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0521844398 - Conflicts of Interest: Challenges and Solutions in Business, Law, Medicine, and Public Policy
Edited by Don A. Moore, Daylian M. Cain, George Loewenstein and Max H. Bazerman
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Introduction

Don A. Moore, George Loewenstein, Daylian M. Cain, and Max H. Bazerman

Many professionals face a conflict between their professional responsibilities to protect the interests of their constituents, shareholders, patients, clients, or students, and their own self-interest. Under the best of circumstances, they stumble along, making implicit tradeoffs that represent some kind of rough compromise between these competing motives. The auditor may give clients some breaks but blow the whistle on cases of egregious corruption. The doctor accepts trinkets from a pharmaceutical company and may even prescribe that company's drug when it is perfectly equivalent to the competition's. The academic serving as an expert witness tries to craft her argument to satisfy the side she is working on but avoids saying anything that she vehemently disagrees with.

At times, however, this fragile equilibrium seems to break down, either within a single profession or more broadly. Exactly why this happens is not well-understood, but it is clear that we are living in such an era. Although conflicts of interest have been a fixture in the economic and political landscape almost from the outset of capitalism, the negative consequences of conflicts of interest seem to have worsened considerably in recent history. The most notorious of these consequences have been those involving the accounting industry. The accounting industry and the audit function it serves act as the primary safeguard for investors against malfeasance by corporate managers, but this function seems to have broken down in recent decades, contributing to a long string of scandals at major American corporations, including Enron, WorldCom, Global Crossing, Adelphia, and many others. But the conflicts of interest that have rocked our society in recent times are not restricted to auditors. As documented in many

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of the chapters of this book, they also permeate other areas of business, medicine, law, and even academic research.

When conflicts of interest come into the public eye as a result of scandals, there typically are efforts at policy reform that in turn lead to debates between professionals and regulators over what form such reforms should take. Academics often play a role in such debates. Thus, several academics testified at the SEC hearings on auditor independence held in 2000, prior to the spate of accounting scandals, but that, unfortunately, failed to produce substantive reform. Ideally, academic input should be an essential ingredient of policy reforms. To remedy the problems caused by conflicts of interest – and enact effective policies to deal with them – an understanding of how conflicts of interest operate at the individual level is required. How does an auditor, whose profession claims independence as its cornerstone, end up complicit in management fraud by signing off on obviously cooked books? How do physicians, who are committed to serving the interests of their patients, end up routinely taking gifts from pharmaceutical companies, then prescribing those companies' unnecessarily expensive and often inferior drugs to their patients? How do academics end up selling their integrity for the fees they receive as expert witnesses?

Academics, however, have not had much influence in these debates. Economists traditionally have had the greatest influence in public policy, but economists have played a very limited role in discussions of policies dealing with conflicts of interest, perhaps because the widespread assumption that people act out of self-interest denies that professional responsibilities would hold any sway over professionals to begin with, outside of reputational concerns. Economic literatures on problems of agency (Jensen & Meckling, 1976) and auditor independence (Antle, 1984), for example, assume that economic actors are motivated exclusively by money and that they will always select the course of action with the highest expected value. Psychologists have better theoretical frameworks for dealing with situations, like conflicts of interest, which involve conflicting motives such as financial gain and ethical duty. But psychologists traditionally have had much less impact on public policies outside of those dealing directly with psychological issues such as reimbursement for psychotherapy. Our main purpose in organizing the conference from which this volume emerged, therefore, was to bring together economists, psychologists, and other academics dealing directly with a variety of professions in which conflicts of interest have led to problems to promote

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the development of new theoretical perspectives and new approaches to policy.

