APPROPRIATION ECONOMICS VERSUS MANAGERS’ ETHICS

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Abstract
Appropriation economics shows mechanisms of taking over companies, independent earnings, and extraneous assets. It can be stated that capital is appropriated by the small groups of individuals who are grasping, lacking ethics and tied to politicians. It is a process that is constantly present in the global economy. In this paper theoretical and practical aspects of these phenomena have been presented, deploying case study method. Appropriation economics constitutes a significant strand of both theory and praxis. It explains creation of social inequalities, payment of unreasonably high bonuses in leading financial and industrial corporations. A social movement to stand up against such practices in business and strong response of public authorities are necessary.

Keywords: bankruptcy, business, ethics, manager, appropriation economics, social inequalities

JEL Codes: G33, D63, M14

Introduction
Can public authorities respond to growing social inequalities, widening gap between the richest and the poorest, salary earned just for ‘being in office’ not for the work? Can and should fortune be made at others’ expense? Can income distribution be more just? Such dilemmas have been discussed in the circles of sociologists, economists and lawyers for a long time. Can we speak of the decline of the classical capitalism; will it be replaced by the zero marginal cost system? As it is being proved by some of the prominent economists.

Numerous scandals related to assets’ usurpation would never have come to light, if not for the fourth estate. It were the journalists who discovered the tax scandals – Panama Papers and Paradise Papers, the seizure of Jewish property in Poland, the Madoff investment scandal or the Amber Gold pyramid scheme (Poland).

Appropriation Economics shows mechanisms of taking over companies, incomes or assets. One may formulate the thesis that the capital is appropriated by the few groups that are greedy, devoid of ethics and linked to politicians, and that it is a process constantly present in the global economy.

The matter of capital appropriation had been already discussed by Marx and Engels, so it is not a new issue. However, this problem is still arising and is fostered by deficiencies in regulations in many countries.

Economy Creating Inequalities
The concept of ‘appropriation economics’ can be defined in institutional terms, as paradigms, regulations, procedures, standards and ethics rules in economic and
administrational activities that create profound social inequalities as a result of values’ appropriation. Such appropriation is carried out by concerns and conglomerates, monopolists, groups of managers and members of public administration supporting each other. It is particularly alarming if this list is supplemented by representatives of the judicial system.

There is an ongoing discussion about economic and social inequalities, their scope, profoundness and causes – and it is by no means about returning to the concept of equality proposed by Marx and Engels. This matter has already been outright and critically expressed by inter alia Boogle, Galbraith (1996), Rifkin (2016) and Stiglitz (2015). Unjustified capital appropriation by a marginal fraction of the society at the expense of the rest cannot be successfully constrained by the so-called market discipline, codes of ethics, CSR activities or soft recommendations put forward by the European Commission (Bazerman and Tenbrunsel, 2011).

Values’ appropriation takes place in different sectors and on different dimensions of the economy (Table 1). This list can be of course more specific (Masiukiewicz, 2017).

<table>
<thead>
<tr>
<th>No.</th>
<th>Lawful activities</th>
<th>No.</th>
<th>Unlawful / criminal activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Not settling liabilities in time by companies or natural persons</td>
<td>1</td>
<td>Operating in the black market</td>
</tr>
<tr>
<td>2</td>
<td>Relocating business activities to tax havens</td>
<td>2</td>
<td>Creating pyramid schemes (Ponzi schemes)</td>
</tr>
<tr>
<td>3</td>
<td>Charging excessively high prices</td>
<td>3</td>
<td>Insider trading, silent partnerships between investors and other crimes on the capital market</td>
</tr>
<tr>
<td>4</td>
<td>Moral hazard of financial institutions; selling toxic assets</td>
<td>4</td>
<td>Siphoning off the assets by owners and deliberate bankruptcies</td>
</tr>
<tr>
<td>5</td>
<td>High bonuses for managers</td>
<td>5</td>
<td>Seizure of pre-war property (including Jewish property) as a result of forgeries (i.e. Switzerland, Poland)</td>
</tr>
<tr>
<td>6</td>
<td>Paramedic services (such as dieting)</td>
<td>6</td>
<td>Corruption of public servants in public contracts, tenders, granting licences or permissions etc.</td>
</tr>
<tr>
<td>7</td>
<td>“Instant” loans for natural persons (at 100% or more)</td>
<td>7</td>
<td>Money laundering</td>
</tr>
<tr>
<td>8</td>
<td>Making competitors go bankrupt and buying them out for nothing</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: own data

