forth.
4. React to the statements below.
- a. "We have a formidable ethics program—we always catch and punish violators."
 - b. "We have a very effective ethics program—we have 100% compliance; no one has ever been caught doing something wrong."
 - c. "Without effective societal institutions—government and business transparency, checks and balances, a free press, independent judiciary—corruption control will be significantly hampered."
5. In 2013, the *New York Times* reported that
- the banks that created risky amalgams of mortgages and loans during the boom—the kind that went so wrong during the bust—are busily reviving the same type of investments that many thought were gone for good. Once more, arcane-sounding financial products like collateralized debt obligations are being minted on Wall Street. . . . [T]he revival . . . underscores how these investments . . . have largely escaped new regulations that were supposed to prevent a repeat of the last financial crisis. (Popper, 2013)
- Discuss.
6. Populist Jim Hightower (2013, 2) writes, "Wall Street's super-rich speculators are now making millions of super-fast, robotic financial transactions per second, generation trillions of dollars a year from them—but producing nothing of real value for us, which is distorting and endangering markets." Discuss.

EXERCISES

1. Check with the secretary of state in your state or a local corporation; ask for a copy of a corporation's state charter. Examine its content and critique.
2. Consult these websites for updates on corruption: www.corpwatch.org, www.corporatepolicy.org, and www.citizensworks.org (which contains 12 reforms to crackdown on white-collar crime).
3. Ralph Nader (2013) suggests that corporate CEOs should recite the Pledge of Allegiance at shareholder meetings because

[i]t is our country that chartered (their corporations) into existence and helped insure their success. . . . And these corporations now wield immense power in our elections, in our economy, over our military and foreign policies, and even in how we spend time with our friends and families. [This] is an ideal time to call out these runaway corporate giants who exploit the patriotic sensibilities of Americans for profit and, in wars, for profiteering, but decline to be held to any patriotic expectations or standards of their own.

Contact businesspeople in your community for their views on this claim.

4. Examine the detailed investigation of corruption in nonprofit organizations by The *Washington Post* (http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html).

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