Currently, policies dealing with conflicts of interest are largely based on misguided intuitions about underlying psychological processes. For example, as Chugh, Bazerman, and Banaji point out, part of the reason that conflicts of interest have been allowed to become so pervasive is that most people think of succumbing to a conflict of interest as a matter of corruption, when in fact it is much more likely to result from processes that are unconscious and unintentional. Thus, many professionals deny – and almost certainly do not believe – that they could possibly be swayed by inappropriate influence. About the time we were putting the finishing touches on this book, for example, U.S. Supreme Court Justice Antonin Scalia had been accused of having a conflict of interest with respect to a case before the Court. Scalia, a longtime friend of Vice President Richard Cheney, had recently flown with Cheney on Air Force Two to participate in a duck-hunting excursion together. In a public statement in which he defiantly refused to remove himself from the case, Scalia insisted that his judgment would not be influenced by their friendship or by the fact that the vice president had given him a ride down to Louisana: "If it is reasonable to think that a Supreme Court Justice can be bought so cheap, the nation is in deeper trouble that I had imagined" (Scalia, 2004). Chugh et al. present evidence suggesting that the nation is indeed in deep trouble – conflicts of interest can bias professional judgment in subtle ways of which those professionals are often unaware. Even if outright and intentional corruption is rare, unconscious and unintentional bias could be common.

Learning what the research says on any given issue is often complicated by the fact that the knowledge is scattered across a number of different sources and is not easily synthesized. This is especially true of conflicts of interest, which tend to be studied, if at all, by specialists in the field in which they occur. Conflicts of interest are rarely taken as a topic of study deserving of its own focus. The scattered nature of scientific knowledge prevents research findings from specific applied domains from being synthesized into general insights. And it makes it easier for people to pay selective attention to research evidence. This book, then, is intended to take a first step toward such a synthesis. In the ten chapters of this book, leading scholars in a wide variety of fields have reviewed the current states of their fields with respect to issues surrounding conflicts of interest.

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The resulting volume is somewhat depressing. Some of the chapters detail the extent to which conflicts of interest have corrupted the practice of what have been historically regarded as respectable, even noble, professions. For example, Kassirer, based on his extensive knowledge of the medical profession and his experience as a journal editor in dealing with conflicts of interest, concludes that the field of medicine is so pervaded by conflicts of interest that its reputation as a caring profession is threatened. During the eight years that he was editor-in-chief of the *New England Journal of Medicine*, Kassirer maintained a strict policy in which reviews and editorials could not be written by anyone with ties to drug companies whose products were being evaluated in the paper. However, it became so difficult to find writers and reviewers who were without conflicts – who were *not* receiving financial support from drug companies – that Kassirer's policy was eliminated by his successor at the *Journal*.

Nelson explores the diverse conflict of interest facing auditors. As in other professions, the charge that auditors have allowed themselves to become corrupted by conflicts of interest is a highly controversial one. Nelson tracks the evidence on this debate and concludes that the preponderance of evidence does support the conclusion that the judgment of auditors is likely to be compromised by conflicts of interest. Nelson's chapter also points out that auditors' conflicts of interest are a direct product of a conflict inherent in modern corporations: the conflict between a firm's owners (the stockholders) and its management. For example, stock options give upper management a powerful incentive to boost short-term stock prices at the expense of long-term viability of the firm. Auditors, who are charged with independently reviewing a firm's financial reports, ideally should uncover accounting practices that provide a false image of the firm's long-term prospects. But accounting firms have strong incentives to not render a negative option on the managers that hire them and pay their accounting fees as well as, in many cases, large consulting fees.

As noted, conflicts of interest have permeated fields beyond medicine and accounting, into law, real estate, investment banking, and even academic research. MacCoun highlights high political stakes at play in one specific area of research – public policy research – and notes the numerous conflicts that academics face, not only between academic honesty and pecuniary gain but also between, for example, the pursuit of truth and the promotion of personal political values. MacCoun argues that it is unrealistic to imagine that we could have (or ever did have) a purely inquisitorial system in which public policy researchers pursued the truth without regard to their own private interests or political agendas. And empirical

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tests suggest that traditional safeguards – peer review and replication – perform rather poorly, especially when research communities share political biases. An alternative approach is to move toward a more explicit adversarial system of research, but MacCoun suggests that disanalogies between policy conflicts and legal trials argue against such a system.