The recent subprime crisis triggered outrage in many countries, when salaries and severance payments of bank managers were revealed. K. Galbraith had already pointed in 1996: “that this sovereignty (of the consumer) has, in substantial degree, been surrendered to those who serve it is the most resisted” (Galbraith, 1996, p. 24). Moreover, he claimed: “Monopoly power – exploitation of the consumer by prices unrestrained by competition and once in the United States the object of the antitrust laws – has surrendered to international competition” (Galbraith, 1996, p. 35). Simultaneously existed capital appropriation by the top managers: “some of the effort
that corporate managers (...) is now committed to gaining, sustaining, or advancing their personal corporate position and, quite specifically, their own compensation” (Galbraith, 1996, p. 26). It concerns financial corporations in particular.

Ethics in finance seem to be of substantial importance for the obvious reasons. Furthermore, the recent subprime crisis revealed that many financial institutions’ managers were lacking basic moral principles (Chrzanowski, 2014).

In addition, there has been formed the theory of white collars, regarding economic crime (Zawadka, 2016). This theory explains methods and instruments used by individuals of high financial, professional and social status in the field of extortions, capital and insurance frauds, money laundering, siphoning off company’s assets etc.

The abovementioned phenomena cause a lot of social criticism, which is reflected in the shift in electoral preferences in the past few years.

According to J. Rifkin, the current model of capitalism will evolve into the zero marginal cost system. This new model “has already wreaked havoc on the publishing, communications, and entertainment industries as more and more information is being made available nearly free to billions of people” (Ryfkin, 2016, p. 9). “But in mature industries where a handful of enterprises have succeeded in capturing much of the market and forced a monopoly or oligopoly, they would have every interest in blocking further economic progress in order to protect the value of the capital already invested...” (Ryfkin, 2016, p. 14).

It seems that the might of the appropriation economics will be declining in the near future.

**Phishing – Pressure on Consumers**

Phishing is to be understood as instruments of promotion (including advertisements) based on future (wishful) facts, incidental facts (creating illusion) and false facts (creative accounting and others) (Masiukiewicz, 2015a; Masiukiewicz, 2015b). According to Akerlof and Shiller (2017, p. 50), advertising executives exploit consumers’ weaknesses, particularly the vulnerability to persuasion and dupery. Marketing manipulations are constantly present on the market. Cialdini (2007, p. 204) analysed the methods and examples of persuasion and manipulation used against the retail clients. Furthermore, he formulated the rule that all is needed to love something is to think that it can be lost. With regard to pyramid schemes – an opportunity to achieve high rate of return can be lost.

Companies deploy relatively effective phishing activities. Unfair advertising practices and misleading information are quite common, no matter if it is public or word-of-mouth marketing.

Akerlof and Shiller (2017, p. 12) presented the theory of phishing which assumes that unfair market practices are possible thanks to psychological support of phishing. They understand phishing as deceitful and manipulative activities designed to gain clients. They believe that this phenomenon will inevitably exist in the free-market economy, and this is not due to the presence of exceptionally wicked people (‘demons’) in our environment, but it is a natural feature of the economic system. It is a controversial opinion, since such phenomena are created by the people presenting certain attitudes and ethics, not by the objective laws of the market. On the other hand, more vulnerable to such offer are clients of low level of education and morality.

An example of such activity in a certain environment (mainly Jewish) was the
activity of B. Madoff and his investment fund, BLMIS, in the United States. After a thorough analysis of this case US Securities and Exchange Commission (SEC) described his operations as an affinity fraud (Masiukiewicz, 2015).

It seems that regulations banning misleading information, promotion and advertisement are insufficient. Moreover, penalisation of such crimes in many countries is unsatisfactory.

