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MORALITY ON WALL STREET

Commencement Address

**University of Southern California
Graduate School of Business Administration**

**Bovard Auditorium
University of Southern California
Los Angeles, California**

May 7, 1987

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Commissioner**

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It's a privilege to be here this afternoon to address this distinguished gathering of unindicted business school graduates, their unindicted faculty, family and friends.

The topic of my address is morality on Wall Street. I'll be brief.

There are three themes I want to develop this afternoon.

First, Wall Street's problems, although certainly serious, are hardly confined to the southern tip of Manhattan. Wall Street is part of America. To a large extent, Wall Street's problems are no different from moral lapses found in academia, in politics, in religious institutions, and in many other walks of life. If we are to address Wall Street's moral problems, we must understand those shortcomings in the context of a larger society that shares many of the same faults.

Second, although Wall Street's moral problems are hardly unique, they have a special significance that demands close scrutiny. Wall Street's moral lapses call into question the moral justification for capitalism. They threaten our shared belief that, on average and over time, Wall Street recognizes a link between merit and reward. To the extent that we fail to address that problem, and thereby fail to reassert a moral justification for our modern market mechanism, the economic,

political, and social equilibrium that allows our securities markets to operate in their current form may be threatened.

Third, we have to do something about this situation. Aggressive law enforcement is one answer, but it is not, by a long shot, a full answer. The idea that ethics and morality can be taught in business school has encountered some skepticism. I believe, however, that the skeptics may be overly pessimistic and that the Nation's professional schools--business schools, law schools, medical schools, and others--can become sources of moral maturity and centers for the careful examination of ethical issues that arise in all walks of life. Indeed, the ability to examine these difficult ethical issues and inculcate a shared set of moral values is one of the primary features that distinguishes a professional school from a technical school where you might go to learn menial and highly mechanical skills, like corporate finance, marketing, or accounting.

Wall Street's Problems Are Also America's

Without for a moment diminishing the importance of Wall Street's current moral quandary, I would like to pose a somewhat impertinent question that may help put the ethical dimensions of Wall Street's problem in better perspective. The question is simple. What's the big deal? You've never heard of an indicted Congressman? You don't watch TV preachers? You believe every operation performed in America is medically necessary? You think every quote in your morning

newspaper is accurate in context and that some reporter won't at least try to write a headline that says "SEC Commissioner Asks 'What's the Big Deal?'" even though that would be fundamentally misleading?

Be real. We have moral problems in our society from top to bottom and from left to right. Wall Street is not a distant planet populated by alien life forms immune to the moral shortcomings that afflict America. Wall Street is part of America; its moral problems reflect and magnify a broader set of shortcomings that pervade our society. From this perspective, if we are to make progress in improving morality on Wall Street, it will be valuable for us to understand what ails us on Main Street.

To pursue this point, and because I am delivering this address at a university campus, I would like to focus on a strong similarity between Wall Street's current insider trading dilemma and revelations of fraud in academia. I should point out that I'm not picking on my academic friends. If I were speaking at a seminary or a Congressional gathering the message would be the same, only the examples would be different.

It's unfortunate but true that you can't trust everything you read in an academic journal. Professors have been discovered falsifying data, doctoring experiments, plagiarizing writings, stealing attributions for basic ideas, and otherwise playing fast and loose with some basic

principles of scholarly research. As a major news weekly recently put it, "There has been a rash of revelations about hyped and falsified scientific research. A study published last month accused 47 scientists at the Harvard and Emory University medical schools of producing misleading papers."¹ A case has also come to light of a researcher who fabricated data in 109 medical publications, and another researcher who, to simulate a skin graft, darkened skin on a white mouse with a pen.² How crude.

To me, one of the more remarkable parallels between the cheats on Wall Street and the ivy tower cheats is that the motives sometimes seem remarkably similar. Wall Street traders appear to have it all. They can make millions honestly, yet some of them violate the law because something in them wants millions more. In academia, academic prestige and the length of one's publication list appears to play the same role as money on Wall Street. Perfectly well respected, tenured members of renowned faculties cross the moral line because they want more respect, bigger grants, more citations, and greater acclaim.

¹M. McLoughlin, J.L. Sheler, G. Witkin, A Nation of Liars?, U.S. News & World Report, Feb. 23, 1987 at 54. See also S. Begley, M. Hager, Tempests in a Test Tube, Newsweek, Feb. 2, 1987, at 64 (The way science is practiced may breed misconduct as much as unethical individuals.); A. Kohn, False Prophets (1987).