As MacCoun's chapter highlights, there are few clear or inexpensive solutions to conflicts of interest, a theme that is echoed in many of the book's other chapters. For example, one of the most popular responses to conflicts of interest historically has been disclosure. Disclosure is popular because, unlike such costly solutions such as divestiture or recusal, it requires minimal disruption of the status quo (Davis, 2001). The assumption underlying disclosure is that people will be able to use disclosure to help them make better decisions. For example, knowing that my real estate agent only gets paid when I buy a house should help me determine the degree to which she is glossing over the house's problems when she encourages me to buy it. Knowing that my doctor gets paid more when she performs a diagnostic test should help me decide whether to follow her recommendation. But the chapter by Cain, Moore, and Loewenstein discusses psychological evidence suggesting that disclosure may be not be able to provide these promised benefits. Worse yet, as Cain et al. suggest, experts may sometimes be more comfortable indulging their private interests and giving more biased advice when they have disclosed them. The surprising upshot is that sometimes consumers may be left worse off for having been warned about a conflict of interest.

Another popular response to conflicts of interest has been to provide incentives for desirable behavior by establishing penalties that outweigh the benefits of malfeasance. The most common approach in this vein has been to legislate stiff penalties for indulging in fraud or corruption. This is generally the approach taken by the Sarbanes-Oxley Act of 2002, passed in response to accounting scandals. But threats of legal sanction are rarely effective at counterbalancing professionals' strong rewards for indulging in self-interested behavior. One of the problems associated with such threats of punishment is that it is often difficult, if not impossible, to prove bias. As such, the probability of being punished is small. Given this small probability, it is usually impractical to increase the size of the penalty so that its expected value outweighs the rewards of self-enrichment, as Issacharoff explains in his chapter.

Issacharoff offers a general framework for understanding policy responses to the conflicts of interest that occur in law, most notably in the relationship between attorneys, who are enjoined to act on behalf

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of their clients but who often face conflicting incentives. He distinguishes between three broad categories of legal responses to conflicts of interest, which he terms "substantive regulation," "liability rules," and "procedural regulations." Substantive regulation involves prohibitions on certain well-specified behaviors – for example, the rule that client funds cannot be invested in attorneys' home, business, or other private undertakings. Liability rules attempt to deter misbehavior by introducing sanctions for breach of fiduciary trust. Finally, procedural regulations involve prohibitions not on substantive outcomes, but on participation in decision making by conflicted agents – for example, a prohibition on government officials negotiating contracts with firms in which they have or have had a financial involvement. Issacharoff concludes that procedural regulations are the single most effective strategy for dealing with conflicts of interests. Substantive regulation is difficult to apply and liability regimes suffer from a dependence on the proper ability of agents to internalize the cost calculus, which cannot be taken for granted. Procedural regulation cuts straight to the heart of the matter by attempting to remove conflicts of interest altogether.

What Issacharoff calls procedural regulation is likely to be the most effective solution to conflicts of interest precisely because procedural regulation changes decision-making or fee procedures to eliminate conflicts of interest. However, this sort of regulation is likely to be politically controversial, difficult to implement, and expensive. Andrew Stark's chapter reminds us of the many varieties of "internal" conflicts of interest that are so inextricably bound to professional roles that eliminating them would be prodigiously costly. For example, in the academic peer-review process, the people who are most likely to be reviewing one's work are those whose own work is most relevant. Their expertise in the area makes them most qualified to review it but also makes it likely that they will have a personal interest in promoting or derogating the research because of its implications for their own work. In Stark's words, "such biases, rivalries or axes-to-grind may (in and of themselves) be functionally internal for the biomedical scientist in his professional role as a researcher." Although one can imagine rules that would minimize these internal conflicts of interest, they are far from costless. For example, academic peer review could be conducted exclusively by people whose own research is unrelated to that being reviewed. Medical patients could see to it that they always receive their diagnoses and treatments from different physicians. As big as these changes would be, they also are not immune from the possibility that quid pro quo arrangements creep back into the process, threatening the independence of outside opinions. Indeed, such favor exchange

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often threatens the independence of corporate boards of directors from management.