**Appropriation of Values – Case Study**

* Turing Pharmaceuticals

There has been a constant outpouring of information about paramedical services offered by imposters, inflated prices of medicines or toxic drugs. Akerlof and Shiller (2017, p. 174) argue that the US Food and Drugs Administration (FDA) is exposed to deceitful acts of pharmaceutical companies, as a consequence of leaving five degrees of liberty in conducting clinical trials and presenting their results.

A notorious example of the moral decay in this sector was the case of Martin Shkreli, manager and owner of Turing Pharmaceuticals. In 2015 he decided to increase price of Daraprim from $13.5 a pill to $750 a pill (Strawiński, 2016). “We need to turn a profit on this drug” he explained this 55-fold rise in price of a drug used in treatment of AIDS patients. In the US there are written about 9,000 prescriptions for this medicine yearly (Kościelniak, 2015). Daraprim has been included in the WHO Essential Medicines List, which means that it should be easily accessible both in case of amount and price. It was argued that it cost of production is just $1 a pill, but Shkreli insisted that there are also other costs. The media gave him several negative nicknames (such as ‘everything that is wrong with capitalism’, ‘morally bankrupt sociopath’); D. Trump called him a ‘spoiled brat’ (Strawiński, 2016). Such drastic price increase was opposed by the medical community, for the good of the patients, and by other pharmaceutical companies that did not want their industry to be perceived as heartless and greedy. The media at the same time showed the manager’s lavish lifestyle – thus making his arguments look ridiculous. Eventually, Shkreli decided to lower the price for hospitals, but only to $375. By the end of 2015 the manager was arrested by the FBI on a charge of fraud in one of his medical companies. However, this event did not influence the shift in price policy for Daraprim.

Taking the deontological perspective, it can be stated that the decision of Turing Pharmaceuticals was lawful, but it robbed patients of their dignity, and some of them may have even become in debt because of it. The wealthy manager expressed his indifference to the rest of the society. Such high price of a product being bought by sick people is far from the concept of fair pricing policy, which is supported by the deontological ethics.

**Bonuses for the Bankrupt Banks’ Executives**

The top-managers’ salaries and bonuses during the recent subprime crisis have become the subject of criticism in the media and street protests against financial institutions (the Occupy movement, demonstrations in the City of London and other). The level of renumeration is baffling in the light of the managers’ qualifications and their role in leading into bankruptcies (Masiukiewicz, 2010; Masiukiewicz, 2011). Some examples of these extremely high salaries and bonuses is presented in Table 2. In addition to the following data - E.S. O’Neal after losing his position was granted...
severance payment in the amount of $160 million (Szweda, 2007).

For decades incentive systems for managers in many countries have not been rewarding risk mitigation, but encouraging moral hazard, CDS trading or operating with high operating leverage. It has made it possible to have high short-term growth of earnings, and as a consequence, increase in the value of company’s shares and managers’ personal earnings. The most important task of the management has become achieving the highest value in the shortest possible time (Masiukiewicz, 2014).

Table 2. Earnings of the CEOs of the bankrupt or acquired banks in the United States (in thousand USD)

<table>
<thead>
<tr>
<th>CEO</th>
<th>Year</th>
<th>Base salary</th>
<th>Cash bonuses</th>
<th>Shares granted</th>
<th>Options granted</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>J. Cane</td>
<td>2006</td>
<td>250.0</td>
<td>17,070.7</td>
<td>14,838.8</td>
<td>35.8</td>
<td>6,154.3</td>
<td>38,349.7</td>
</tr>
<tr>
<td>(Bank Bear Stearns)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E.S. O’Neal</td>
<td>2006</td>
<td>700.0</td>
<td>18,500.0</td>
<td>66,780.1</td>
<td>3,070.5</td>
<td>2,324.7</td>
<td>91,375.4</td>
</tr>
<tr>
<td>(Bank Merrill Lynch)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>J.A. Thain,</td>
<td>2007</td>
<td>57.7</td>
<td>15,000.0</td>
<td>902.9</td>
<td>1,342.5</td>
<td>4.4</td>
<td>17,307.6</td>
</tr>
<tr>
<td>(Bank Merrill Lynch)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: own calculations, based on Proxy Statements of Banks [online], www.wynagrodzenia.pl

Many managers successfully avoided responsibility for their operations (also after the recent subprime crisis). Usually the only consequence was losing one’s position without stating the reason of dismissal. Members of supervisory boards making such decisions were often linked with the management and jointly responsible for the bad calls. In this model of problem solving ethics has been lost and it has created the conditions for further responsibility avoiding (Międzynarodowe bankructwa i afery bankowe, 2010). There has been a common principle of unrestricted right to make mistakes by managers. The clawback principle of financial liability has been introduced much later (Dec and Masiukiewicz, 2016).