²See Begley, Hager, supra note 1.

Many of these professors don't really need that extra article, just like many traders don't really need that extra million. Yet, something has gone wrong. The internal moral compass is out of sync. The professors and the traders both appear to have lost an independent sense of self-worth. The professor measures his value by his prestige and the length of his vita just as superficially as the trader measures his value by the size of his checkbook and the price of his cigar.

Apparently, moral failure is not isolated within particular classes of our society--it can be found almost anywhere, although there are, I hope, differences of magnitude and degree. If we are serious about doing something to improve the quality of our moral lives, it makes sense, I think, to learn from the ubiquity of our moral failures. It makes sense to search out and understand the common denominator that causes moral failure among academics, arbitrageurs, Congressmen, preachers, lawyers, and doctors. We are, after all, all human, and we must grasp the full implications of that unavoidable weakness if we are to make substantial progress raising the moral calibre of life in any part of American society--not just on Wall Street.

The Moral Justification for Capitalism

Although the moral problems confronting Wall Street are hardly unique, they have a special and powerful meaning in the context of modern American culture. Symbols are important in society. Just as Jim and Tammy are, for better or worse,

symbols of electronic evangelism, Ivan, Dennis, and Marty are symbols of modern capitalism. And, just as Jim and Tammy's problems are, perhaps unfairly, lightning rods for criticism of a much broader religious movement that has millions of decent and God-fearing followers, Ivan's, Dennis', and Marty's problems crystallize society's concern over the operation of what may be a largely honest Wall Street community.

The parallel between the Bakkers and the insider traders is deeper still. Religion has a moral basis. When proponents of a faith act in a potentially hypocritical manner the moral basis for their faith is inevitably questioned. Capitalism also has a moral basis. In our society, there is a general consensus that capitalism will, at least on average and over time, tend to reward people on the basis of merit. It's part of the American ethos that if you're talented, you can thrive; if you're hardworking, you can prosper; if you're willing to take risks and innovate, you can flourish; and if you save and invest, you can grow rich over time. The link between merit, effort, perseverance, self-sacrifice, and reward constitutes an important part of the moral justification for a capitalist system.

Indeed, at the core of the American dream is the vision that the poorest immigrant can land on America's shores and succeed within a generation because of sheer initiative and ability. In this dream--and it's an important dream, a shared

dream--it's your ability and willingness to work hard that counts. In other words, it's what you know, not who you know.³

Wall Street plays a special role in this dream because, to many, Wall Street is the pot of gold at the end of the dream's rainbow. One particularly popular version of the dream is get out there, take a big risk, and build a company from scratch, like Steve Jobs at Apple, Mitch Kapor at Lotus, or Bill Gates at Microsoft. If you want to, you can then take the company public on Wall Street, and make millions, or even a billion. Another popular version of the dream is to go to Wall Street and, through extraordinary intelligence, hard work, and creativity, gain the competitive insight that, at the cutting edge of a multi-trillion dollar market, moves billions in volume and generates millions in profits as resources are reallocated to higher valued uses and capital is deployed more efficiently in the economy.

Ivan, Dennis, and Marty are part of the nightmare, not part of the dream. Through their criminal acts they have revealed how delicate the moral justification for capitalism can be. And, through their hypocritical claims that they gained their wealth through honest effort and brilliant insight⁴ they have called into question the integrity of all

³For a similar recent analysis see R. Gilson, The Outside View of Inside Trading, N.Y. Times, Feb. 8, 1987, at E-23.

⁴See, e.g., I. Boesky, Merger Mania (1985) (passim).

of us who believe that there is a moral justification for capitalism; who believe that capitalism is imperfect but works better than any other economic system; and who believe that Wall Street works because, on average and over time, the good ideas rise to the top while the bad sink to the bottom.

From this perspective, the inside traders have poisoned part of our shared dream. They may be sentenced. They may pay substantial penalties. They may serve their time. They will one day be released back into society. But for trashing the moral justification for capitalism--however strong or weak that justification may be--they are not likely to be forgiven.

What To Do?

To this point, I've explained why we must look beyond Wall Street's problems if we are to understand those problems, and I've explored the special meaning those problems have for modern American capitalism. This analysis is all well and good, but it leaves us with a rather basic practical question. What do we do?