The chapters by Kassirer, Stark, and Nelson suggest that conflicts of interest are both more serious and widespread than is widely recognized. The chapters by MacCoun and Cain et al. suggest that policies for dealing with them are far from straightforward. However, the situation is not entirely devoid of cause for hope. Tyler, for instance, points out that people do not always act in ways that are consistent with their own narrow self-interest. In fact, people regularly comply with ethical precepts even when doing so incurs real costs (or forgone opportunities for gain). This compliance sometimes comes in the service of some larger entity or organization. Often, that entity is the profession or the industry in which the individual works. For instance, it may be in the interest of a particular politician or a particular corporation to engage in negative advertising in order to criticize and attack its rivals. However, the more politicians or corporations use negative advertising strategies, the more the entire profession or industry falls in public esteem. The truth is that industries whose members choose to cooperate with each other and thereby promote the welfare and success of the entire industry are more likely to prosper collectively; but the benefits of collective cooperation do not eliminate the incentives for individuals to make noncooperative choices. Although cooperation may be undesirable when it comes to price-setting, it is certainly desirable when it comes to the upholding of professional codes of conduct and resistance to the corrupting influences of conflicts of interest. Tyler presents evidence suggesting some of the ways in which organizations can reinforce such cooperation.

Frank's chapter concurs with Tyler's perspective. Indeed, he suggests that absolute (nonconsequentialist) moral principles are likely to be a better guide for organizational practice and for public policy than are utilitarian goals of producing the greatest good. The reason, Frank argues, is that utilitarian prescriptions depend on identifying and predicting "good" outcomes. Because those judging the value of these outcomes are likely to be biased by their own conflicts of interest, a disinterested prediction of policy outcomes will be exceedingly difficult to obtain. In other words, although it might be desirable (as Rawls, 1971, has argued) for those making public policy to not have any personal stake in the outcome, Frank points out that it is almost never practically feasible. Perhaps, as Frank suggests, better results are likely if we adopt codes of conduct that are less prone to biased interpretation.

Perhaps the last defense against conflicts of interest, therefore, is professionals' personal concern for their clients, customers, and constituents.

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Even when legal regulations are weak or unenforceable, as Tyler discusses, people will comply with norms of professional conduct simply because it is the right thing to do. For example, people observe norms of fairness, even in one-shot encounters with anonymous others (Güth, 1995; Güth, Schmittberger, & Schwarze, 1982; Kahneman, Knetsch, & Thaler, 1986, 1987). They will behave altruistically – looking out for the interest of others whom they might exploit – because it is the right thing to do (Camerer & Thaler, 1995). But Dana reminds us that this altruistic behavior is unreliable. People will steer clear of situations that activate these preferences in them. For example, people will avoid walking past a beggar, in part because they anticipate the risk that they might feel compelled to give something. Furthermore, the same people who would not knowingly cause harm to others often will take action to intentionally remain ignorant of harm which they bring about. The implication of this stream of research for addressing conflicts of interest would seem to be that professionals should not be allowed to remain ignorant of the costs of their choices for others toward whom they have a fiduciary responsibility. For instance, physicians, who are routinely ignorant of the fees associated with the tests and treatments they prescribe, should be sent copies of the bills that their patients get. Dana argues that neither people nor firms should be judged less guilty of crimes committed on their behalf because they were willfully ignorant of those crimes. For example, although we would surely punish a pharmaceutical firm that deliberately fabricated data from drug trials, we also should punish a firm that outsources its drug trials, offers clear incentives for favorable results, and then turns a blind eye to questionable research practices. MacCoun's chapter brings this lesson home for researchers by recommending research practices that pit alternative hypotheses against each other. He argues that we need to promote research practices that encourage within-study hypothesis competition ("strong inference") and boundary seeking on effects ("condition seeking" and "destructive hypothesis testing"), as well as a greater reliance on meta-analysis rather than single studies.

In this brief introduction, we have only mentioned a few of the many conflicts of interest that permeate professional life in the United States. Justice Scalia's choice not to recuse himself from the case involving his friend is only the latest of a long series of recent events in which conflicts of interest have been enacted in part because of what appears to be an erroneous understanding of psychology. It is exactly this ignorance, pervasive among members of government, industry, and the general public, which has led to institutions and policies that deal ineffectively, and even

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sometimes counterproductively, with the problems caused by conflicts of interest. Our goal in creating this book was to see what insights the social and behavioral sciences could offer to the problem of conflicts of interest and to the design of policies intended to deal with the problems that they cause. We hope that the diverse insights represented by the different chapters will not only stimulate further investigation but also help to spur the development of more effective policies for dealing with what has become a pervasive problem facing our society.

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PART ONE

BUSINESS

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