In rare trials regarding the biggest scandals and bankruptcies exceptionally harsh sentences were passed mainly in the United States (Table 3).

An example of a bank president who did not suffer any consequences for the losses is Chuck Prince, former CEO in Citigroup Inc., who took the office in 2003 when the share price was $47. Later the bank created highly risky portfolio of assets and it led to losses in 2007. The price of shares fell to $0.72. Prince was paid $138 million for his actions in the bank’s prosperity time. However, for the bank’s downfall he took no financial responsibility and stepped down in November 2007 (Masiukiewicz, 2011).

It is obvious that the top-managers’ high salaries paid for many years have depleted shareholders’ dividends and might have influenced more expensive products for their clients. To conclude, the rule of privatisation of profits and public ownership of losses has been true in this case.
<table>
<thead>
<tr>
<th>No.</th>
<th>Institution</th>
<th>Residence</th>
<th>Form of terminating business activities</th>
<th>Penalties ordered</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bernard Madoff Fund</td>
<td>United States</td>
<td>Bankruptcy</td>
<td>B. Madoff (owner and CEO) sentenced to 150 years imprisonment and forfeiture of goods</td>
</tr>
<tr>
<td>2</td>
<td>Bear Sterns Cos. (hedge fund)</td>
<td>United States</td>
<td>Bankruptcy</td>
<td>Provisional detention for 2 managers; acquitted in a civil suit</td>
</tr>
<tr>
<td>3</td>
<td>Barings Bank (incl. Barings Futures Singapore)</td>
<td>United Kingdom</td>
<td>Segmentation and sale</td>
<td>N. Leeson (trader in Barings Futures Singapore) sentenced to 6.5 years imprisonment</td>
</tr>
<tr>
<td>4</td>
<td>New Castle Funds (hedge fund), tied to Galleon Fund</td>
<td>United States</td>
<td>Liquidation</td>
<td>M. Kurland (founder and CEO) fined $900 thousand and sentenced to 27 months imprisonment (leniency due to cooperation in Galleon Fund case)</td>
</tr>
<tr>
<td>5</td>
<td>Northern Rock Bank</td>
<td>United Kingdom</td>
<td>Nationalisation; still operating</td>
<td>D. Baker (deputy chief executive) fined £504 thousand and banned for life from working the financial industry; R. Barclay (managing credit director) fined £140 thousand and banned from performing any ‘significant influence position’</td>
</tr>
<tr>
<td>6</td>
<td>Societe Generale (bank)</td>
<td>France</td>
<td>Still operating</td>
<td>J. Kerviel (trader) sentenced to 4 years imprisonment</td>
</tr>
<tr>
<td>7</td>
<td>Bank Staropolski</td>
<td>Poland</td>
<td>Bankruptcy (the biggest bankruptcy in Poland)</td>
<td>Provisional detention for P. Bykowski (co-owner and chairperson of supervisory board); criminal trial for 10 chairpersons, members of management and supervisory boards – for 9 years without conclusion</td>
</tr>
</tbody>
</table>

Source: own data, based on Międzynarodowe bankructwa i afery bankowe (2010), and Masiukiewicz and Mackiewicz (2009)

**Conclusion**

Appropriation economics constitutes an important strand of both theory and praxis, since it explains creation of social inequalities, gap in salaries between employees and managers, unjustified factually payment of large bonuses in big financial and industrial corporations.

Creators and decision-makers of the perverse incentive structures, people responsible for exorbitant prices of medications, medical equipment, licence fees and other similar things, as well as those who use phishing against their clients – operate without scruples and any ethical principles. At the same time, in the name of free market governments do not deploy instruments to prevent these pathologies.

There is need for a social movement to protest against such practices in business and certain response of the public authorities. Although it seems that the might of the appropriation economics will be declining, it is still alive and well.
References