Clearly, one answer is to enforce the laws and vigorously pursue all scoundrels whose immoral or unethical acts are also illegal. This, however, is only a partial answer to a deeper question. Law enforcement, when properly applied, can act as an optimal deterrent. It is unclear, however, how effective legal rules can be in changing value systems that lead people to behave unethically or immorally. Unless and until internal

value systems are changed little may be accomplished at the moral level.

The question of how to inculcate moral values is hardly new. Given the current state of affairs, however, it appears that many of the traditional answers are not working as well as many of us would like. The church, home, family, and community appear to be failing us for a wide variety of reasons. Rather than dwell on the reasons for these shortcomings, it makes sense, I think, to look for innovations in the teaching of ethics and new methods that may be more appropriate in the context of modern American society.

There certainly appears to be an unfilled demand for such ethical education. The presence of such an unfilled demand presents a striking opportunity for bold entrepreneurs willing to act as venture capitalists in the market for new ideas about teaching ethics and morality.

As many of you have probably heard, the Harvard Business School recently announced a substantial gift by John Shad, Chairman of the SEC, to help fund a \$30 million program on ethics.

Aside from one glaring mistake--he is giving the money to Harvard, not USC, or at least Yale, my alma mater--John Shad has, I think, hit upon a wise, bold, and timely idea. John Shad's idea is to fund a program that will develop new approaches to old problems. The program will search for innovative ways to teach morality and ethics across a broad

spectrum of society. It will include case studies, research and development on the extent and ways in which the marketplace rewards quality, integrity and ethical conduct, the ultimate consequences to those who attempt to get ahead by lying, cheating and stealing, as well as awards to those who have made major contributions to business practices and concepts, and other features. These case studies and other research materials will not only be used at Harvard, but will also be made available to the 6,000 other graduate schools that use the Harvard Business School's research materials. They will also be simplified and adapted for use in colleges, high schools, elementary and even nursery schools. John believes that you do not have to wait for the hereafter to enjoy the rewards of ethical conduct. He believes "ethics pays"--that it's smart to be ethical. The Harvard program will test and amplify these and other concepts.

The idea has encountered some skepticism. Some critics call it a case of "throwing money at a problem that money helped produce."⁵ A junior faculty member at Harvard observed "[t]hey still have to sell this to 100 tenured faculty who think the whole discipline is garbage."⁶

Well, nobody ever said it would be easy. Law schools, for example, have long taught courses in ethics. Nonetheless,

⁵A. Byrne, A Beam, Harvard's \$30 Million Windfall for Ethics 101, Bus. Week, Apr. 13, 1987, at 40.

⁶Id.

there is no shortage of unethical or indicted members of the bar. But that doesn't mean we stop searching for new approaches, and if Harvard's 100 tenured faculty really think the discipline is and must remain "garbage," then perhaps they are part of the problem, not part of the solution.

We know ethics and morality can be learned. It can be learned from life experience, and from powerful stories--such as the legends found in the Bible and great works of literature.⁷ We are not so sure, however, of how morality can be taught, and that's where the need for imagination and creativity sets in.

Thirty million dollars will fund a lot of imagination and creativity. It will cause people to look at the problem from a fresh perspective. It will also generate some new ideas about teaching morality and ethics that, I think, would be less likely to come about if the same gift were given to a religious organization, or other group more traditionally affiliated with the teaching of ethics. Indeed, the gift may, in the long run, do far more good than an equally large gift to fund a new museum, classroom building, or library. The ethics gift is clearly a risky proposition--but if it pays off the return may be truly spectacular.

The problem of teaching ethics is a tough and old one. It's time for a new and bold approach. John Shad may have

⁷See, e.g., R. Coles, Storytellers' Ethics, Harvard Bus. Rev., Mar.-Apr. 1987, at 8.

given us all a fair shot at finding out if we can come up with a better way.

Advice

At this point, it's traditional for the commencement speaker to close with a wise bit of advice that the graduates can carry with them for the rest of their years. Such eternal verities are hard to come by, but I will do my best by sharing with you the advice I have often threatened to offer President Reagan.

Before I came to the SEC, I was on the staff of the Council of Economic Advisers. While there, I was invariably asked, "Joe, what economic advice do you offer the President?" My response was simple. I told people that I stood ready to offer infallible economic advice to the President. If given the chance, I would tell him, "Mr. President, buy low, sell high, and everything else is a detail we can have our staffs work out later."

So, to you, the graduating class, I offer a bit of advice every bit as sage, wise, and practical as that I've offered our Nation's leader.

Buy low, sell high, but never, never sell yourself short.
Good luck.